



FBI





Federal Bureau of Investigation Criminal Investigative Division

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BKA HERBSTTAGUNG

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Mortgage Fraud Tool?



Mortgage Fraud Reality!



Lender was stuck
with a \$250,000
loan.

Most Common Type of Mortgage Fraud Origination Scheme

The classic property "flip."



Property-flipper purchases a property for \$200,000

Property-flipper has the property **fraudulently** appraised for \$400,000.



Property-flipper sells the property for \$400,000, and walks away with a \$200,000 profit.

Home usually results in foreclosure



The bank is left with an \$400,000 mortgage on a \$200,000 home for a loss of \$200,000. If the loan was FHA insured, the government absorbs the loss.

**The Current State of the old Mortgage Fraud “Tools”
House recently sold for \$1.75 on eBay
*(Sold in October 2008 - Saginaw, Michigan)***



Re-emerging Scheme: Builder-Bailout

Step 1



Builder/Developer has difficulty in selling his/her inventory.



Step 2

Builder/Developer obtains an artificially inflated appraisal reflecting a \$240,000 value for a \$200,000 home.



Step 3

Loan Documents state an inflated home value of \$240,000



Step 4

Lender funds a mortgage loan of \$200,000 believing that \$40,000 was paid to the builder, creating home equity.

Step 5



The builder forgives the \$40,000 down payment. Hence, the lender unknowingly funds 100% of the home's value and the Builder/Developer keeps any profits.

Emerging Scheme: Short-Sale Fraud

Initiation



Perpetrator of a short-sale scheme



Strawbuyer recruited by Perpetrator to purchase property.



Perpetrator has strawbuyer secure a mortgage for 100% of the property's value.



Perpetrator may have the strawbuyer refinance the home and obtain an additional \$30,000 for "repairs."



Perpetrator approaches the lender prior to foreclosure and offers to pay less for the home than would otherwise be received in a competitive foreclosure sale.



Strawbuyer informs the lender that the home will foreclose and recommends the perpetrator as a potential buyer in a short sale.



No payments are made, so the mortgage will default.



Perpetrator pockets the \$30,000. No repairs are made.



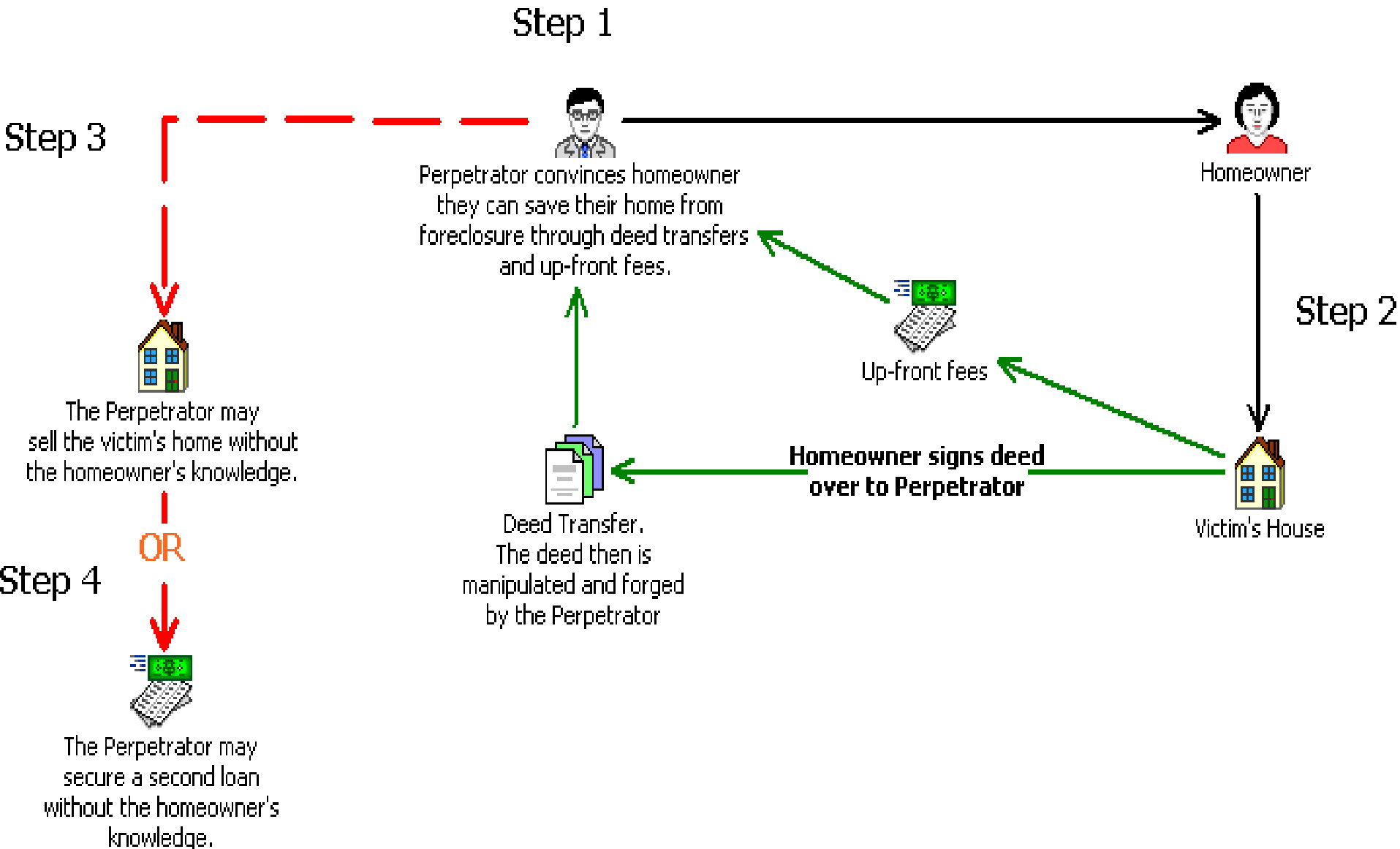
Lender agrees to the short sale not knowing that the mortgage payments were deliberately not made to create this short-sale situation.

