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BANK AND THRIFT  
FRAUD

Overview of the Federal  
Government's Response

Statement of  
Harold A. Valentine  
Associate Director  
Administration of Justice Issues



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BANK AND THRIFT FRAUD:  
OVERVIEW OF THE FEDERAL GOVERNMENT'S RESPONSE

SUMMARY OF STATEMENT BY HAROLD A. VALENTINE  
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The Chairman of the Subcommittee on Consumer and Regulatory Affairs requested GAO to discuss the role of the Special Counsel for Financial Institution Fraud, the resources allocated for investigating and prosecuting financial institution fraud, and the results achieved with those resources.

In 1989, the Attorney General announced that wrongdoing in the savings and loan industry may be the biggest white-collar swindle in the history of the nation. Through the Financial Institutions Reform, Recovery, and Enforcement Act and the Crime Control Act of 1990, Congress provided the Department of Justice with significant additional powers and resources to address the crisis. Yet even so, Justice continues to be pressed to do more. As of September 30, 1991, the FBI had more than 8,400 financial institution fraud cases ongoing. About 4,300 of these are major cases: those involving failed institutions or alleged losses of \$100,000 or more. Since 1987, the FBI has experienced a 54-percent increase in its major case workload.

As part of its strategy to attack this enormous and unprecedented challenge, Justice appointed a Special Counsel to provide coordination and leadership. That initiative was subsequently enacted into law by the Crime Control Act. Among other things, the act required the Special Counsel to (1) supervise and coordinate matters concerning financial institution fraud and (2) ensure that adequate resources are made available to investigate and prosecute financial crimes.

GAO believes that the Special Counsel has made important strides since assuming his position almost 1 year ago. However, his ability to carry out his responsibilities is constrained by limited management authority and information. For example, the Special Counsel has little control over departmental resources. Because most attorneys are controlled by local U.S. Attorneys, the Special Counsel can provide little assurance that those resources are applied to the most significant cases.

The limitation of the Special Counsel's authority relative to non-Justice agencies is even more pronounced. Both supervisory examiners and IRS agents are critical to effective bank and thrift fraud investigations. Yet the Special Counsel has little information on how many such personnel are involved in these investigations, much less whether those resources are adequate.

GAO believes that the government needs a unified effort to attack a crisis of this magnitude and scope. Whether such a unified approach can come from the Special Counsel, as currently established, remains to be seen.



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss how the government is addressing the enormous problem of criminal financial institution fraud. You asked us to discuss the activities of the Special Counsel for Financial Institution Fraud, a position legislated by the Crime Control Act of 1990. You also expressed an interest in the status of the allocation of Justice resources, as provided under both the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) and Crime Control Act and the results achieved to date.

In summary, Mr. Chairman, the pursuit of bank and thrift fraud has called for additional Justice resources as well as assistance from numerous agencies outside the Department. The Special Counsel, whose role is to ensure that financial institution fraud investigations and prosecutions are being effectively carried out, has limited information and authority to achieve that end. We believe that this raises concerns about the government's ability to provide leadership over such a national multiagency effort. This issue becomes more serious when considered against the backdrop of a financial institution fraud crisis of unprecedented proportions.

For this testimony, we drew upon results that we developed during ongoing work on bank and thrift fraud. It has involved interviews with numerous officials inside the Department of Justice, including the Special Counsel for Financial Institution Fraud and other senior officials with the FBI, Executive Office for U.S. Attorneys (EOUSA), and the Criminal Division. As part of that work, we also interviewed officials with the Internal Revenue Service (IRS), Postal Service, and Secret Service, along with officials from the financial supervisory agencies. We did those interviews in Washington and in 21 cities around the country. We also analyzed data from Justice, EOUSA, and FBI management information systems and reviewed information in the monthly reports submitted to Congress by the Attorney General.

