



Department of Justice

STATEMENT OF

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BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY

HEARING ENTITLED

“PROPOSALS TO FIGHT FRAUD AND PROTECT TAXPAYERS, INCLUDING:
H.R. ___, THE “FIGHT FRAUD ACT OF 2009”; H.R. 1292, TO AMEND TITLE I
OF THE OMNIBUS CRIME CONTROL AND SAFE STREETS ACT OF 1968;
H.R. 1667, THE “WAR PROFITEERING PREVENTION ACT OF 2009”; H.R.
___, THE “FALSE CLAIMS CORRECTIONS ACT”; H.R. ___ THE
“FINANCIAL CRIMES RESOURCES ACT OF 2009”; H.R. ___, THE “MONEY
LAUNDERING CORRECTION ACT OF 2009”; AND H.R. 78,
THE “STOP MORTGAGE FRAUD ACT.”

PRESENTED

APRIL 1, 2009

Good morning Mr. Chairman and members of the Committee. Thank you for your invitation to address the Committee concerning the Department of Justice's efforts to prevent and combat financial fraud. It is an honor to appear before you today. Since there are now seven bills that are part of this hearing, most of which have just been introduced, we would like to express our desire to work with the Committee on these bills before they move forward in the legislative process. Because of timing, we will not be addressing them in this testimony.

The Nation's current economic crisis has had devastating effects on mortgage markets, credit markets, the banking system, and all of our Nation's citizens. Although not all of our current economic ills are the result of criminal activity, the financial crisis has laid bare criminal activity – such as Ponzi schemes – that may have otherwise gone undetected for years. The Department of Justice (the Department) is committed, during these difficult times, to redoubling our efforts 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. We are committed to adopting a proactive approach for better detecting and deterring fraud in the future. Put very simply, where there is evidence of criminal wrongdoing – including criminal activity that may have contributed to the current economic crisis or any attempt to criminally profit from the current crisis – the Department will prosecute the wrongdoers, seek to put them in jail, work tirelessly to recover assets and criminally derived proceeds, and strive to make whole the victims of such crimes.

Today, I want to address some of the steps the Department has taken to combat financial fraud and mortgage fraud and the actions the Department is taking to help protect taxpayers'

money. Further, I want to address some steps that could be taken to aid in the Department's enforcement activities.

Financial Fraud Enforcement

Historically, the Department has had tremendous success in identifying, investigating, and prosecuting massive financial fraud schemes. Last year, for example, 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. Similarly, last year, the Department obtained a conviction of a former AIG executive who engaged in corporate fraud by executing two false reinsurance transactions to conceal a \$59 million decrease in the loss reserves of AIG. From the Department's prosecution of executives of Enron to Worldcom to Adelphia to AIG, to the prosecutions of mortgage fraudsters and architects of Ponzi schemes across the country, the Department has considerable institutional experience and knowledge upon which it can, and will, draw in fighting crimes that relate to the current crisis.

Indeed, in recent weeks, the Department has made clear that its commitment to prosecuting financial crimes will not abate. In the last few weeks, the Department has secured a guilty plea from Bernard Madoff for securities fraud and mail fraud violations, among other charges; filed a criminal complaint against Laura Pendergest-Holt, the chief investment officer of Stanford Financial, which alleges that she obstructed a Securities and Exchange Commission (SEC) investigation into the activities of Stanford Financial; and arrested Charles "Chuck" E.

Hays, who is alleged to have engaged in a large Ponzi scheme operation in Minnesota. These are but a few examples of the Department's ongoing, vigorous enforcement efforts.

Mortgage Fraud Enforcement

Although there are many causes and effects of the current financial crisis, one of the most often cited is mortgage fraud and, indeed, mortgage fraud continues to be an escalating problem across the country. The U.S. Department of the Treasury recently reported that depository institutions filed over 62,000 Suspicious Activity Reports (SARs) on mortgage fraud between June 2007 and June 2008. That is a 44 percent increase over the prior year. To address this growing problem, the Department has been waging an aggressive campaign. We have deployed a broad array of enforcement strategies to ensure the best use of our investigative and prosecutorial resources.

Mortgage Fraud Law Enforcement Coordination

Effectively combating mortgage fraud requires coordination among various law enforcement agencies and close cooperation between law enforcement and industry representatives. The Federal Bureau of Investigation (FBI), Department of Housing and Urban Development (HUD) Office of Inspector General, the Financial Crimes Enforcement Network (FinCEN), Internal Revenue Service (IRS) Criminal Investigative Division (CID), U.S. Postal Inspection Service, SEC, Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and other federal, State and local agencies are among the many agencies that monitor, investigate and pursue mortgage fraud. Prosecutions are then brought by both federal and State prosecutors. Because this problem

touches neighborhoods across the country, coordination and the sharing of intelligence and investigative resources are critical to our collective success in addressing mortgage fraud.