Completed



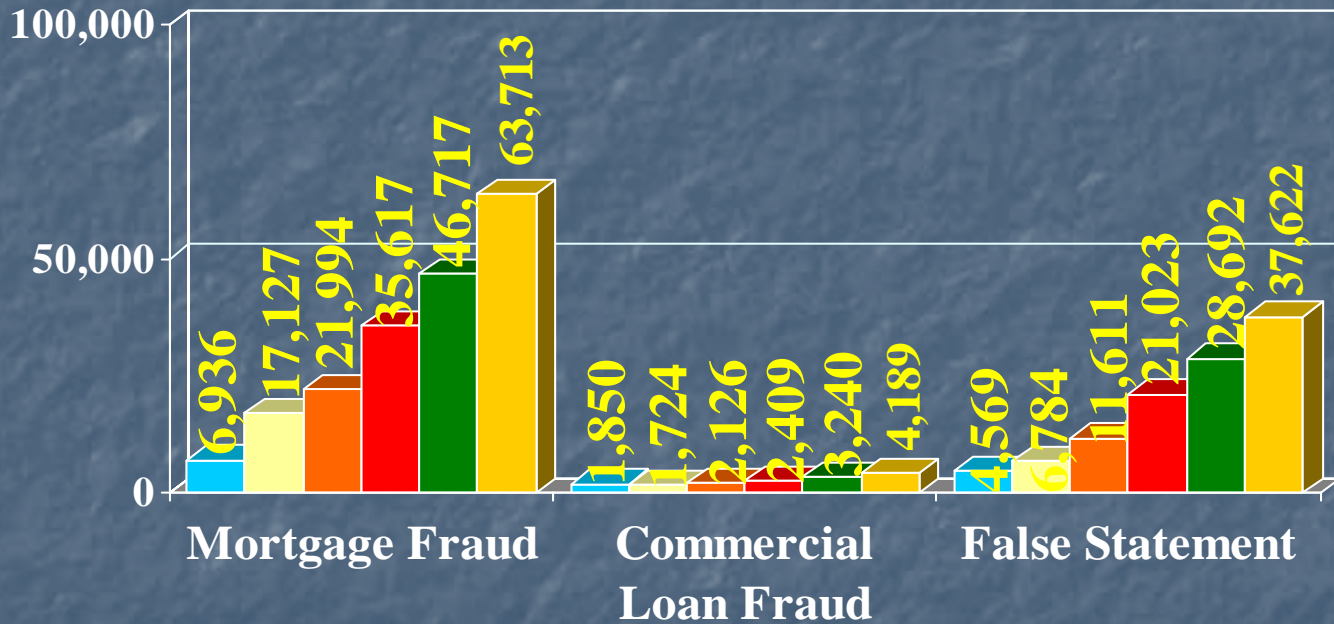
Perpetrator sells the property at actual value for a profit, or has the property artificially inflated to conduct an illegal property flip.

Re-emerging Scheme: Foreclosure Rescue Scams



Mortgage Related Fraud SARS Fiscal Years 2003 – 2008 (10/1/2002 – 9/30/2008) Nationwide

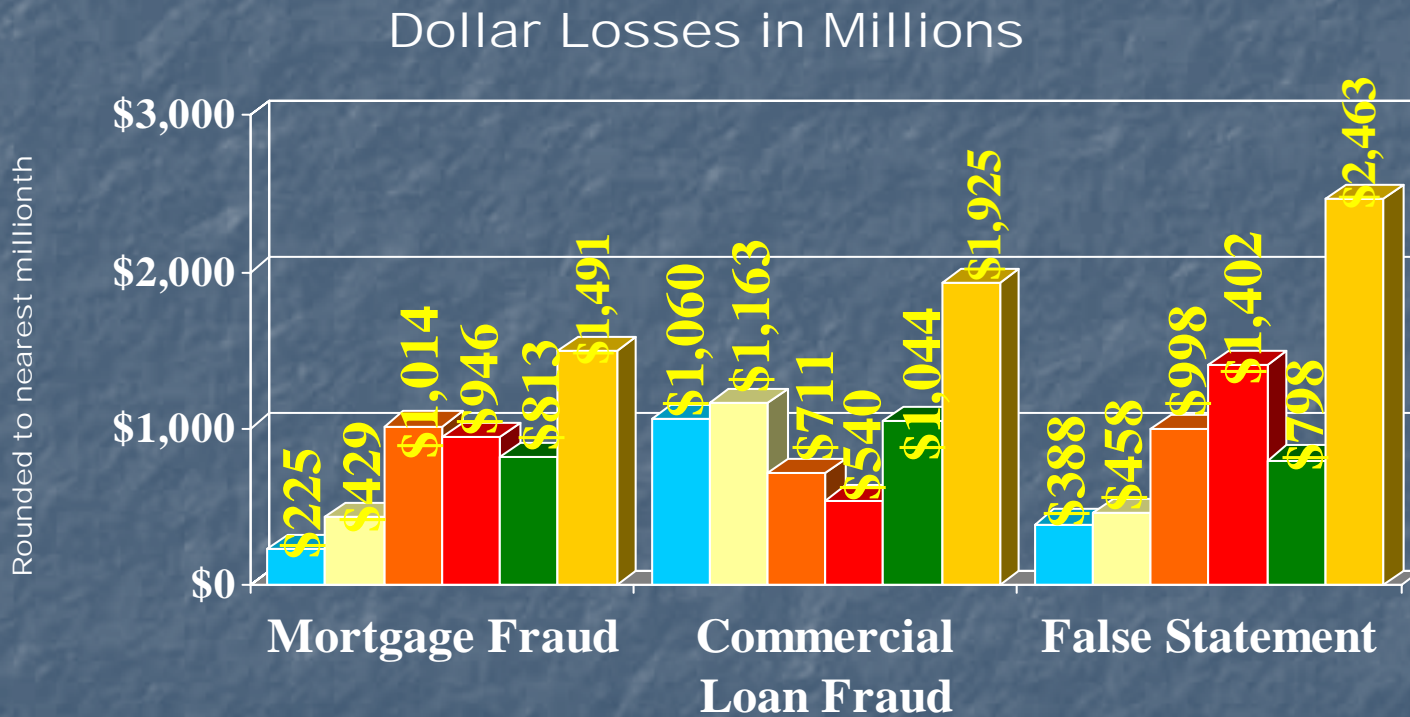
Number of SARs received



■ Fiscal Year 2003	■ Fiscal Year 2004	■ Fiscal Year 2005
■ Fiscal Year 2006	■ Fiscal Year 2007	■ Fiscal Year 2008