#### BACKGROUND

Several federal agencies have roles and responsibilities in identifying, investigating, and prosecuting financial institution fraud. Financial institutions and their supervisory agencies--the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration, the Office of Thrift Supervision (OTS), the Federal Reserve System, and the Resolution Trust Corporation (RTC)--refer suspected criminal activity to local FBI and U.S. Attorney offices.<sup>1</sup> During fiscal year 1991, the FBI received

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<sup>1</sup>There are a few exceptions. For example, allegations regarding credit card fraud go to the Secret Service, and alleged violations of the Bank Secrecy Act go to IRS.

over 24,600 financial institution fraud referrals. More than 400 of those involved suspected losses of \$1 million or more.

Of the criminal fraud investigated, the vast majority is done by the FBI, which had 8,454 financial institution fraud investigations underway as of September 30, 1991. Of those, about 4,300 were major case investigations: those involving failed institutions or alleged losses of \$100,000 or more.<sup>2</sup> In addition, the Postal Service, IRS, and other federal agencies may also be involved in investigations, as well as the U.S. Secret Service, which gained authorization to investigate fraud against financial institutions in the Treasury, Postal Service, and General Government Appropriations Act for fiscal year 1991. As of September 30, 1991, 57 Secret Service offices were investigating 245 financial institution fraud cases.

Most bank and thrift fraud cases are prosecuted by attorneys in each U.S. Attorney's office. In addition, Justice Tax Division and Criminal Division Fraud Section attorneys actively participate in criminal financial institution fraud enforcement.

#### Legislative Efforts Address Financial Institution Fraud

Since 1989, Congress has enacted two major pieces of legislation that have significantly influenced the government's efforts against financial institution fraud. The Financial Institutions Reform, Recovery, and Enforcement Act, enacted in 1989, addressed financial institution fraud by strengthening civil and criminal penalties for defrauding financial institutions. The Crime Control Act of 1990 built upon FIRREA's antifraud provisions. Among other things, both acts made substantial changes to how Justice and federal financial supervisory agencies can combat unlawful activities affecting financial institutions.

First, FIRREA and the Crime Control Act expanded the resources available to attack financial institution fraud. FIRREA authorized Justice Department appropriations of \$75 million per year for fiscal years 1990 through 1992 for investigations, prosecutions, and civil proceedings involving financial institutions. The Crime Control Act amended FIRREA by authorizing \$162.5 million per year for fiscal years 1991 through 1993. According to Justice's fiscal year 1991 report to Congress on financial institution fraud, these new resources, combined

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<sup>2</sup>EOUSA defines a major case differently from the FBI. To EOUSA, a case is major when (a) the amount of fraud or loss was \$100,000 or more; or (b) the defendant was an officer, director, or owner (including shareholder); or (c) the schemes involved multiple borrowers in the same institution; or (d) the case involved other major factors.

with internal reprogramming, have allowed for the addition of 482 new FBI agent positions and 493 Justice attorney positions. Justice now has 986 FBI agent positions and 636 attorney positions available for financial institution fraud. Information from the Executive Office for U.S. Attorneys indicates that by the end of fiscal year 1991, U.S. Attorney offices had applied a total of about 264 staff years to bank and thrift fraud (excluding management and administration time). In addition, information from the FBI shows that the Bureau had applied a total of about 609 direct agent work years to financial institution fraud in fiscal year 1991.<sup>3</sup>

Second, the Crime Control Act legislatively created new organizational structures to combat bank and thrift fraud. Among other things, the act established a Special Counsel to (1) supervise and coordinate investigations and prosecutions of financial institution fraud; (2) ensure that federal law relating to civil enforcement, asset seizure and forfeiture, money laundering, and racketeering are used to the fullest extent authorized to recover the proceeds of unlawful activities from persons who have committed crimes in and against the financial services industry; and (3) ensure that adequate resources are made available for investigations and prosecutions of financial institution fraud.

In addition to increasing resource authorizations, the Crime Control Act enacted into law some organizational changes that the Justice Department had already started. Following the enactment of FIRREA, Justice appointed a Special Counsel for Financial Institution Fraud in June 1990. The person who currently holds the position of Special Counsel, Ira Raphaelson, replaced the acting Special Counsel and was confirmed by the Senate in May 1991.