The Department is leading these coordination efforts through the Corporate Fraud Task Force and the Mortgage Fraud Working Group. Through these groups, law enforcement officers and regulators work to develop strategies to investigate and prosecute wrongdoers and their enterprises engaged in systemic mortgage fraud. In addition, there are 18 regional Mortgage Fraud Task Forces and 47 mortgage fraud working groups in which the FBI, and other federal, state, and local enforcement agencies are working together to address this problem. These efforts continue to grow. For example, within the last several weeks, the United States Attorney's Office in Maryland announced the formation of the Maryland Mortgage Fraud Task Force linking federal, state and local agencies in an effort to better coordinate civil and criminal enforcement actions relating to mortgage fraud, recover more money for victims, and more effectively communicate information to the public about common schemes in an effort to prevent them from becoming victims of mortgage fraud in the first place.

In addition, the FBI has established a National Mortgage Fraud Team at FBI Headquarters. This unit, working closely with the Department's 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 identify mortgage fraud "hot spots" around the country and to promote real-time enforcement operations. This model has achieved initial success in the Southern District of Florida with the Department's Health Care Fraud Strike Force, which is also based on intelligence-based

investigations. We hope to learn from these experiences and disseminate the lessons learned to other districts around the country.

The sharing of information and ideas is essential to a coordinated approach to the mortgage fraud problem. Accordingly, the Department has encouraged, and led by example, a comprehensive information sharing effort within the Department and among our partner agencies.

Investigation and Prosecution of Mortgage Fraud

When criminals go to jail, we deter similar conduct by others. The Department has, over the last several years, aggressively prosecuted mortgage fraud cases, and the Department's efforts have yielded nationwide sweeps, resulting in hundreds of convictions, and sending hundreds of criminals to jail. As just one example, in partnership with the FBI, the Department has conducted three nationwide mortgage fraud and other banking crime sweeps. In Operation "Malicious Mortgage", conducted last year, U.S. Attorneys' Offices brought charges against more than 400 defendants across the nation, largely as a result of the work of local and regional task forces and working groups currently targeting mortgage fraud. 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. These operations spanned the country and involved the participation of U.S. Attorneys' Offices and over forty of the FBI's 56 field offices.

Operation “Homewrecker” is yet another example of our aggressive enforcement efforts. Operation Homewrecker was 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 IRS CID, which resulted in the indictment of 19 individuals on mortgage fraud-related charges. The case stemmed 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). This is just an example of the hundreds of mortgage fraud cases prosecuted by the Department over the last several years.

In addition to criminal enforcement activities, 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 under the FCA have exceeded \$1 billion and, since 1986, the Department’s recoveries have exceeded \$22 billion. The Department has used the FCA to protect a broad range of government programs and contracts, including matters relating to mortgage fraud. For example, the Department recently obtained a \$10.7 million settlement from 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. *U.S. v. Eghbal*, 475 F.Supp. 2d 1008 (C.D. Cal. 2008), *aff’d* 548 F.3d 1281 (9th Cir. 2008); *U.S. v. Dolphin Mortgage Corp.*, 06-c-499, 2009 WL 153190 (N.D. Ill. 2009). The Department will

continue to vigorously utilize the FCA to hold accountable those who engage in all types of housing related fraud.

Oversight of Economic Stimulus Funding and Protecting Taxpayer Money

In addition to continuing our efforts to prosecute the types of fraudulent conduct described above, we must ensure that the funds that Congress has authorized 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.

From past experience – including the many prosecutions we have brought relating to the Hurricane Katrina recovery funds and the funds used as part of the Iraq reconstruction efforts – the Department is well aware that when large investments of taxpayer money are doled out over a short period of time, people will try to exploit the system and criminally profit. In anticipation of the need to protect the moneys that have been and will be provided as a part of the Troubled Assets Relief Program (TARP) and other economic stimulus packages, the Department has forged a working relationship with the Special Inspector General for TARP and is working to help identify ways to prevent fraud and abuse. Furthermore, we are continuing to assess whether additional working groups or taskforces should be created or whether resources should be focused to augment the existing working groups.

