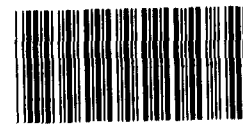


September 1990

FINANCIAL
INSTITUTION FRAUD

Effect of Regional Fraud
Offices Unclear



142463

General Government Division

B-241059

September 28, 1990

The Honorable Joseph R. Biden, Jr., Chairman
The Honorable Strom Thurmond, Ranking
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Committee on the Judiciary
United States Senate

The Honorable Donald W. Riegle, Jr., Chairman
The Honorable Jake Garn, Ranking
Minority Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate

The Honorable Jack Brooks, Chairman
The Honorable Hamilton Fish, Jr.
Ranking Minority Member
Committee on the Judiciary
House of Representatives

The Honorable Henry B. Gonzalez, Chairman
The Honorable Chalmers P. Wylie, Ranking
Minority Member
Committee on Banking, Finance,
and Urban Affairs
House of Representatives

The Honorable Doug Barnard, Jr., Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
Committee on Government Operations
House of Representatives

This report responds to a legislative mandate and a request relating to financial institution fraud. Section 965 of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) mandates that the Department of Justice create a regional office of the Fraud Section of the Criminal Division¹ in northern Texas. It also requires that we study and report to Congress on whether additional such offices should be established in other parts of the country. In addition, the Chairman,

¹The Fraud Section of the Criminal Division operates out of Washington, D.C., and assists U.S. Attorney offices in prosecuting complex fraud cases.

Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, requested that we determine whether Justice had created a regional office of the Fraud Section in northern Texas as mandated by section 965 of FIRREA.

Background

During the last 7 years, the need to prosecute financial institution fraud placed an increasing burden on Justice's resources. Several U.S. Attorneys established task forces to combine the skills and resources of investigative agencies and federal prosecutors to focus on financial institution fraud. One such task force was established in 1987 after a request from the U.S. Attorney for the Northern District of Texas, who said he needed more people to address the massive thrift and bank fraud crisis. The task force, known as the Dallas Bank Fraud Task Force, continues to operate today.

The Dallas Bank Fraud Task Force was different from the other task forces established to address the thrift and bank fraud crisis in that it was headed by a Fraud Section attorney who reported to the Deputy Chief of the Fraud Section in Washington, D.C. Other task forces were headed by the U.S. Attorney for that particular district.

FIRREA, enacted in August 1989, was Congress' response to the thrift crisis. It provided \$50 billion in "bail out" money for failed thrifts, changed the way the government regulates the thrift and banking industry, and authorized \$75 million for Justice's efforts to ferret out and prosecute those involved in financial institution fraud. In another provision of FIRREA (section 965 (a)), Congress also mandated that Justice "create a regional office of the Fraud Section of the Criminal Division in the Northern District of Texas, and maintain such office, by providing sufficient legal and other staff and office space, through fiscal year 1992."

The conference report accompanying FIRREA provides insight to the intent of section 965 of the act. It states that the conferees intend that the Criminal Division substantially reduce the numbers of Fraud Section attorneys traveling from Washington, D.C., to Dallas by transferring some senior or supervisory personnel to Dallas and by hiring additional attorneys to work in Dallas.

Results in Brief

Justice has established a Fraud Section regional office in Dallas as mandated by FIRREA. It did so by taking two actions. First, it designated the

senior Fraud Section attorney who was heading the Dallas Bank Fraud Task Force as the director of the new regional office. Second, it designated the other Fraud Section attorneys on that task force as staff of the office. Justice took no further steps. For example, it established no separate functions for the newly designated regional office. The regional office head and staff continued to function as before—as attorneys taking part on the Dallas Bank Fraud Task Force. The actions Justice took were the minimum steps necessary to bring it into compliance with section 965(a) of FIRREA.

Further, the reduction in the number of Fraud Section attorneys that travel between Washington, D.C., and Dallas sought by the conferees so that the attorneys could be on site working on financial institution fraud cases has not been achieved even though five Fraud Section attorneys now live in Dallas. Eleven attorneys now assigned to the task force commute between Washington, D.C., and Dallas. The Fraud Section has not been able to transfer attorneys or hire enough new attorneys to staff the regional office without having attorneys commute from Washington, D.C.