Dollar Losses Reported of Mortgage Related Fraud SARS Fiscal Years 2003 – 2008 (10/1/2002 – 9/30/2008) Nationwide

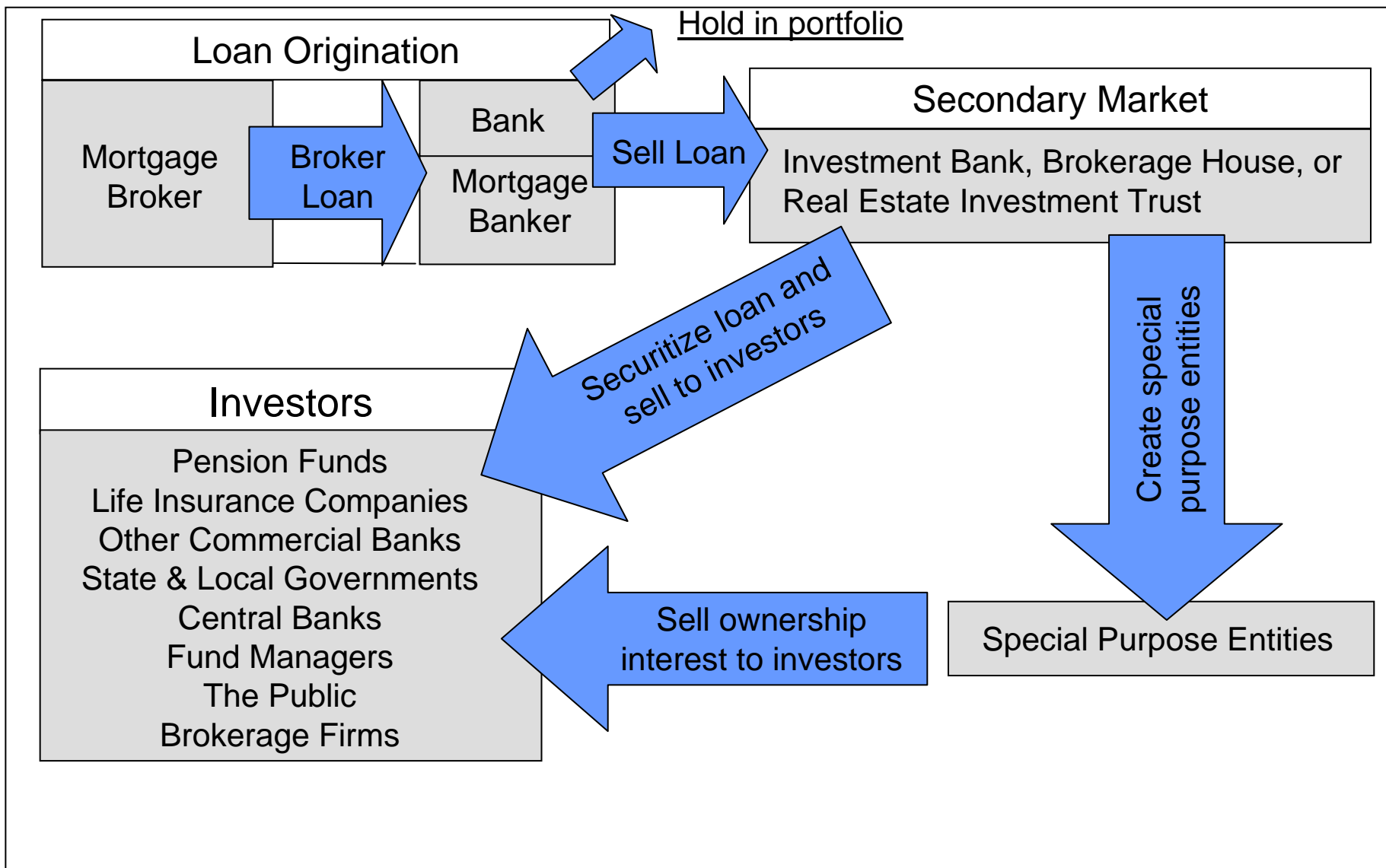
Dollar Losses Reported in Millions



■ Fiscal Year 2003	■ Fiscal Year 2004	■ Fiscal Year 2005
■ Fiscal Year 2006	■ Fiscal Year 2007	■ Fiscal Year 2008