#### JUSTICE IS FACED WITH INCREASING DEMANDS TO DO MORE

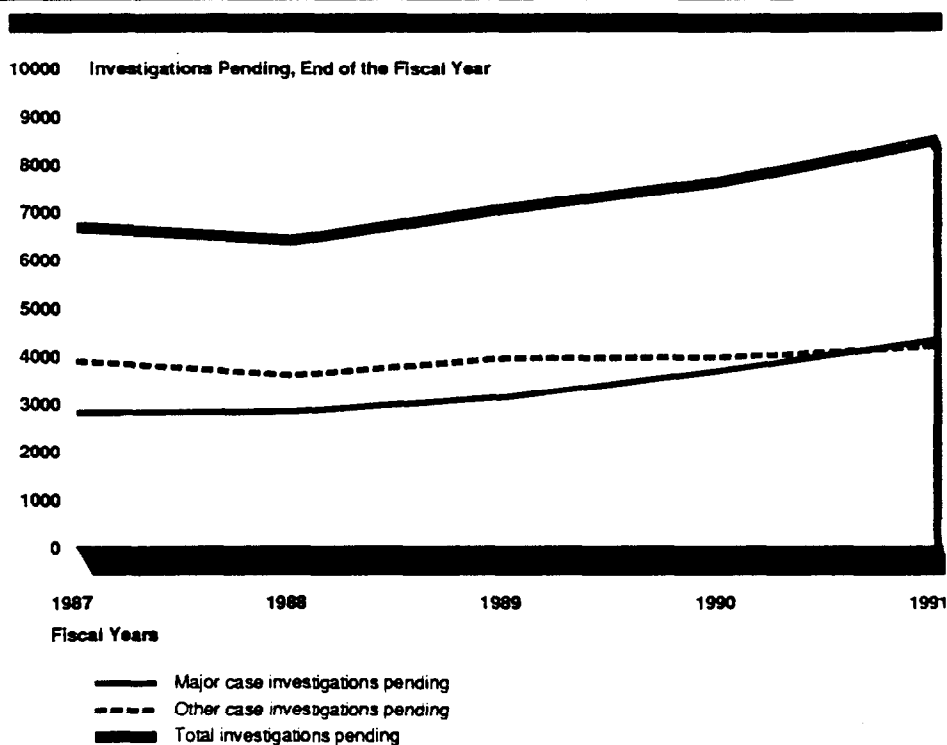
The financial institution fraud problem has not diminished. As of September 30, 1991, the FBI had more than 8,400 financial institution fraud cases underway. Nearly 4,300 of these were major case investigations. About 83 percent of FBI agent time spent on financial institution fraud involved major case investigations.

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<sup>3</sup>The FBI measures the time of field investigative agents in terms of direct agent work years (DAWY). A DAWY accounts for all the time an agent spends on investigative work, along with administrative time and compensated leave. For fiscal year 1991, an FBI DAWY equates to 2,563 hours.

The workload is growing. The total number of investigations pending at the end of the year rose 27 percent between fiscal years 1987 and 1991. Most of this change is due to the increase in the number of major case investigations. Major financial institution fraud case investigations on hand have increased about 54 percent from 2,785 case investigations at the end of 1987 to 4,293 as of September 30, 1991. Figure 1 shows this growth. The FBI is now opening about 261 major case investigations a month, up from 165 per month in 1987. With investigative activity increasing, the prosecutorial workload is growing as well. In fiscal year 1991, the U.S. Attorneys began prosecuting about 300 defendants per month, up from about 230 per month in 1987. In addition, as the workload has grown and despite added resources, the median length of processing time between indictment and disposition has significantly increased from 4.0 months in 1987 to 6.3 months in 1991.