Justice opposes the concept of establishing Fraud Section regional offices. Citing the more traditional role of the Fraud Section as a resource for U.S. Attorneys, the Assistant Attorney General for the Criminal Division said that the establishment of regional offices fails to adequately recognize the U.S. Attorney's role as the chief federal law enforcement official in the 94 judicial districts. He also said such offices would lead to needless friction between the Fraud Section and U.S. Attorneys.

Because we found that the Fraud Section regional office had no observable impact on Justice's prosecution of financial institution fraud, apart from what the office head and staff were already contributing as members of a task force, we have no basis to determine whether regional offices of the Fraud Section should be set up in other parts of the country. The major thrust of Justice's efforts in prosecuting financial institution fraud has been to order the creation of task forces dedicated to prosecuting fraud in 27 cities and to add over 400 prosecutor, investigator, and accounting technician positions allocated by the Attorney General in December 1989 to the task forces in these cities. In addition, Justice created the Special Counsel for Financial Institution Fraud to coordinate Justice's efforts and ensure that resources are allocated to the most significant cases.

Objective, Scope, and Methodology

In determining whether Justice established a regional office of the Fraud Section in northern Texas in compliance with FIRREA, we first analyzed section 965 of FIRREA and its associated legislative history to determine the Department of Justice responsibilities with respect to the regional office. We interviewed officials of the Fraud Section in Washington, D.C., and Fraud Section attorneys assigned to the regional office. We interviewed Federal Bureau of Investigation (FBI) and Internal Revenue Service (IRS) investigators and Office of Thrift Supervision attorneys and examiners assigned to the Dallas Bank Fraud Task Force. We also talked with the U.S. Attorney for the Northern District of Texas and the FBI Special Agent-in-Charge of the Dallas FBI Field Division. We reviewed various correspondence and other documents provided by these officials.

In considering whether other Fraud Section regional offices should be established, we gathered information on the operations and accomplishments of two Justice initiatives in Dallas. Our purpose was to gain an insight as to how the initiatives helped Justice achieve its goals for investigating and prosecuting financial institution fraud. One initiative was a task force headed by the U.S. Attorney for the Northern District of Texas that had Fraud Section attorneys working on it. This task force, known as the I-30 Task Force, was formed in response to questionable banking and real estate transactions that resulted in a massive oversupply of condominiums along the Interstate 30 corridor near Dallas. The second initiative was the Dallas Bank Fraud Task Force. Because it had been headed by a senior attorney from the Fraud Section since its inception in 1987 and because Fraud Section attorneys working on the task force became part of the Fraud Section regional office, this task force came as close to constituting a "regional office" as we could locate for the purpose of gathering information on a regional office.

In addition, we obtained information on other Justice initiatives—a 27-city attack on savings and loan fraud and the creation of a Special Counsel for Financial Institution Fraud—which could have a bearing on the decision to replicate the regional office in other locations. As part of our work, we also talked with officials from 10 U.S. Attorney offices and 7 FBI field divisions in Texas, California, and Florida about the potential benefits of a regional fraud office in their localities.

We did our work from October 1989 to August 1990 in accordance with generally accepted government auditing standards.

Fraud Section Regional Office Established as Mandated by FIRREA

Although section 965 requires that Justice provide “sufficient legal and other staff and office space” for the mandated regional office, the determination of what is “sufficient” is left to Justice. In response to the mandate, Justice designated the Fraud Section attorney who already headed the Dallas Bank Fraud Task Force as director of the regional office. In an August 4, 1989, memo to the Fraud Section staff, the Chief of the Fraud Section stated:

“I have selected Richard M. Fishkin to be the Director of the Dallas Regional Office of the Fraud Section, which office shall be responsible for the work of the Dallas Bank Fraud Task Force . . . Mr. Fishkin reports to the Section Chief of the Fraud Section through the Deputy Chief responsible for bank and securities fraud cases and matters.”