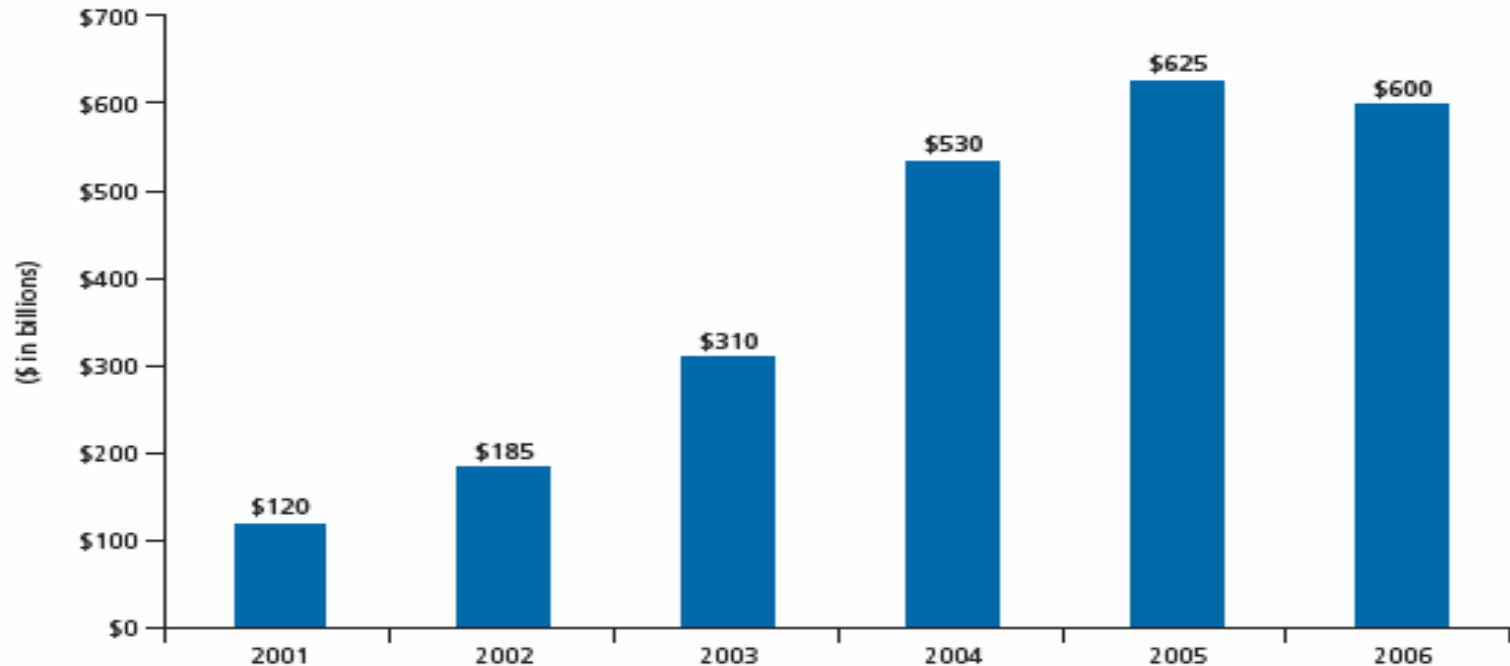


The Sub-Prime Loan Process



SUB-PRIME COLLAPSE

Figure 1. Total Subprime Originations



Source: Inside Mortgage Finance as presented in Sandra Thompson Testimony, March 22, 2007.

- 80.2% of securitized sub-prime loans originated during 2005 had adjustable rates; 74.9% of these loans were 2/28 adjustable-rate loans.
- These ARMS had fixed mortgage rates for the *first two years* after origination and were subject to reset in 2007.

The Life of a Swap

How financial players transfer their risk in an opaque market:



Credit Default Swap

1. A company raises cash by selling bonds



2. The buyer of a credit default swap—a pessimist in this scenario—does so to insure against a default on a bond or simply to bet that default risk will rise.



3. In exchange for regular payments over a fixed period of time, a seller of the credit default swap agrees to make a large payout to the buyer if the specific bond defaults.

Novation



1. Sometimes a buyer is worried about the ability of the seller to meet its obligations. The buyer may choose to exit a swap before the contract expires.



2. To exit the trade, the buyer does another deal with a third party, requesting that it take the buyer's place in the original trade, in a process known as 'novation.'

The Aftermath of Mortgage Fraud

Foreclosed/Abandoned Homes

Mortgage Crisis Reverses Tide of Urban Renewal



BY SUSAN BIDDLE — THE WASHINGTON POST

Baltimore's Reservoir Hill has been hit hard by foreclosures and vacancies. A housing bill to help cities buy foreclosed properties is nearing approval.



Financial Companies' Losses Top \$1 Trillion

S&P 500 index loses nearly \$150B in value in trading Monday

NEW YORK | U.S. financial companies have lost more than \$1 trillion in value this year, and yet another decline on Monday shows concerns aren't going away soon.

Banks and brokerages began the week lower on the same fears that have been proven toxic since last summer in the ongoing credit crisis. The financial sector was hit with a confluence of troubles on Monday: cautious remarks from a Federal Reserve official and new capital concerns at Freddie Mac and Fannie Mae.

The drop in names like Lehm-

an Brothers, Morgan Stanley and Merrill Lynch caused the financial section of the Standard & Poor's

500 index to lose almost \$150 billion in value on Monday, according to the rating agency. That means S&P 500's 85 financial components have lost some \$1.3 trillion since the sector reached a high last October.

Howard Silverblatt, S&P's senior index analyst, said financial stocks will likely continue to be hurt until some signs develop that show banks and brokerages have a better grip on credit problems. JOE BEL BRUNO (AP)

.84
The percentage the Standard & Poor's 500 index fell during trading on Monday, closing at 1,252.31.

Impact of Sub-Prime “Crisis”

Problems Related to Credit Contraction

- Economy slows
- Reduced available credit for new development
- More difficult for people to obtain mortgages
- Refinancing opportunities are less available
- Financing becomes more expensive
- Reduced interest from foreign investors in MBSs

Problems Related to Poor Underwriting

- Increased number of foreclosures
- Depreciating real estate values
- No room for equity withdrawals

Problems Related to Write-downs

- Stock market declines
- Reductions in dividends
- Increased need for capital infusions:
(sources include sovereign wealth funds)

Pool of Red

Write-downs by banks, brokerage firms and others in the subprime-mortgage downturn:

Company	Write-downs, in billions
Merrill Lynch	\$22.4
Citigroup	19.9
UBS	14.4
Morgan Stanley	9.4
HSBC	7.5
Credit Agricole	3.6
Deutsche Bank	3.2
Bank of America	3.0
CIBC	3.0*
Wachovia	2.7*
AIG	2.7
Barclays	2.7
Royal Bank of Scotland	2.5
Credit Suisse	1.9
Bear Stearns	1.9
J.P. Morgan Chase	1.4
Countrywide	1.0

~~Others: \$4.6 billion~~

~~Total: \$107.8 billion~~

*Includes fourth-quarter forecasts

-Compiled by David Gaffen, WSJ.com

\$500 billion as of Sept '08



Sub-Prime Meltdown Timeline



2004

June

Federal Reserve began a series of Fed Funds Rate increases. By June 2006, there will have been 17 consecutive increases raising the rate from 1% to 5.25%.