**Figure 1: Major Case Investigations Are Becoming a Greater Part of FBI's Pending Workload**

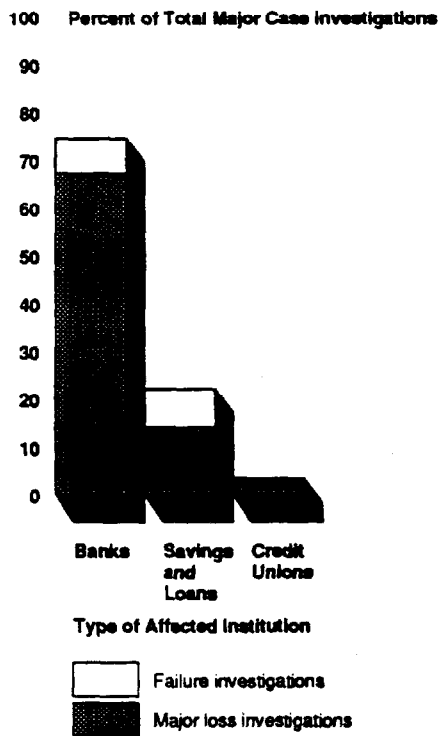


Source: GAO analysis of FBI data.



In 1989, the Attorney General announced that wrongdoing in the savings and loan industry may be the biggest white-collar swindle in the history of the nation. At the end of fiscal year 1991, however, most of the FBI's major case investigations involved banks rather than savings and loans. Of the 4,293 major case investigations pending at the end of fiscal year 1991, about 75 percent were bank investigations, 22 percent involved savings and loans, and the remaining 3 percent were credit union investigations. Because of the general complexity involved, however, the FBI spent relatively more time working savings and loan case investigations. Of the total time devoted to major case investigations, the FBI spent about 56 percent of agent time working bank cases, and 41 percent of its time on savings and loan cases. Figure 2 provides a breakdown of major case investigations by type of affected institution.

**Figure 2: A Majority of FBI's Major Case Investigations in Fiscal Year 1991 Involved Banks Rather Than Savings and Loans**



Source: GAO analysis of FBI data.

THE SPECIAL COUNSEL'S OVERSIGHT  
ABILITY IS LIMITED

Faced with an expanding workload and widespread participation by federal agencies, the Justice Department sought to provide coordination and leadership over its investigative and prosecutorial efforts. Appointing a Special Counsel was a key initiative designed toward achieving that end. According to the Attorney General, the large volume of cases and interagency involvement in financial institution fraud made it appropriate to vest overall policy and operational control in a senior Justice official.

Since his confirmation, the Special Counsel has made significant strides toward facilitating the government's overall effort to pursue financial institution fraud. This progress is encouraging. For example, he has worked with the Executive Office for U.S. Attorneys and the FBI to develop and improve a tracking system for bank and credit union statistics, worked on fiscal year 1993 Justice staffing requests, and coordinated training activities for the FBI and U.S. Attorney offices.

Notwithstanding these positive actions, the Special Counsel's ability to carry out his responsibilities is constrained by the office's limited authority and information. The Crime Control Act requires the Special Counsel to ensure that adequate resources are available to pursue fraud, yet he has little influence over those resources--for both Justice as well as non-Justice entities.

Control Over Justice  
Resources is Limited

Most of the additional resources provided by FIRREA and the Crime Control Act went to local FBI and U.S. Attorney offices. The Criminal, Tax, and Civil Divisions also added a total of 170 attorneys and 122 support personnel.

Justice allocated all of the FBI and U.S. Attorney positions to field offices. Of the FBI's 56 field divisions, 30 received FIRREA special agents, with Dallas gaining the most, 37. For the most part, agents were allocated to cities designated by the Attorney General for "task force" investigations. Following the Crime Control Act, the FBI allocated dedicated special agents to 47 field divisions. Some offices that received FIRREA agents did not, however, receive Crime Control Act agents.

