STATEMENT OF

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- - -

BEFORE THE
UNITED STATES SENTENCING COMMISSION

- - -

HEARING ON
PROPOSED AMENDMENTS TO THE FEDERAL
SENTENCING GUIDELINES

WASHINGTON, D.C.

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Madam Chair and Members of the Commission:

Thank you for the opportunity to testify on behalf of the Department of Justice and federal prosecutors across the country about the Sentencing Commission's response to the Dodd-Frank Wall Street Reform and Protection Act. We commend the Commission for its leadership in the area of economic crime sentencing policy over the last decade - beginning in 2001 with a comprehensive review that resulted in the so-called "Economic Crimes Package" and continuing in

2003 with implementation of the Sarbanes-Oxley Act - and are pleased that the Commission is now considering an in-depth, multi-year review of section 2B1.1 and related provisions of the sentencing guidelines.

The lingering economic crisis has had devastating effects on mortgage markets, credit markets, the banking system, and virtually all of our citizens. Whatever the cause or causes of our financial crisis, the crisis has certainly laid bare criminal activity across a wide spectrum of our financial markets. I see it every day in my own District - whether in connection with billion-dollar Ponzi schemes (like Bernard Madoff's) or in mortgage fraud scams that have led to over 100 arrests in the past 18 months alone.

As a result, the Department has redoubled its efforts to combat every manner of financial fraud - including securities and mortgage fraud. Our mission has been to prosecute wrongdoers; recover stolen money; make financial crime victims whole; and protect taxpayers. Through their efforts over the past year alone, the various U.S. Attorneys Offices across the country, together with our colleagues in the Criminal Division and our many law enforcement partners, have prosecuted thousands of defendants for fraud and obtained judgments, restitution orders and

settlements amounting to billions of dollars. The U.S. Attorney's Office for the Southern District of New York, for example, collected and deposited into the asset forfeiture funds $269 million from civil and criminal forfeitures in FY 2010. In addition, the Office obtained forfeiture judgments totaling in excess of $932 million. The Southern District of New York also had $49.5 million in criminal collections and $138.9 million in civil collections.

Prosecuting fraud remains a top priority for federal prosecutors everywhere as we pursue criminals who steal from the pockets of the American people to line their own and who undermine the integrity of our markets. We are grateful for the support that Congress has provided our criminal enforcement efforts through legislation like the Dodd-Frank Act, the Fraud Enforcement and Recovery Act, and the Affordable Care Act.

Moreover, we believe a strong sentencing policy that leads to consistent, tough, and fair sentencing outcomes is critical to effective fraud enforcement. There is concern, based on the experience of some Districts, that more and more, particularly in the context of high-loss, large-scale fraud cases, there are not consistently tough and fair outcomes. We have observed - and the Commission's

data have confirmed - that district courts are relying less and less on the sentencing guidelines, which are now advisory. Some are voicing concern that the fraud guidelines counsel sentences that are inappropriate to the crime committed. Others have expressed frustration that the guidelines provide inadequate assistance in developing intelligent and consistent sentencing decisions in certain white-collar cases.

As we have stated before, the Department fully supports the Commission's plan for a thorough review of the federal sentencing guidelines that relate to fraud offenses generally as well as to securities, bank, and mortgage fraud offenses in particular. As the Commission has acknowledged, these guidelines are complex and broad in scope. Therefore, the Department further agrees that any thoughtful amendment of these guidelines and related policy will require study beyond this 2010-11 cycle of the Commission, and the Department, of course, commits to working with the Commission to the fullest extent appropriate to address the issues presented by these guidelines and Congress's directives.

We have a number of specific guideline amendment proposals that we hope the Commission will examine as part of this review. We do not believe

across-the-board penalty increases are warranted for all fraud offenses sentenced under section 2B1.1. Indeed, it is our experience that in cases involving large-scale financial harm, the guidelines generally provide for commensurately stiff punishment. What the guidelines sometimes do not offer, however, is meaningful guidance for differentiating between and among financial criminals and accurately gauging their relative culpability. We believe that the twin goals of fairness and deterrence can be furthered through a few modest amendments, and I would like to mention now just some ideas for your consideration toward that end. We hope to work with you to flesh out these preliminary ideas, and possibly others, in the coming months.

I. SECURITIES FRAUD

In the securities fraud context, we would propose two new sentencing enhancements: one for sophisticated insider trading conduct and the other for engaging in a course or pattern of insider trading (especially where such criminal conduct has not resulted in financial profit, despite a defendant's best efforts).

