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MORTGAGE BANKERS ASSOCIATION

NATIONAL FRAUD ISSUES CONFERENCE

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Good morning. I am honored to open this morning's panel which will provide an industry update in the fight against mortgage fraud. Among the considerable challenges facing the mortgage finance industry - from reduced originations, to an unprecedented volume of repurchase requests, and a record number of delinquent loans – to name a few, we unfortunately must include mortgage fraud on this list.

Mortgage fraud is an insidious crime that has robbed many homeowners of not just the roof over their head, but often of their savings, and their security. What draws many of you here today is to guard against instances when mortgage fraud is perpetrated for profit; such criminal profit is meant to be at the expense of you and the institutions you represent. Mortgage fraud is also tied to other serious crimes: identity theft, money laundering and others. But together we must fight this crime by using all the tools at our disposal and by coordinating our activities with law enforcement.

FinCEN's efforts in this area are a priority, and we are harnessing all of our authorities to support the mortgage finance industry in this fight. We are engaging with our regulatory partners at the Federal and State level, working closely with Federal, State and local law enforcement, and communicating directly with international partners to coordinate activities to combat this crime. These combined efforts to root out illicit financial activity increase confidence in and promote the integrity and stability of the financial system. These are critical contributions to helping the banking system return to what it does best: promoting legitimate economic activity and growth.

In other words, you are not alone in fighting mortgage fraud.

FinCEN offers a unique analytical perspective on mortgage fraud because of our position at the intersection of law enforcement and the financial industry. This perspective will help both constituencies assess the risks to the financial system from their points of view.

From this special vantage point, FinCEN has a line of sight into suspicious financial activities across the nation to identify trends and patterns that may not be visible to an individual financial institution or industry, or apparent at the local or even regional level.

While the Bank Secrecy Act is most often associated with its considerable power to thwart money launderers, FinCEN intends to continually improve our expert analysis of BSA data to provide early warning to the nation of incipient trends of fraud or other criminal abuse of the financial system.

FinCEN Focus on Mortgage Fraud

FinCEN first focused on analyzing trends and patterns related to mortgage fraud back in 2002 in the context of an effort to identify areas of potential concern in the sales and management of real estate. In our November 2003 SAR Activity Review, we published some of the results of two related FinCEN strategic analytical studies focused on SARs reported in 2001 and 2002.

For that period, overall suspected fraudulent activity was only a small portion of the suspected illegal activity in connection with real estate transactions. Even among a relatively small sample, however, we noted that mortgage fraud was the predominant reported concern. We also explained the few instances of “flipping,” defined as “the buying and selling of the same property within a short period of times with the intention of making a quick profit,” warning that flipping activity is often coupled with mortgage fraud and other forms of fraud.¹

As we continued to follow the trends in SAR reporting from 2003 into 2004, FinCEN analysts noted a dramatic increase in the number of filings indicating suspected mortgage fraud, leading us to drill down more closely into this area.

For our first detailed study focusing exclusively on mortgage fraud, published in November 2006², we proceeded to go back to take a closer look at all of the mortgage fraud filings since the inception of the SAR reporting requirements, analyzing ten years of mortgage fraud reporting data nationwide. Depository institutions filed more than 82,000 (82,851) SARs describing suspected mortgage fraud between April 1, 1996 and March 31, 2006. SARs pertaining to mortgage fraud increased by 1,411 percent in the nearly a decade between 1997 and 2005, compared to a 543 percent increase for SARs overall.

¹ See http://www.fincen.gov/news_room/rp/files/sar_tti_06.pdf (pages 31-36)

² See http://www.fincen.gov/news_room/rp/reports/pdf/mortgage_fraud112006.pdf

In the November 2006 study we explained a range of fraudulent schemes in an effort to provide the financial industry with red flag indicators that could help them protect their financial institutions and their customers from being victims of fraud. The report detailed that material misrepresentation/false statements were reported on approximately 2/3 of reports, and noted the vulnerabilities posed by automated processing and low documentation/no documentation loans. The report also distinguished that mortgage fraud can be divided into two broad categories:

- *Fraud for property* – homebuyers misrepresenting income or assets to purchase homes for personal use (approx. 2/3 of sample); and
- *Fraud for profit* – perpetrator intends to abscond with proceeds, with little or no intention to occupy the property; often committed with the complicity of industry insiders (approx. 1/3 of sample).