2006

December

The weakest Sub-Prime mortgage originators begin to fail; by December 2007, over 110 mortgage origination companies will have closed their doors.

2007

April

New Century (2nd largest originator of Sub-Prime loans) filed for bankruptcy.



Sub-Prime Meltdown Timeline



2007

July

Bear Stearns announced that investors in their Sub-Prime hedge funds would receive little or no recovery; the two funds had lost 90% of their value.

August

RealtyTrac announced that foreclosures had risen 93% in one year.

November

Goldman Sachs forecasted Sub-Prime losses for the financial sector would reach \$400 billion.

2008

April

Sub-Prime losses reached \$232 billion and the IMF estimated that financial institutions world-wide may face losses of \$945 billion over the next two years.



Sub-Prime Meltdown Timeline



2008

June

Ralph Cioffi & Matthew Tannin are indicted and arrested on Securities Fraud and Insider Trading charges related to the failure of the Bear Stearn's Sub-Prime based hedge funds.

July

IndyMac Bank, located Pasadena, California, became the second largest Thrift in U.S. history to fail and be assumed by the FDIC.

August

Investment houses begin to settle Auction Rate Securities cases with a number of state regulators.

September

Wall Street is radically transformed: Fannie Mae & Freddie Mac are taken over, Lehman Brothers declares bankruptcy, Bank of America purchases Merrill Lynch & a \$700 billion Bailout is proposed.

FBI Statement to Congress in 2004

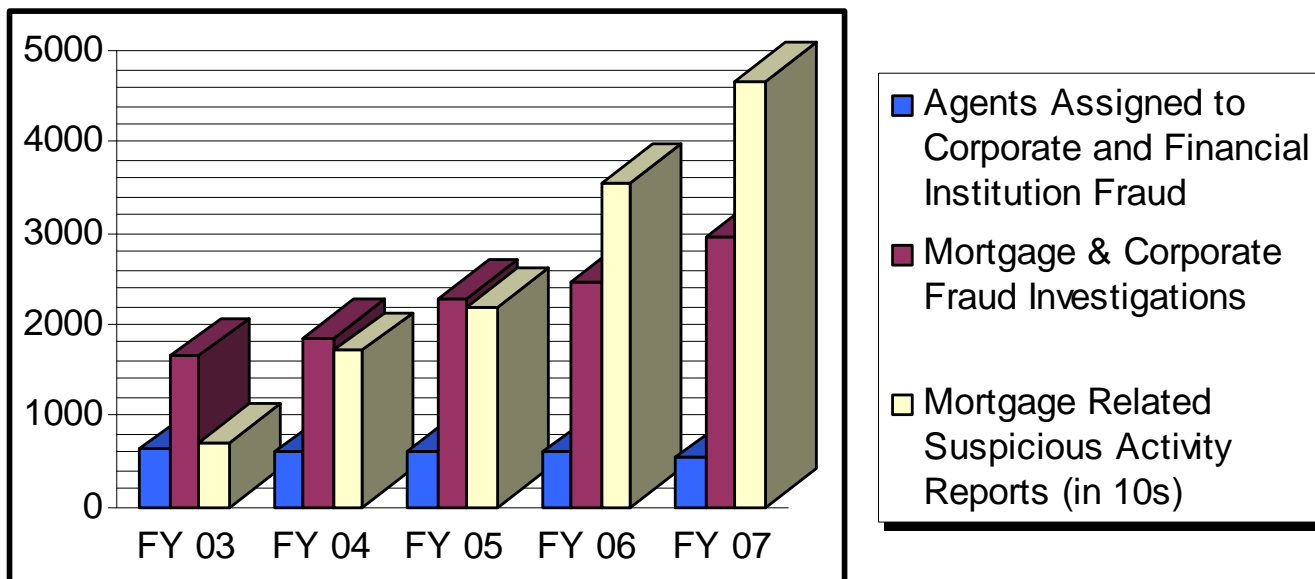
- *“The potential impact of mortgage fraud on financial institutions and the stock market is clear. If fraudulent practices become systematic within the mortgage industry and mortgage fraud is allowed to become unrestrained, it will ultimately place financial institutions at risk and have adverse effects on the stock market.”*
- Chris Swecker, Former FBI Assistant Director, Criminal Investigative Division, Introductory Statement: House Financial Services Subcommittee on Housing and Community Opportunity, October 7, 2004.