A. Sophisticated Insider Trading Conduct

In the Southern District of New York, we have had considerable historical

and recent experience with insider trading investigations and prosecutions. In the past 18 months alone, we have charged 46 individuals with participation in insider trading schemes. We have observed in connection with these recent cases that insider trading crimes are becoming increasingly complex and difficult to detect. Today's insider trading cases often involve networks of illegal activity, operating on a global basis, using technologies that make the crime more difficult to detect and employing sophisticated measures to conceal the criminal activity. Some examples of this involve passing inside information through heavily coded emails; employing anonymous pre-paid cellphones to prevent the identification of the phone's subscriber; using portable flash drives, instead of company servers, to store illicit inside information; creating "cover" documents to make it appear that a particular trade was based on public information; and engaging in strategic and pretextual trading in and out of stocks to create false patterns and thereby mask illegal trading. Pushing the level of sophistication even further, in many recent cases, traders have employed the cover of so-called expert networking firms, ostensibly for purposes of gaining generic and legitimate information from "experts" in certain industries, but in reality for purposes of creating thinly-veiled covers for illegally peddling still-secret revenue and earnings information before public announcements. Based on our experience, the nature and scope of insider

trading activity has evolved substantially, but the guidelines have not completely kept up.

While the fraud guideline provision found at USSG §2B1.1, which is generally applicable to securities fraud offenses, includes a two-level enhancement for use of "sophisticated means," no such enhancement exists in USSG §2B1.4, the guideline provision applicable to insider trading offenses. Application Note 8 to USSG §2B1.1, which concerns the "sophisticated means" enhancement, defines such conduct as "especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense. For example, in a telemarketing scheme, locating the main office of the scheme in one jurisdiction but locating soliciting operations in another jurisdiction ordinarily indicates sophisticated means. Conduct such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore financial accounts also ordinarily indicates sophisticated means." The intricate techniques that many of today's insider trading defendants utilize to perpetrate their schemes closely mirror this type of conduct, and the people who employ them should similarly face increased penalties under the guidelines.

B. "Profitless" Insider Trading

We also have observed individuals who clearly trade on the basis of material, nonpublic information but do not make a profit because the market does not react to the disclosure of the information in the way anticipated by the defendant or because other countervailing and unforeseeable market forces arise, as for example when an expected upward stock swing upon disclosure of unexpectedly high earnings for an oil company does not materialize because of a sudden political crisis in the Middle East. In that hypothetical case, a trader might have clear criminal intent and expect to profit handsomely from an illegal advance tip about earnings, but because of external forces may not ultimately realize a profit from his position. Less dramatic examples abound, and for insider trading defendants who are trading professionals and who therefore trade often, this can happen with some frequency. Section 2B1.4 of the guidelines, however, currently offers no mechanism to differentiate culpability other than by the amount of trading gain as a result of the value realized by trading in securities (by cross-reference to the loss chart in USSG §2B1.1). This creates the potential for a defendant to commit multiple and brazen acts of insider trading and yet face only the base offense level 8 that is prescribed by USSG §2B1.4. We propose an enhancement that also allows for incrementally higher punishment for a defendant

based on some measure other than net trading gain, as it would address this increasingly commonplace discrepancy. That other measure could be based on the number of times a defendant trades on inside information; the size of the positions taken; the number of different stocks in which inside trades took place; or some other measure that ensures that extremely culpable insider trading defendants do not avoid serious punishment simply because of the vagaries of the very market whose integrity their conduct has undermined.

II. MORTGAGE FRAUD

In contrast to the securities and corporate fraud context, the mortgage and financial institution fraud guidelines tend to more accurately address relative culpability because the amount of loss to victims resulting from such fraud generally is a fair and appropriate basis to weigh relative culpability; that is, the loss amount most often does accurately capture the nature and seriousness of the mortgage or financial institution fraud. Nevertheless, establishing the amount of loss in these types of cases is the difficulty, and we suggest four proposals in connection with these guidelines.