With the challenges we face in the mortgage industry, opportunities for fraud are ever present. The use of the Internet and related technology to receive and process loan applications is increasing. The growing faceless nature of these transactions increases the opportunities for fraud (especially identity fraud) and, coupled with “low-document” or “no-document” loans, created a condition vulnerable to fraudulent activity.

Since the publication of our first study in November 2006, FinCEN analysts have engaged in nearly 40 formal training events – in addition to other numerous speaking and outreach opportunities by FinCEN leadership - to educate the financial, regulatory and law enforcement communities. When you consider FinCEN’s staff is only about 300 people, I think this speaks to our commitment to conduct outreach in this area.

FinCEN also published reports based on SAR analysis that indicated how proceeds of crime generally, although not necessarily connected to mortgage fraud, may be laundered through investments in commercial real estate³ and residential real estate.⁴ These reports, issued in December 2006 and April 2008, respectively, added to the earlier discussion of money laundering vulnerabilities from the 2003 SAR Activity Review report.

FinCEN issued its second study in the mortgage fraud area in April 2008, which provided an update of fraud schemes, with more details on complicit insiders.⁵ A key finding was a 50 percent increase in SARs that reported intercepting the suspected fraud prior to funding a mortgage (an indication of growing vigilance and awareness in the financial community). The report also noted that the total for mortgage fraud SARs filed reached nearly 53,000 (52,868), an increase of 42 percent from the previous year.

We received feedback on this study from Kieran P. Quinn, CMB, and past Chairman of the Mortgage Bankers Association, who stated after the release of our April

³ See http://www.fincen.gov/news_room/rp/reports/pdf/CREAssessment.pdf

⁴ See http://www.fincen.gov/news_room/rp/files/MLR_Real_Estate_Industry_SAR_web.pdf

⁵ See http://www.fincen.gov/news_room/rp/files/MortgageLoanFraudSARAssessment.pdf

2008 report that it is “*the authoritative source for data on fraud perpetrated against mortgage lenders and one which our members rely heavily on to spot trends and stay one step ahead of the fraudsters.*”

Just two weeks ago, FinCEN issued its third strategic analytical report in the mortgage fraud area.⁶ Our February 2009 report looked at 62,084 SARs reporting mortgage fraud, the third most reported type of suspicious activity (following only BSA/structuring/money laundering, and check fraud). Filings have increased 44 percent from 43,000 the prior year. New trends include suspected fraud identified when mortgage purchasers exercise rights to send mortgages back to originators, and in the context of foreclosures.

Another trend FinCEN spotted in this latest round of analysis is the increase in mortgage fraud detection in connection with mortgage purchasers sending home loans back to originators for repurchase. Filing institutions referenced repurchase demands in 8 percent of filings.

FinCEN also found that filing institutions referenced foreclosures in 13 percent of their SAR filings, insurers in 8 percent and early default payments in 2 percent of filings as indications of suspected fraud. These patterns of filings generally involved the detection of suspected fraud after the mortgage had been granted. That notwithstanding, there also was an increase in the percentage of SARs filed prior to granting the loan – 34 percent compared with 31 percent in the prior one-year period. In FinCEN’s April 2008 report, the increase was 21 percent over the preceding decade. Once again, this reaffirmed the trends we had been seeing since we began examining this issue, and also indicated a growing vigilance and awareness within the financial industry.

What types of suspicious activities are being reported? “False statement” was the most reported activity in conjunction with mortgage fraud, while identity theft was the fastest growing secondary characterization reported. Reports of identity theft in conjunction with mortgage fraud SARs increased 96 percent from the previous study. Other typical fraudulent activities associated with this category in the SAR filing sampling are: appraisal fraud, fraudulent flipping and straw buyers. In SAR filings describing fraud for property, fraudulent activities observed include: asset fraud; occupancy fraud; employment and income fraud; debt elimination fraud; identity theft; and straw buyers.