According to the Deputy Chief of the Fraud Section, no other actions were necessary to comply with FIRREA. We noted, however, that Justice has policies and procedures for opening regional offices (Department of Justice Order 1000.2A). The order requires that organizational components of Justice desiring to establish a regional office submit to the Deputy Attorney General and the Attorney General plans for the new office. According to a Justice Management Division official, the plans should include such things as number of staff, where the staff will come from, and a proposed operating budget. When approved, Office of Management and Budget and Justice’s legislative committees must be notified. Justice officials in the Justice Management Division and the Fraud Section also told us that the order did not apply to the establishment of the regional office because the office was mandated by FIRREA.

The Deputy Chief of the Fraud Section said that Fraud Section employees assigned to cases being pursued by the Dallas Bank Fraud Task Force make up the staff of the regional office. There were 10 such attorneys as of August 4, 1989. These attorneys were to continue to report to and be rated by the Fraud Section, so no personnel actions were required. The Deputy Chief also said that there were no other documents or correspondence prepared relating to the establishment of the regional fraud office.

Consistent with the Deputy Chief’s statement that no further actions were necessary, we found no additional indications of a Fraud Section regional office as a separate entity. There is no phone listing for the regional office either in Dallas or in the Justice phone directory. There is no organizational chart that shows the regional office as part of the Fraud Section. In congressional testimony and other documents, Justice

officials, including the Attorney General, have often referred to the Dallas Bank Fraud Task Force rather than the Fraud Section regional office.

It should be noted that Fraud Section attorneys make up only a part of the Dallas Bank Fraud Task Force. Other participants on the task force include 7 Assistant U.S. Attorneys, 3 Tax Division attorneys, 49 FBI agents, 13 FBI accounting technicians, 16 Internal Revenue Service agents, 3 Office of Thrift Supervision examiners, and 1 Office of Thrift Supervision attorney. Nearly all of these task force members are located in Dallas. Together these task force members investigate and prosecute cases that typically involve complex transactions and often take years to complete. Fraud Section attorneys, serving full time on the task force, have not assumed any cases or other responsibilities beyond those assigned to them as members of the task force.

The House and Senate conferees envisioned that Fraud Section attorneys would live in Dallas rather than commute from Washington, D.C. As of August 1990, five attorneys assigned full time to the regional office lived in Dallas. (One of the five lived in Dallas prior to passage of FIRREA.) Eleven other attorneys assigned full time to the regional office commuted from Washington, D.C., to Dallas. In August 1989 nine Fraud Section attorneys commuted from Washington, D.C., to Dallas. Ultimately, Justice plans to assign 22 Fraud Section attorneys to the regional office full time.

The Director of the regional office of the Fraud Section told us that he has attempted to get Washington-based Fraud Section attorneys to transfer to Dallas, but these efforts have been largely unsuccessful. We talked with three Fraud Section attorneys who confirmed they had been asked to transfer to Dallas; none expressed an interest in a transfer. The Fraud Section also has encountered difficulty recruiting newly hired attorneys to work in Dallas. The conferees expected that a number of the 24 additional attorneys for the Fraud Section hired with funds appropriated under FIRREA would be hired to work in Dallas. Fraud Section officials often cited the pay differential as the primary cause of their inability to hire new attorneys. They said that in the private sector a qualified financial attorney can make a much higher salary than that offered by the Fraud Section. For example, a Fraud Section official said he recently interviewed a person in private industry who had 3 years experience. The person was earning \$148,000 a year and Justice could offer him only about \$42,000 a year. The Fraud Section official added

that even the U.S. Attorney in Dallas could offer higher salaries to new employees than he could.

No Basis to Determine Whether Regional Fraud Offices Should Be Replicated

There was no quantifiable information available for us to use in concluding whether or not Fraud Section regional offices should be replicated in other locations. Examining two task force approaches in Dallas—one headed by the U.S. Attorney and one headed by a senior Fraud Section attorney—provided little insight into which approach would be better.