A. Establishing a Default Loss Amount for Each Mortgage Fraud Loan

We have seen two issues of concern in connection with mortgage fraud guidelines calculations. First, it is often difficult to calculate the loss amount in mortgage fraud schemes. The guidelines determine loss in mortgage fraud cases -- as explained in the application notes -- as the amount of the fraudulently obtained loan minus either the amount the victim has recovered or the fair market value of the asset pledged for the loan. See USSG §2B1.1, app. note 3(E)(ii) (credits against loss). While this appropriately calculates the true loss to the bank from a fraudulent loan, since, in mortgage fraud cases at least, the banks are secured by the value of the property, oftentimes the property is in default or foreclosure but the bank has not yet sold the property (and thereby sustained a measurable loss). Thus, there is no easy, efficient way to determine the fair market value of the property without the expense of an appraisal. This can be extremely unwieldy in cases involving multiple loans, which arise frequently. We regularly see cases involving dozens of loans. Second, there are often loans that are "flips" of properties in which one defendant, through fraud, is able to sell a property without causing a loss to the bank. Under the guidelines as currently drafted, if the bank does not actually suffer a loss, there is no loss under the loss table and the defendant's sentencing range is inappropriately low.

We would propose amending Application Note 3(F) - which lays out "special rules" for calculation of loss - to set a default loss amount of approximately 30% of the value of the loan as a floor for the loss amount, which in our experience is the reasonable estimation of the average loss suffered by banks on fraudulent loans. This approach has worked well in connection with access device fraud, in which the guidelines provide for a floor of $500 in loss per access device. Establishing such a floor for fraudulent loans would resolve both of the issues mentioned above.

B. Expanding the Definition Of Victim In USSG §2B1.1

Another possibility is to hold a defendant responsible (1) for injury to individuals who are induced, through the defendant's mortgage fraud scheme, to purchase in their own name properties that they cannot afford; or (2) for injury caused to non-culpable straw purchasers who are sometimes induced to or tricked into entering a scheme through false representations by the defendant. At times, the purchasers of the properties in mortgage fraud schemes are unknowing victims of the scheme themselves - the purchaser or straw buyer's good credit is used by the bad actors to buy the properties. In the case of straw buyers, we recognize that they can be victims or co-conspirators, depending on their knowledge and the facts

of the case. We have seen some straw buyers who are more like victims, since they are frequently promised that the property is an investment that will be paid for by rental income, and that they have no financial risk - all of which is typically false.

One way to deal with this would be to address the definition of "victim," which would allow both banks, innocent purchasers, and some straw buyers, where appropriate, to be considered victims. Another alternative would be to include an upward departure provision for additional victims not otherwise accounted for in the guidelines.

C. Upward Adjustment or Departure For Depressed Housing Values/Blight

Currently, the guidelines do not take into account the broader damage to neighborhoods from mortgage frauds schemes that lead to foreclosures and ultimately lead to depressed housing values and neighborhood blight. While proving such damage may be complex at times, this is sometimes a significant and painful consequence of these schemes, and it only serves to further and deepen the economic crisis. While this concept arguably might be covered by USSG §5K2.5 (authorizing increases in sentences above the applicable guideline range where the

offense caused loss not taken into account by the guidelines), the Commission could broaden the standard of "intended or knowingly risked" to clarify that the "reasonably foreseeable" harm of a mortgage fraud scheme (that is, depressed property values and neighborhood blight from shuttered homes) may give rise to an increased sentence.

D. Enhancement for a Participant in the Real Estate or Mortgage Industry

Finally, mortgage fraud schemes cause greater harm, are more widespread, and more severely undermine the confidence of the public in the real estate and mortgage industry when industry professionals are involved. Real estate and mortgage professionals should be trusted gatekeepers of the system, not facilitators of fraud. As such, they should especially be deterred from using their insiders' knowledge to exploit weaknesses in the industry and vulnerabilities in the public. To strengthen deterrence, therefore, we would propose a two-level enhancement in mortgage fraud cases in which the defendant participated as a real estate or mortgage expert or professional, including but not limited to, real estate agents, appraisers, mortgage brokers or bankers. The enhancement could be effected either through a new subsection similar to USSG §2B1.1(b)(17)(A) which, among other things, applies a four-level enhancement to a defendant who violates the

securities laws and at the time of the offense is "a registered broker or dealer, or a person associated with a broker or dealer." Alternatively, Application Note 4 to USSG §3B1.3 could be amended to include real estate agents, appraisers, mortgage brokers and bankers, who participate in fraudulent mortgage transactions, as individuals who use a "special skill" and are subject to the enhancement.

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In closing, I want to thank the Commission for soliciting feedback from the various practitioners and for leading the way to fraud-related sentencing guidelines that assist courts and practitioners alike in fairly and more accurately weighing culpability in terms more significant than simple dollar amounts. We believe that this effort will lead to more predictable and consistent sentencing practices, resulting in greater confidence - by the courts and the general public - in the guidelines and in federal criminal justice. The Department pledges its support as you undertake this challenging and worthwhile endeavor.