While our most recent strategic report identifying trends and patterns in the SAR data was issued only about two weeks ago, I am also pleased to announce that FinCEN is today releasing another study that looks at the relationship between mortgage fraud and other financial crime and identifies how financial crime runs through the different financial industries.⁷

⁶ See http://www.fincen.gov/news_room/nr/pdf/20090225a.pdf

⁷ See http://www.fincen.gov/news_room/rp/files/mortgage_fraud.pdf

This newest study tracks the activities of people reported in depository institution SARs for mortgage fraud between July 2003 and June 2008, by evaluating three other types of SARs:

- SAR-MSBs, filed by money services businesses;
- SAR-SFs, filed by securities brokers and dealers, and insurance companies, and
- SAR-Cs, filed by casinos and card clubs

From depository institution SARs, we identified 156,000 mortgage fraud subjects, and found that 2,360 were reported for suspicious activity in 3,680 of the other SAR types. Collectively, these reports provided information about how mortgage fraud subjects and their associates hid, moved, or disposed of large sums of cash. They also provided information about other financial crime involving mortgage fraud subjects, like stock manipulation, insurance fraud, and check fraud.

Suspicious activities of mortgage fraud subjects most often reported in the SAR types reviewed were money laundering and structuring, accounting for 85 percent of SAR-MSBs, 47 percent of SAR-Cs, and 28 percent of SAR-SFs.

Check fraud by mortgage fraud subjects was reported in the SAR-Cs at an unusually high level – 17 percent - compared to only 3 percent of all SAR-Cs during the same 5-year period. In SAR-SFs, we found an unusually high number of reports of suspicious documents, fraudulent IDs, and forgery.

A key finding of this study was a decrease in the proportion of mortgage fraud SARs that reported current mortgage fraud *activity*. When looking at the date that a SAR filer reported a mortgage fraud began, rather than just the date the report was filed, we found that the percentage of SARs filed between July 2007 and June 2008 that reported mortgage fraud occurring in the same 12-month period was 37 percent, compared to 49 percent in the previous 12-month period and 51 percent in the 12-month period before that. In other words, although the number of newly filed SARs reporting mortgage fraud has increased substantially between July 2006 and June 2008, the proportion of those SARs reporting current mortgage fraud *activity* has decreased by more than 28 percent.

Let me step back for a minute. I've just thrown out a lot of facts and statistics, and I encourage those interested to review and think through the reports available on our website. One of the reasons we publish some of our analytical products is to give value back to the financial industry. What I mean by that is financial institutions are required by FinCEN's regulations to have robust AML compliance programs in place to prevent criminal abuse of their institutions and to report to FinCEN information that is useful to law enforcement in fighting crime. I recognize that these responsibilities come at a cost to financial institutions that commit significant resources to these efforts.

But our analytical products are designed not only to provide insights into some of the way we use the data filed under the BSA. They are also designed in part to provide

feedback on risks and vulnerabilities to better arm your financial institutions and customers to protect themselves from becoming victims of mortgage fraud. The continuing dialogue between the financial industry and government, through reporting, feedback and discussions like at this conference today, promote our common goal.

I also would like to announce today that we have created a new mortgage fraud section on the front page of our website - www.fincen.gov – to serve as a resource to the financial, regulatory and law enforcement community.

Information contained in mortgage fraud SARs provides law enforcement with better insights into possible criminal activity and helps mitigate the risks to your organizations. In 2009, FinCEN will be further expanding upon our strategic work in this area by conducting additional analyses to examine the relationship between mortgage fraud and other financial fraud, and will further explore reported activities, locations, and subjects. In this context, FinCEN will further examine identity theft, international connections, and mortgage-related activities found in other BSA reports.

Additional Support Provided by FinCEN

Most of you here at a conference focusing on mortgage fraud are obviously familiar with these broadly-cited public documents. But these capture only a portion of FinCEN's ongoing work related to mortgage fraud, in particular our efforts in close cooperation with criminal investigators and prosecutors to hold accountable those persons engaged in criminal activity. While you will understand I cannot speak about specifics in individual pending cases, I would like to give you an insight into this area of our work.