U.S. Attorney I-30 Task Force—In the early 1980s, an oversupply of condominiums existed along the Interstate 30 corridor east of Dallas. A series of fraudulent transactions were discovered involving borrowers and officers of savings and loan institutions. These transactions had been made in order to finance the development of the condominiums. The U.S. Attorney, building on the initial investigative work of the FBI and the Texas Department of Public Safety, formed a task force in 1985 to develop cases and to prosecute those cases as warranted. This task force—known as the I-30 Task Force—was headed by the U.S. Attorney and included several Assistant U.S. Attorneys and FBI investigators. The task force also included Fraud Section attorneys. The staff of the I-30 Task Force was located in secure office space in Dallas.

As of August 1990, the I-30 Task Force had charged 115 individuals with bank fraud-related charges of which 103 had been convicted. The defendants ranged from outsiders, such as lawyers, accountants, and appraisers, to insiders and borrowers at the institutions. Sentencing in these cases has varied from probation to 35 years in prison, and prosecution has resulted in restitution orders of more than \$12 million. However, its most significant case to date—involving a conspiracy trial of seven major participants—ended in a mistrial. For the remaining five individuals, one has been acquitted, charges against two were dismissed, and charges are still pending for two others.

Dallas Bank Fraud Task Force—This task force differs from the I-30 task force in that it was established in response to the growing savings and loan crisis in northern Texas and it is headed by a senior Fraud Section attorney reporting to the Justice headquarters in Washington, D.C. It was established in August 1987 after the U.S. Attorney for the Northern District of Texas and the FBI Special Agent-In-Charge

in Dallas made urgent requests for increases in staffing to handle the mounting workload.

Initially, the Fraud Section attorney heading the task force had limited managerial authority. Plea agreement and prosecution decisions had to be made by the Fraud Section Chief in Washington, D.C. According to task force attorneys, this resulted in excessive time being spent before cases could be brought to indictment. In February 1990, the Fraud Section delegated to the task force head (with the agreement of the U.S. Attorney for the Northern District of Texas) the authority to make plea agreements and prosecution decisions. As the chief federal prosecutor in the district, the U.S. Attorney has continued to sign all indictments prepared by the task force. According to Justice officials, this delegation should expedite the process for obtaining plea agreements and prosecution decisions by eliminating headquarters' reviews.

The Dallas Bank Fraud Task Force has made progress in its fight against financial institution fraud since its establishment in August 1987. As of August 23, 1990, the task force had charged 86 individuals of whom 60 had been convicted and 2 had been acquitted (charges were still pending on 24 individuals). In fiscal years 1988, 1989, and 1990 (through August 23) the task force obtained 12, 26, and 22 convictions, respectively. About half of the individuals convicted were senior executives. The individuals convicted included bank and savings and loan owners and officers, real estate brokers and developers, accountants, and borrowers. Sentences for those convicted ranged from probation to 35 years in prison, and fines and restitution orders ranged from \$1,000 to \$2.5 million. The first significant case indicted in 1988 resulted in acquittal of the defendants; however, there has been only one further acquittal. The task force has over 500 individuals targeted for investigation and has open investigations on over 40 financial institutions.

We observed common elements in both approaches that we believe are important in dealing with complex issues such as the investigation and prosecution of financial institution fraud. In both approaches a wide-ranging and complex problem was identified, resources were dedicated solely to the resolution of the problem, and personnel assigned to the problem were accountable to a designated task force head.

It should be noted that two Justice initiatives have been undertaken that may have rendered moot the question of whether additional regional

offices should be established. In December 1989, the Attorney General announced the establishment of task forces in 27 cities across the country for investigating and prosecuting financial institution fraud. He allocated over 400 prosecutors, investigators, and accounting technicians to the task forces, most of which were from increased staffing levels authorized under FIRREA. As of June 1990, most of these positions had been filled. In addition, Justice recently created the position of Special Counsel for Financial Institution Fraud to be the focal point for Justice's efforts in this area. The role of Special Counsel, who reports to the Deputy Attorney General, is to ensure that resources are allocated to the most significant cases, ensure good coordination between Justice and the thrift and bank regulatory agencies, and track and maintain data on criminal enforcement actions. As part of his efforts to achieve these goals, the Special Counsel plans to meet with U.S. Attorney office officials to discuss the status of their financial institution fraud cases. The Special Counsel expects that through this review, he will gain a better understanding of where resources are needed.