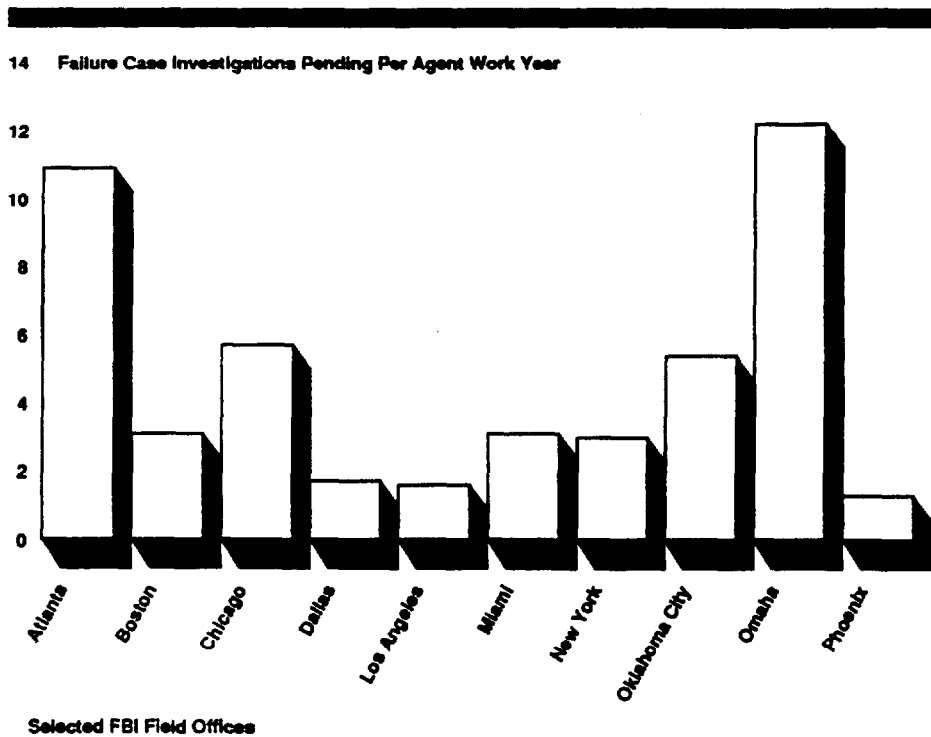
FIRREA also resulted in significant increases in U.S. Attorney staff resources. In fiscal year 1990, EOUSA allocated 121 dedicated assistant U.S. Attorneys to 37 offices. The Crime Control Act nearly doubled that increase, adding another 228 assistant U.S. Attorneys to 73 offices. Many FBI and U.S.

Attorney offices also received auditor, paralegal, and support staff as well.

Due to the decentralized structure of the Department, however, local U.S. Attorneys have significant discretion in the management of their offices. As such, the Special Counsel must depend on the assessment of the U.S. Attorneys and the FBI to ensure that resources are applied to the most significant cases.

There are no readily available criteria to evaluate whether staffing at various offices is adequate, but we have noted wide variations in workload at selected locations. In general, these are cities that had a large number of major case investigations pending at the end of fiscal year 1991. For example, approximately 12.2 major failure cases are assigned to each FBI agent in Omaha, while each agent in Phoenix is assigned 1.3 major failure cases. FBI officials told us that, ideally, the FBI would like to have sufficient resources to assign two agents to each failure case (0.5 case per agent). Figure 3 illustrates these differences for 10 different FBI field offices.

**Figure 3: FBI's Failure Case Investigation Workload Varies Widely Among Different Field Offices**



Source: GAO analysis of FBI data.

Control over Non-Justice  
Resource Allocations is Limited

The Special Counsel's influence over non-Justice resources is even more limited. Justice recognizes that IRS and the supervisory agencies provide valuable expertise to complex financial institution fraud investigations. Yet the Special Counsel has little information on how many such personnel are involved in financial institution fraud investigations, much less whether those resources are adequate.

Since 1987, the Criminal Investigation Division (CID) of IRS has participated in the investigation of over 200 institutions. Officials at many field locations we visited indicated that the investigative resources of IRS are a valuable commodity for most local U.S. Attorney offices.