On an interagency basis, FinCEN is actively involved with a number of initiatives that focus on combating fraud: The Bank Fraud Working Group and the Mortgage Fraud Working Group, jointly sponsored by the Departments of the Treasury and Justice, and the President's Corporate Fraud Task Force which is run out of the Department of Justice. In fact, within the past two weeks, FinCEN staff has briefed the Mortgage Fraud Working Group on our latest mortgage fraud study and hosted the Bank Fraud Working Group. FinCEN also provides technical advice and analytical support to prosecutors at the Federal and State levels.

In addition to the published analytical reports, FinCEN provides both strategic and tactical support to the law enforcement and financial regulatory communities to investigate and prosecute fraud. For instance, we have supported the FBI in their investigations in the mortgage fraud area, providing information to their Financial Crimes Intelligence Unit to assist in identifying potential investigative targets.

FBI Deputy Director John S. Pistole, in his recent Congressional testimony focusing on the FBI's mortgage fraud efforts, spoke to the importance of utilizing lead information from SARs in their efforts to combat fraud; and he also noted the many

interagency efforts the FBI has underway with FinCEN and others to tackle mortgage fraud.⁸

Sharon Ormsby, section chief of the Financial Crimes Section, Criminal Investigation Division of the FBI, also commented on the value of SARs to their investigative efforts following our April 2008 report: *“[This study] is an excellent example of the value of suspicious activity reporting. These types of SAR-based assessments are not only of benefit to law enforcement in assessing crime problems and trends; they also provide valuable feedback to the financial institutions who report the information.”* FinCEN is continuing to work to develop common analytical methods and efficient use of data sources for investigations, as well as participating in individual cases, resources permitting.

FinCEN has provided analytical support to the FDIC in their work with problem institutions, where BSA data is proving very valuable to their investigations in the mortgage fraud area. Last summer, FinCEN also supported SEC efforts to identify potential securities fraud linked to mortgage fraud. We have also recently provided assistance to the HUD-OIG to help them identify targets suspected to be involved in fraudulent FHA loans, as well as possible elder exploitation for FHA loans.

Speaking for a moment more generally on our efforts to combat fraud, FinCEN is also partnering with numerous other federal agencies in a broad, multi-agency task force announced last week by the Inspector General for the Troubled Asset Relief Program (SIGTARP), in coordination with the Special Inspector General for the Board of Governors of the Federal Reserve System. This proactive initiative will combine law enforcement civil and criminal resources to deter, detect and investigate instances of fraud in the forthcoming Term Asset-Backed Securities Loan Facility (TALF).⁹ More broadly, we are working with Office of Inspector General (OIG) offices around the country to support their efforts to root out the waste, fraud, and abuse in a range of government programs from housing to Medicare to military contracting to food stamps.

FinCEN has also facilitated requests from law enforcement through our 314(a) program where law enforcement indicated that mortgage fraud was a component of their significant money laundering investigations.

In the international arena, FinCEN also makes available its analytical capabilities for criminal and terrorist financing investigations, such as sharing information with its counterpart financial intelligence units (FIUs) in other countries. FinCEN is currently exchanging information in the mortgage fraud area with the FIU of the United Kingdom (SOCA). FinCEN and SOCA are working jointly to review current SAR activity on mortgage fraud linked to both the U.S. and U.K. FinCEN’s analysis of SAR filings indicate that most of the reports were triggered by applicants providing fraudulent

⁸ Pistole, John. Statement Before the Senate Judiciary Committee, Washington, D.C. 11 February 2009.

See <http://www.fbi.gov/congress/congress09/pistole021109.htm>

⁹ See http://www.fincen.gov/news_room/nr/pdf/20090311.pdf

occupancy, (i.e. properties reported to be used as primary residences actually being used as vacation or rental units), as well unsubstantiated or unverified income information. In turn, SOCA has provided FinCEN with information derived from U.K. SAR filings associated with mortgage fraud involving a U.S. connection. FinCEN and SOCA have conducted additional research and developed new investigative leads for law enforcement based on these continuing SAR filing exchanges.

None of the analytical work FinCEN is doing to fight mortgage fraud would be possible without the SARs that financial institutions file. And those of us who receive and use this information have an important public trust to uphold. Accordingly, we have just proposed amendments to our SAR regulations to expand the confidentiality of SAR information, along with parallel “SAR Sharing” guidance to ensure that the appropriate parties, but only those parties, have access to SARs.¹⁰ Among other things, these proposals clarify the responsibilities of both government employees and financial institutions to protect this information. Law enforcement investigators should receive higher caliber information from SARs, and corporate affiliates are able to share information with each other about dangerous customers who can harm the institution’s bottom line or reputation.