FBI Resources



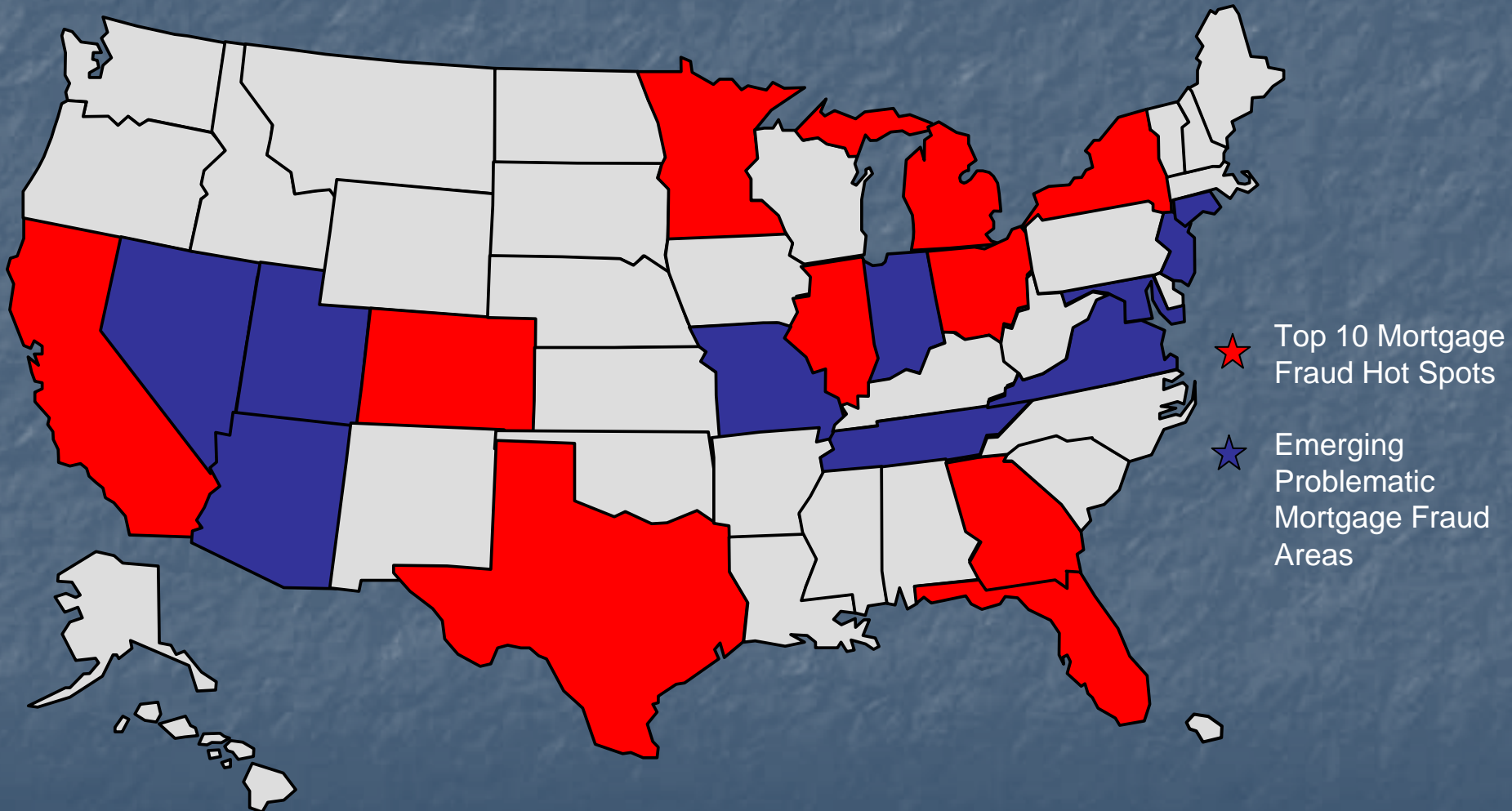
Corporate & Mortgage Fraud Investigations



- Forecast: Current trend analysis projects the total number of Mortgage Fraud related SARS to exceed 63,000 by the end of fiscal year 2008
- Mortgage Fraud Cases (329 Classification): 1,550
- Sub-Prime Corporate/Securities Fraud Cases (318 Classification) : 31 (521 Corporate Fraud Cases)

Where is the crime problem?

14 FBI field offices reside in the top ten mortgage fraud hotspots as identified through intelligence from multiple source indicators.



Source: FBI 2007 Mortgage Fraud Report

Operation Malicious Mortgage

March 1, 2008 to June 18, 2008



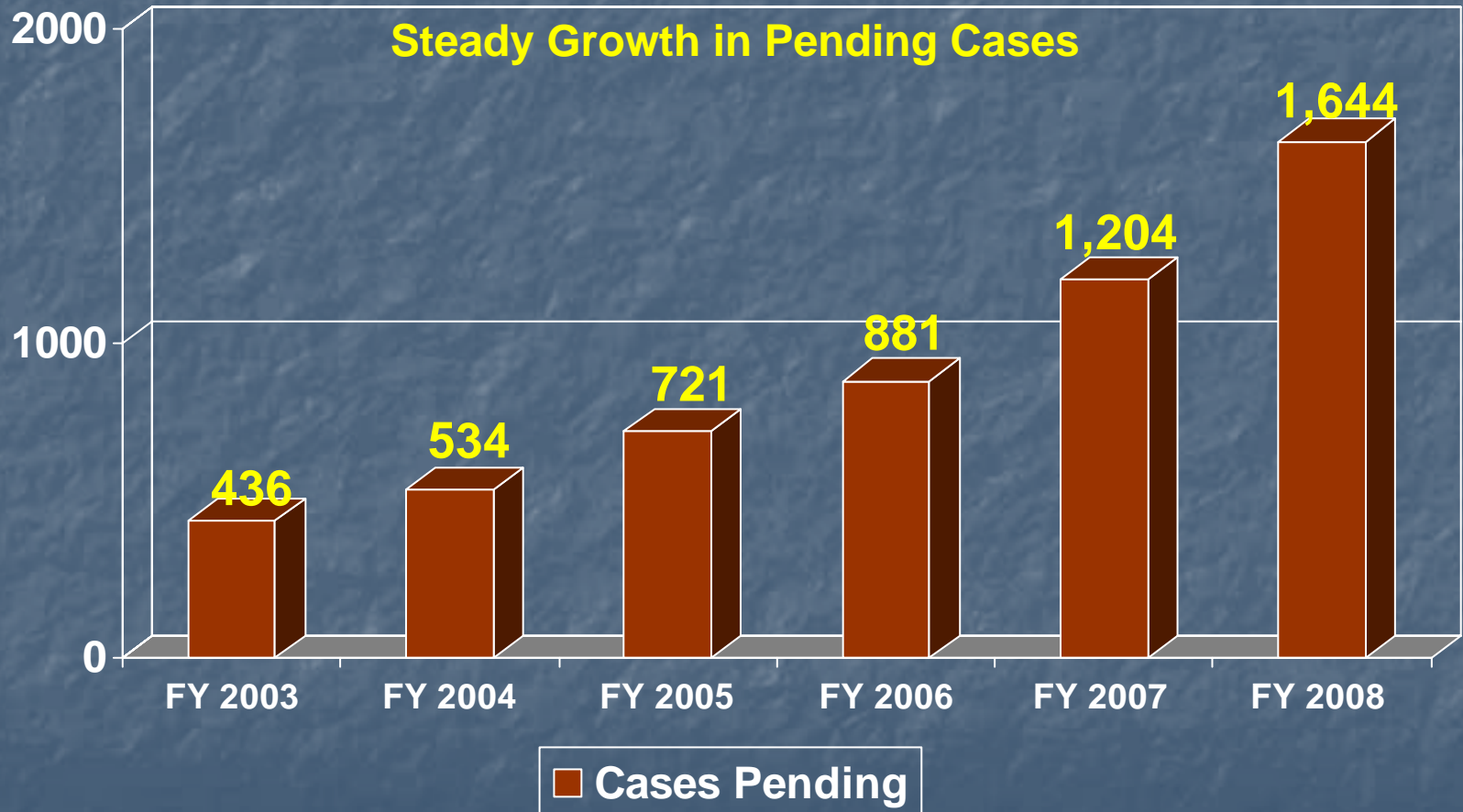
Seized Assets from Operation Malicious Mortgage