Justice Officials Generally Oppose the Concept of Regional Fraud Offices

Based on discussions with officials from 10 U.S. Attorney offices in Texas, California, and Florida, attempts to establish Fraud Section regional offices would encounter much resistance from U.S. Attorneys. These officials, with the exception of the U.S. Attorney in the Northern District of Texas, opposed the establishment of Fraud Section regional offices in their districts. The reasons given for their opposition included the following:

- Experience and pay. Trial experience was considered important to the successful prosecution of these cases, and Fraud Section attorneys tend to have far less trial experience than Assistant U.S. Attorneys. Further, the pay disparity between the Fraud Section and the Assistant U.S. Attorneys makes it easier for the U.S. Attorneys to attract qualified personnel. For example, an attorney with 7 years of experience can earn an average of \$9,000 more in the U.S. Attorney's office than in the Fraud Section and other headquarters offices.
- Jurisdictional conflicts. Many of these officials believed that the regional offices would result in Fraud Section attorneys and U.S. Attorneys competing over investigative resources and over which office would handle the cases.
- Unfamiliarity with the local environment. Prosecutors from outside the district are less likely to be familiar with the local banking situation (e.g., the interrelation between various targets of investigations, or who the best sources are for specialized expertise within the various state

and federal bank regulatory agencies), the idiosyncrasies of district judges, and the attitudes of district residents.

- Unnecessary duplication of effort. These officials felt that providing sufficient training, office space, and support staff for federal prosecutors in a second office was unnecessary.

It should be noted that the U.S. Attorney for the Northern District of Texas had originally requested that additional resources be assigned directly to his office and be under his control. When such resources were not forthcoming, he said he accepted the establishment of a Fraud Section-controlled task force in his jurisdiction. Further, although he said he now cooperates with and supports the Fraud Section's regional office, he would have preferred that the additional resources were under his authority rather than under the Fraud Section's.

FBI officials that we spoke with in six field offices in California and Florida were also opposed to Fraud Section regional offices. Some FBI officials said that they had already established good working relationships with the U.S. Attorneys and could not see the advantage in creating another office to do essentially the same thing. Another concern raised was the potential for competition for preferred cases between agents assigned to assist the regional office and those working with the U.S. Attorney.

The Assistant Attorney General for the Criminal Division said that the establishment of regional offices fails to adequately recognize the U.S. Attorney's role as the chief federal law enforcement official in the 94 judicial districts. He also said such offices would lead to needless friction between the Fraud Section and U.S. Attorneys. Similar concerns were expressed by the Fraud Section officials we spoke with. The Acting Chief of the Fraud Section told us that establishing regional offices would constitute a major change in the structure and function of the Fraud Section. The Fraud Section would no longer be assisting districts that request aid but would instead be establishing a permanent and perhaps unwanted presence. He also said that clearly designating such offices as Washington-run operations would diminish their potential for success by alienating local officials responsible for the investigation and prosecution of financial institution fraud.

Conclusions

Justice initiated the minimum necessary actions to bring itself into compliance with FIRREA requirements for a regional office of the Fraud Section in northern Texas. However, the reduction in the number of Fraud

Section attorneys traveling back and forth between Washington, D.C., and Dallas has not been achieved.

Justice opposes the concept of establishing regional fraud offices. Because we found that the Fraud Section regional office had no observable impact on Justice's prosecution of financial institution fraud, apart from what the office head and staff were already contributing as members of a task force, we have no basis to determine whether regional offices should be set up in other parts of the country. Further, we believe that subsequent actions by the Justice Department to establish task forces in 27 cities and create the position of Special Counsel for Financial Institution Fraud may have rendered moot the question of whether additional regional offices should be established.

We discussed the information in this report with officials from the Fraud Section and the Regional Fraud Office in Dallas. These officials concurred with the results of our work. Copies of this report are being sent to the Attorney General, Justice's Criminal Division, and other interested parties.

Major contributors to this report are listed in the appendix. If you have any questions about this report, please call me on 275-8389.



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