The Relevance of Fraud and Money Laundering

FinCEN’s work in the mortgage fraud area illustrates that while fraud and money laundering are often viewed as separate criminal enterprises, acts of fraud and acts of money laundering are interconnected: the financial gain of the fraudulent activity ultimately needs to be integrated into the financial system. Therefore, money laundering is often a malignant and pernicious product of fraud. By fighting fraud, you are fighting money laundering. And in turn, by identifying money laundering, you could be alerting law enforcement to a criminal attempting to mingle the proceeds of fraudulent activity committed against innocent victims – some of whom may do business with your bank.

FinCEN’s expert analysis of the BSA data is often used in ways that may be, to some, unexpected. As examples, the Commodity Futures Trading Commission (CFTC) recently cited FinCEN’s assistance in breaking up two different multi-million dollar fraud schemes.¹¹ I mention these as further evidence of how broadly financial crime can spread and how sophisticated our criminal adversaries can be.

Money laundering, prosecuted under 18 U.S.C. §§ 1956 and 1957, is defined with respect to the proceeds of specific unlawful activities, including the proceeds of numerous types of fraud (e.g. bank fraud, wire fraud, and mail fraud). Fraud often involves falsification of documents, and if the falsified documents are bank entries – including applications for mortgage loans that include material falsehoods – that fraud itself is also a federal crime under 18 U.S.C. § 1005 (bank entries, reports and transactions) or 18 U.S.C. § 1344 (bank fraud). Thus, in a situation involving mortgage

¹⁰ See http://www.fincen.gov/news_room/nr/pdf/20090303.pdf.

¹¹ See <http://www.cftc.gov/PressRoom/PressReleases/pr5616-09.html> and <http://www.cftc.gov/PressRoom/PressReleases/pr5610-09.html>

fraud, both the fraud itself and the laundering of the proceeds of the fraud are crimes. The structure of the law makes it possible to tackle the problem from both sides.¹²

It is important to appreciate that the information your institution collects to comply with your anti-money laundering program requirements in many ways mirrors the information you would gather in any event for anti-fraud purposes. Therefore, the resources being spent on fraud detection and prevention within your institution can often be harnessed for anti-money laundering (AML) purposes, and vice versa.

In the case of fraud, financial institutions have a clear interest in expending significant resources to combat this crime taking place within their businesses. This obviously makes selling the business case for fighting fraud within your institution easier, because there is a tangible impact on your institution's bottom line.

FinCEN recently completed an outreach initiative with some of the nation's largest financial institutions in order to learn more about how their AML programs operate. As distinct from large gatherings like this today, we are holding discussions with individual institutions to hear candid views on the AML/CFT framework and how to improve it. This, in turn, will provide opportunities to promote efficiencies in the financial industry's reporting regimes while at the same time preserving the tremendously valuable information that you provide to law enforcement. This is just the first step in the enhanced outreach effort that I launched last year – once we have completed this initial round with the largest depository institutions, we will be identifying other industry segments to conduct similar outreach.

Among the things we've learned is that the AML programs within many of the largest banks in this country are run separately from the bank's fraud detection departments and programs. Some of the institutions we've spoken with have also told us that they are challenged with "selling the business case" to fight money laundering within their institution. This is not to say the banks are not committed to fighting money laundering. Without question, we know first hand that these banks are active and engaged partners in the government's efforts to fight financial crime and terrorist financing. They are committing the resources in both time and money to do their part.

We understand that AML is sometimes viewed as purely a cost-center driven by regulatory requirements. A large part of this is due to the fact that the benefits of running an effective AML/CFT program accrue to the financial system as a whole and society at large. Money is spent by the institution for technology and personnel necessary to detect and report suspicious activity, but there is little for the bank to recover to make up for their expenditures. For the financial institution, the business case for fighting fraud is a much easier argument to make if every investigation aims at least in part to recover proceeds of fraud.

¹² See 18 U.S.C. §§ 1005, 1344, and 1956.