Yet the Special Counsel does not have any authority over IRS resources, much less over the assignment of CID agents to work particular financial institution fraud cases. Whether IRS applies CID resources to these cases depends on the priorities of each Regional Commissioner. For example, in Jacksonville, the Regional Commissioner applied about six agent staff years to bank and thrift fraud cases; in Phoenix, less than one agent staff year was applied. The Special Counsel met with Treasury officials to discuss IRS' CID participating more in financial fraud enforcement, but progress has been slow. For example, although Justice established the New England Bank Fraud Task Force in May 1991, IRS has not yet provided CID agents to it.

A similar situation exists with examiners from financial supervisory agencies. The Department recognizes that the demand for examiners by investigators and prosecutors has increased across the country. However, participation remains largely uneven. Because information maintained by supervisory agencies on resource assignments is incomplete, we are unable to present this data. The Special Counsel indicated that supervisory agencies do not generally provide his office with information on resource allocations except in two instances--when they seek reimbursement or provide advance notice of the allocation to a regional office. Generally, whether supervisory agencies provide assistance depends on the availability of their resources and the success of the U.S. Attorney in soliciting their assistance.

Furthermore, many supervisory agencies have been somewhat reluctant to provide examiners to assist in fraud investigations. OTS entered into an agreement with Justice on reimbursing the agency for the use of its resources for fiscal year 1991. That agreement, reached only after year-long negotiations, is no longer in effect. While other supervisory agencies would like to receive reimbursement from the Justice Department, no negotiations for compensating these agencies are planned.

JUSTICE'S RESPONSE TO  
BANK AND THRIFT FRAUD:  
NO MEASURABLE CRITERIA  
TO EVALUATE RESULTS

It is extremely difficult to evaluate Justice's progress against criminal bank and thrift fraud. Aside from President Bush's pledge to put "the cheats ... chiselers ... and charlatans" behind bars, there are few clear goals. The Special Counsel told us that there are no other Justice investigative and prosecutorial programs against which this program can be compared, and no measurable criteria against which the program may be gauged have been developed.

According to the Special Counsel, any single quantitative or statistical indicator of the program's progress would be imperfect. Before making any assessment of the program, qualitative factors should be considered as well. He mentioned, for example, the quality of cases, the strength of case management, the order and priority of prosecutions, and whether prosecuting a high-profile defendant might exert a greater deterrent effect than prosecuting another case. The Special Counsel also told us that other factors outside the Department's control, such as congestion in the federal courts, affect the speed with which Justice can process cases. We agree that both qualitative and quantitative considerations are important for evaluating such programs.

Given the absence of qualitative measures, however, the Special Counsel cites statistics as measures of success. He lauds the Department's conviction of hundreds of persons for major financial institution fraud crimes as evidence of Justice's "spectacular" record. Lacking any basis of comparison, however, we find it difficult to put this success into perspective.

Justice and the FBI are maintaining several databases that provide information on financial institution fraud efforts. We analyzed some of this information. For example, table 1 shows FBI information on the number of indictments, informations, and convictions Justice has obtained over the past 5 years.

Table 1: Major Financial Institution Fraud Case Results, Fiscal Years 1987 Through 1991

| Fiscal year                  | Indictments and informations | Felony convictions | Restitution ordered (millions) | Fines ordered (millions) |
|------------------------------|------------------------------|--------------------|--------------------------------|--------------------------|
| 1987                         | 881                          | 692                | \$104                          | \$5.8                    |
| 1988                         | 913                          | 706                | 156                            | 2.4                      |
| 1989                         | 981                          | 728                | 342                            | 2.4                      |
| 1990                         | 1,066                        | 982                | 234                            | 9.0                      |
| 1991                         | 1,345                        | 922                | 469                            | 7.1                      |
| Totals                       | 5,186                        | 4,030              | \$1,305                        | \$26.7                   |
| Percent increase (1987-1991) | 52.7%                        | 33.2%              | 351.0%                         | 22.4%                    |

Source: FBI.