Identifying and Helping Victims

In addition to detecting, deterring, and prosecuting crimes, the Department is always mindful of our obligation to help victims of all crimes and, to the extent possible, attempt to make them whole. To this end, the Department's prosecutors and law enforcement partners work to locate and recover assets from the criminals who perpetrate financial frauds and to provide restitution to their victims. Recovery of assets from criminals, however, is challenging and prosecutors have, in some instances, sought creative solutions. In one particularly egregious mortgage fraud case prosecuted in the North District of Georgia, for example, the court ordered the defendant to pay restitution of almost \$6 million. To secure the restitution money for the victims, 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. The Department also effectively uses asset forfeiture as an important law enforcement tool and, last year alone, returned over \$435 million to victims of financial crimes.

Because some financial frauds involve the victimization of hundreds of people, the Department also expends considerable resources finding the victims in the first instance. The Department's many victim-witness coordinators and law enforcement officials work tirelessly to help ensure that what money is recovered reaches the victims of the crimes. The Department uses traditional methods of investigation to identify victims but also is proactively trying to reach and alert potential victims. For example, in the Stanford Financial matter, the FBI recently issued a press release about the investigation and provided a telephone number for potential victims to call. Ultimately, identifying victims is a significant and time-consuming task

especially when, for example in the Bernard Madoff case, this undertaking can involve thousands of victims around the globe.

Potential Improvements for Law Enforcement Efforts in the Future

Although the Department believes it has the tools it needs to continue to vigorously combat financial fraud, there are legislative steps that can be taken to close existing gaps and strengthen the statutes that prosecutors use to bring these cases. The Fraud Enforcement and Recovery Act of 2009 (FERA), was introduced in the Senate on February 5, 2009 and approved by the Senate Judiciary Committee on March 5, 2009, and the Department supports this legislation. FERA contains a number of legislative modifications that would greatly benefit law enforcement.

For example, the legislation would amend the definition of “financial institution” to include “mortgage lending business” in Title 18, United States Code. At the height of the subprime lending era, independent mortgage companies made a significant proportion of the higher-priced, first-lien mortgages in America (some estimate nearly half). The loans originated by these private mortgage companies were not generally covered by current federal fraud statutes, such as bank fraud and bank bribery statutes. The new definition would ensure that private mortgage companies are both protected by, and held fully accountable under, federal fraud laws. The loans originated by these private mortgage companies were not generally covered by current federal fraud statutes, such as bank fraud and bank bribery statutes. 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.

The legislation would also expand the prohibition regarding false statements to financial institutions under 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. This new provision would ensure that private mortgage companies are held fully accountable under this federal fraud provision by providing prosecutors with an important tool to charge those who make false applications and appraisals.

Another proposal under FERA would amend the federal major fraud statute (18 U.S.C. § 1031) to include “any grant, contract, subcontract, subsidy, loan, guarantee, insurance or other form of Federal assistance.” This amendment will make sure that federal prosecutors have jurisdiction to use one of their most potent fraud statutes to protect the government assistance provided during this most recent economic crisis, including money from the TARP and circumstances where the government purchased preferred stock in companies to provide economic relief.

These are just a few of the provisions of the FERA legislation which the Department supports. In addition to the proposals in FERA, the Department respectfully submits there are additional areas that could be addressed through legislative action, and we welcome the opportunity to work with this Committee and others to develop such proposals. For example, a

law mandating that persons who provide real estate settlement services must maintain the settlement statements and related loan documents would give law enforcement an important tool to investigate mortgage fraud. Half of the top ten subprime mortgage originators in the second quarter of 2006 had either gone out of business or been sold by the second quarter of 2007 – only one year later. The Department has found that the records we need to investigate or prosecute mortgage fraud would have been in the possession of those providing settlement services (such as lenders, mortgage brokers, and title companies), but that they are frequently unavailable or difficult to obtain. All too often, such entities go out of business, and their records are either abandoned or destroyed. Requiring those who provide real estate settlement services to maintain appropriate records for ten years following the original date of a loan would significantly assist in the investigation of mortgage fraud.

The Department would welcome the opportunity to work with this Committee to provide additional information about proposed legislative modifications that would assist our prosecutors and investigators.

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 concomitant 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.

Conclusion

The financial crisis demands an aggressive and comprehensive law enforcement response, including vigorous fraud investigations and prosecutions of individuals who have defrauded their customers and the American taxpayer and otherwise placed billions of dollars of private and public money at risk. The Department is committed to this effort and will ensure that we look at all allegations of fraud closely, follow the facts where they may lead, and bring our resources to bear to prosecute those who have committed crimes. Thank you for the opportunity to provide the Committee a brief overview of the Department's efforts to address the current financial crisis and we look forward to working with the Committee on legislation.

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