I want to emphasize that financial institutions can benefit by leveraging their fraud resources with their AML efforts and starting to take advantage of the significant efficiencies that I see being available through this leverage.

BSA Data Aids Investigation of Mortgage Fraud

I'd like to spend a few minutes providing you feedback on a specific case where the BSA data – filings by institutions such as yours – played an invaluable role. In a case where investigators believe that as much as \$7 million in losses may be realized, BSA records helped identify coconspirators, accounts, and elements of a mortgage fraud scheme. Specifically, SARs described transactions related to the fraud in both personal and business accounts belonging to the defendant. In addition, Currency Transaction Reports (CTRs) filed by a bank and a money service business, point to transactions enabling the defendant to obtain cash from the fraudulent activity.

For about 3 years, the defendant and his co-conspirators profited by selling residential real estate in the mid-Atlantic region to individuals referred to as "straw buyers." The defendant and his co-conspirators, through a company the defendant established, helped the straw buyers obtain 100% mortgage financing to purchase the properties. To obtain the mortgage financing, the conspirators produced fraudulent loan applications that included materially false statements related to the buyers' employment, income, immigration status, and intent to occupy the properties as primary residences. The straw buyers frequently defaulted on these mortgages, causing losses to banks and commercial lenders in excess of \$2,500,000.

During the period of the fraud, several banks filed additional SARs noting unusual patterns. SARs filed on the defendant's business noted information that appeared out of the ordinary. Generally, such information included employment discrepancies, income anomalies, concerns about use as a primary residence, and other information indicative of a non standard mortgage transaction. SARs filed on the defendant's personal accounts highlighted patterns of structured withdrawals and official and cashier checks cashed in a manner consistent with fraud.

When the investigators reviewed the SARs, they reached out to the respective banks for more information on the defendant and his coconspirators. At that point, the banks began to monitor the accounts more closely and filed additional SARs on transactions that did not appear to serve a logical business purpose. For instance, the bank noted that the receipt of wires and checks from title companies into a personal account by an individual who has a mortgage lending business is unusual.

A few months ago, a Federal judge sentenced the defendant to more than 5 years in prison, followed by supervised release, and ordered him to pay several million dollars in restitution.

The foregoing is but one example of a law enforcement investigation where BSA records played a vital role in identifying and investigating ongoing fraudulent activity and

bringing the perpetrators to justice. In cases of fraud in particular, your astute reporting of this activity has a multiplying effect: you are helping the government get criminals off the streets; you are helping protect your own financial institution from financial losses as well as reputational risk; and you are protecting your customers from falling prey to this kind of criminal activity.

In fact, I am looking forward to meeting later today with Gregory Brower, United States Attorney for the District of Nevada, to discuss how that office can utilize the Bank Secrecy Act data filed by financial institutions in support of their ongoing investigative and prosecutorial efforts.

Conclusion

Again, what brought us all here today is that we all have a mutual concern about this issue and are harnessing all of our authorities in this fight. We view this as a specific – and very important - part of our mandate to promote market integrity and help banks protect themselves from fraud.

FinCEN is also pursuing policy initiatives that will augment our strategic, outreach and law enforcement support programs. In the coming months, we will be reaching out to gather information about the possible impact of applying FinCEN's AML program and SAR requirements to independent, non-bank mortgage companies. Once this information gathering process is complete, FinCEN will determine what, if any, regulatory activity might be necessary.

In fighting mortgage fraud, in particular, our interests are aligned: banks want to avoid a credit loss on a fraudulently obtained loan, and law enforcement wants to deter and hold accountable those who seek to criminally abuse institutions and their customers. And, from a regulatory standpoint, as FDIC Chairman Sheila Bair said in a recent speech: *“Cracking down on mortgage fraud in particular is a safety and soundness issue for both the banking industry and the housing markets.”*¹³

I also want to impress upon you that by being vigilant and filing SARs you are protecting your business, your neighbors' business and maybe an unrelated business located a thousand miles away. In addition, our partnership against financial crimes protects our economy. In these difficult times, that may be more important than ever.

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¹³ Bair, Sheila. National Association of Attorneys General, Washington, D.C. 3 March 2009. See <http://www.fdic.gov/news/news/speeches/archives/2009/spmar0309.html>