Seized Assets from Operation Malicious Mortgage

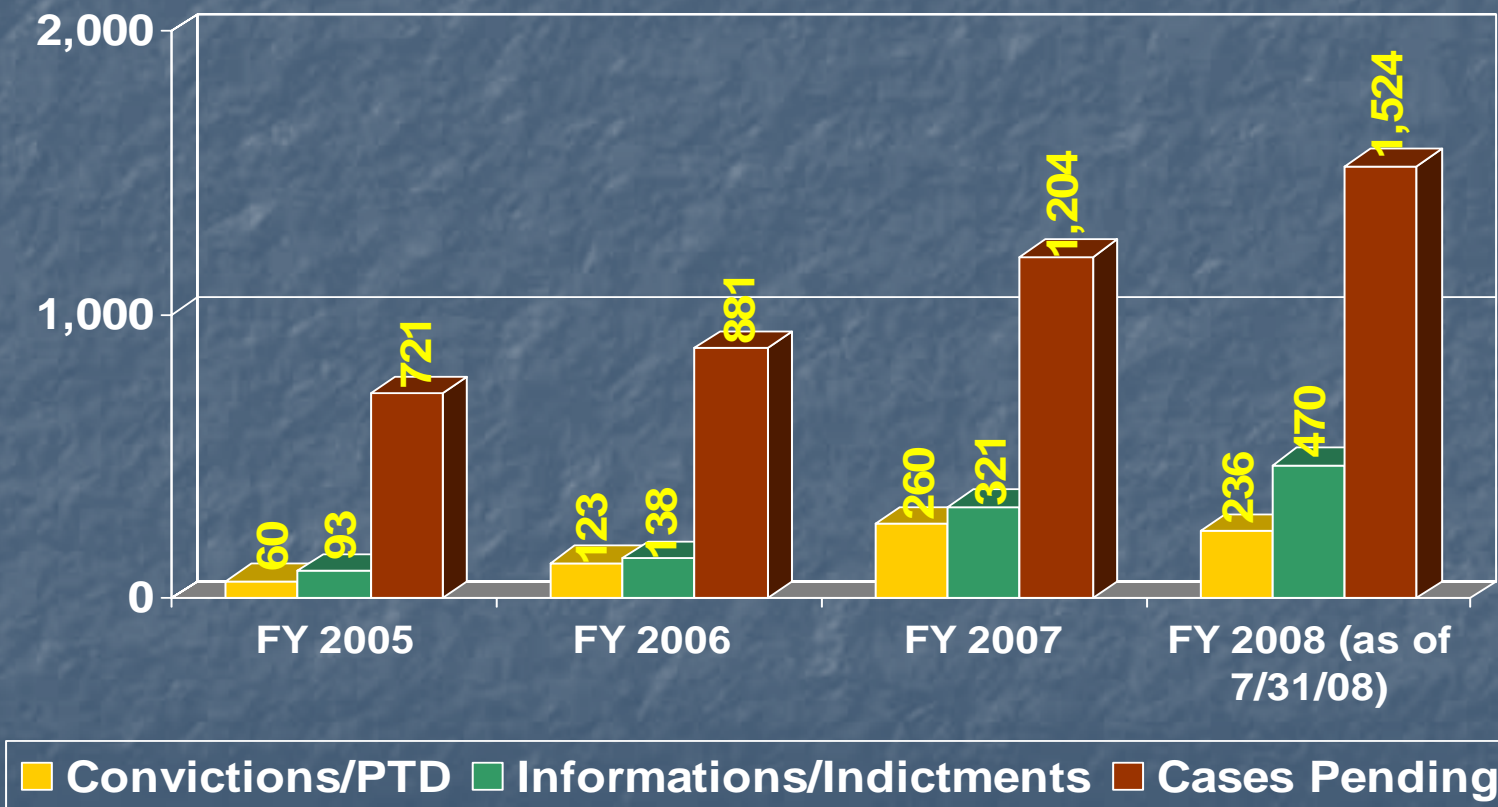


Pending Mortgage Fraud Cases Fiscal Years 2003 to 2008



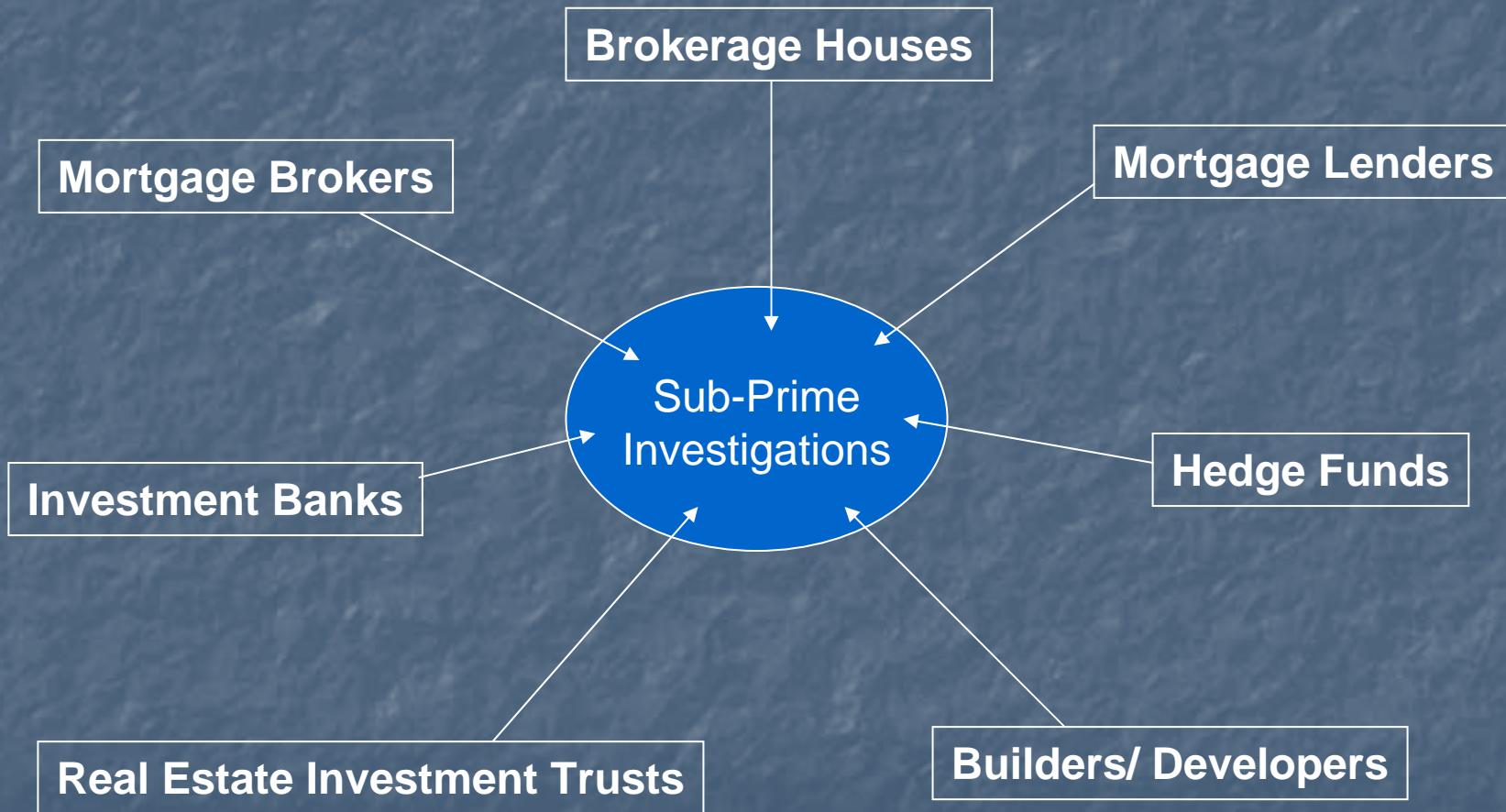
FY 2003 -2004 CPI Codes; FY 2005-2006 - 29L& 29Ms;
& FY 2007 – present - 329 Classifications Only

FBI Mortgage Fraud Indictment/Information Statistics Fiscal Years 2005 - 2008





FBI Sub-Prime Fraud Investigations





Positive Results



Bear Stearns: Ralph Cioffi & Matthew Tannin Arrests





High-Profile Corporate Fraud Cases



Bear Stearns

Managers: Ralph Cioffi, Matthew Tannin

Status: Charged with insider trading & Sec. Fraud



National Century

CEO: Lance Poulsen

Status: Found guilty; Sentencing Pending.



Peregrine Systems

CEO: Stephen Gardner

Status: Entered guilty plea; Sentence pending (faces 20 years)



Brocade Communications

CEO: Gregory L. Reyes
VP of HR: Stephanie Jensen

Status: Reyes sentenced to 21 months and a \$15 million fine; Jensen sentenced to 4 months and a \$1.25 million fine





High-Profile Corporate Fraud Cases



Enron

CEOs: Jeffrey Skilling,
Kenneth Lay (deceased)

Status: Skilling sentenced
24 years, 4 months



Qwest

CEO: Joseph Nacchio

Status: Convicted at
trial, overturned on
appeal, gov't to appeal
decision



Worldcom

CEO: Bernard Ebbers

Status: Sentenced 25
years



Hollinger International

CEO: Conrad Black

Status: Sentenced to
6 years, 6 months





Major Cases

- National Century Financial Enterprises: The financial loss attributable to fraudulent activities is estimated to be approximately \$1.9 billion. On 3/13/2008 five executives were found guilty and on 3/17/2008 former CEO Lance Poulsen was convicted of Obstruction of Justice and Witness Tampering.
- Bayou Management: This Securities Fraud investigation resulted in the conviction of two hedge fund managers and a Chief Financial Officer for providing investors with false earnings and fraudulent financial statements from almost the fund's inception; resulting in client losses in excess of \$400 million.
- Broadcom: On 6/4/2008, a Federal Grand Jury indicted Broadcom co-founder Henry Nicholas and former CFO, William Ruehle.