To get further information, we looked at Justice Department data on major case prosecutions from fiscal years 1989 through 1991. These data show that those cases involved estimated losses of nearly \$10 billion. Of the individuals sentenced in those cases, 77 percent were sentenced to jail. Fines and restitution ordered in those cases totalled \$686 million.

Justice does not have complete information on how much of this restitution has actually been paid. Restitution collection procedures vary around the country. In some districts, the Probation and Pretrial Services Division of the Administrative Office of the U.S. Courts monitors collection of restitution. In other districts, U.S. Attorney offices monitor collection. In addition, actual payments are received at a number of different access points at several agencies, which include Justice, FDIC, and the Probation Office of the U.S. Courts. The Special Counsel said that fine and restitution collection is not solely the responsibility of the Justice Department, and he does not believe that the amount collected should be used to evaluate Justice's financial institution fraud program. However, Justice has provided guidance to U.S. Attorneys to help ensure that fines and restitutions imposed are more collectible.

We also analyzed Justice Department data on the prosecution results of the top 100 savings and loan referrals.<sup>4</sup> As of September 30, 1991, Justice had obtained indictments and informations against 219 defendants who victimized 55 of the top 100 savings and loans. As shown in table 2, those cases resulted in 145 convictions. Of those 145 defendants, 55 are awaiting sentencing and 90 have been sentenced. The median prison sentence for those 90 individuals was 18 months. The fraud alleged in those cases involved losses of about \$597.1 million, and fines and restitution ordered totalled about \$83.6 million. Fines and restitution collected, on the other hand, amounted to about \$365,000, or less than one-half of 1 percent of the total amount ordered. Table 3 shows the results of those cases.

Table 2: Prosecution Results of the Top 100 Major Savings and Loan Referrals

|                        | Number of defendants |
|------------------------|----------------------|
| Under Investigation    | a                    |
| Indictment/Information | 219                  |
| Convictions            | 145                  |
| Acquittals             | 7                    |
| Awaiting Sentencing    | 55                   |
| Sentenced              | 90                   |

<sup>a</sup>The Justice Department would not provide this information.

Source: GAO analysis of Justice Department data.

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<sup>4</sup>OTS, RTC, and FDIC identified the top 100 savings and loan criminal referrals at the Indianapolis, Indiana, regulatory conference in June 1990.

Table 3: Sentencing Information on the Top 100 Major Savings and Loan Referrals

|  |               |
|--|---------------|
| Sentencing information                     |               |
| Median prison sentence (months)            | 18            |
| Total fraud alleged                        | \$597,117,954 |
| Total fines ordered                        | 4,521,000     |
| Total restitution ordered                  | 79,092,886    |
| Total fines collected                      | 15,200        |
| Total restitution collected                | 349,810       |
| Percent of fines and restitution collected | 0.437%        |

Source: GAO analysis of Justice Department data.

CONCLUSION

In summary, Mr. Chairman, criminal bank and thrift fraud played a major role in what is perhaps the most significant financial crisis in this nation's history. Justice is principally responsible for investigating and prosecuting criminal fraud, and it has made progress in convicting growing numbers of financial institution fraud defendants. Yet this is a challenge that calls not only for multiagency involvement, but for a unified federal response.

Appointing a Special Counsel was a positive step toward providing coordination and leadership to the criminal bank and thrift fraud issue. We believe that the Special Counsel has enhanced efforts to improve the federal government's response. However, limitations to the Special Counsel's responsibility and authority restrict his ability to lead, oversee, or influence the necessary agencies. The lack of a national perspective may have limited the government's effectiveness. For example:

- Financial institution supervisory agencies, faced with their own priorities, have been reluctant to provide assistance to Justice.
- IRS delegates decisions regarding its commitment to financial institution fraud investigations to regional officials.
- And while Justice is gaining increased judgements for fines and restitutions, management responsibility for collections is diffused.



The government needs a unified effort to attack a crisis of this magnitude and scope. Whether such a unified approach can come from the Special Counsel, as the position is currently established, remains to be seen.

This concludes my statement, Mr. Chairman. We would be pleased to respond to any questions.



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