

HEARING OF THE SENATE JUDICIARY COMMITTEE

THE NEED FOR INCREASED FRAUD ENFORCEMENT IN THE WAKE OF THE ECONOMIC DOWNTURN

CHAIR: SENATOR PATRICK J. LEAHY, (D-VT)

WITNESSES

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SEN. LEAHY: As we all know, we're in the middle of trying to put together the stimulus package. We have -- everybody's being pulled five different ways. Senator Grassley is the ranking member of the Finance Committee. The Finance Committee, of course -- a integral part of this. I'm one of the senior members of the Appropriations Committee and may have to go, but I know you have to go the meeting with the majority leader, Chuck. Why don't I yield to you so you can give your opening statement? You're going to be acting as ranking on this --

SEN. CHARLES E. GRASSLEY(R-IA): Yeah.

SEN. LEAHY: -- thing anyways. You're one of the co-sponsors of the bill. Why don't you go ahead, and then come back whenever you can?

SEN. GRASSLEY: Yeah, yeah. It is my intention coming back, although I don't have any idea ahead of time how much Senator Reed wants of our time, but I should give him all the time he wants.

So thank you very much, Mr. Chairman, for that courtesy. Thank you very much for holding this important hearing. It's very timely, particularly given the economic downturn, particularly the unprecedented amount of money from the Treasury that's going to be expended to shore up the banking system, retail, lending institutions, and efforts to stabilize housing. In these times of federal, financial intervention in the marketplace, we need to heighten awareness about how taxpayer dollars are being spent and what controls are in place to ensure that they're effectively used.

Today's hearing is an opportunity to discuss the important work done by auditors, federal agents, prosecutors and others in their efforts to investigate and prosecute particularly mortgage fraud. The economic crisis that the country is experiencing began with problems that were related to over leveraged, over priced, and unsustainable housing bubble. Simply put, the housing market got too big too fast, and there weren't enough controls. With so much money in the housing market, unscrupulous individuals found a marketplace that was lax in regulation and enforcement, making it easy to commit fraud.

I refer to a chart here that my staff will put up that's based upon information collected by FinCEN, Financial Crime Enforcement Network, in Treasury. This chart shows the number of suspicious activity reports filed by banks related to mortgage transactions. As you can see, the numbers of these SARs increased very dramatically between '96 and 2007 with over 52,000 reported -- filed in 2007. While suspicious activity reports do not in themselves represent criminal wrongdoing, they are an indicator of potential criminal acts, such as mortgage fraud, money laundering, identity theft, or even tax evasion.

This hearing isn't limited to mortgage fraud, and we have an opportunity to examine the impact that fraud and abuse are having on our entire economy. As I stated earlier, the problems of the housing market are the root. Each and every American has been impacted, whether they've lost a job, whether they owe more in their home than it's worth, or even if they to purchase a new car. The financial markets have experienced the most dramatic decline, and so have manufacturers, consumers and small businesses.

When Congress passed the TARP legislation, I pushed to ensure that we had a strong, independent inspector general, and that led to the creation of the Special Inspector General for TARP. So I'm pleased that that person is here getting that office up and running and helping us account for the taxpayers' money.

Today I'm interested in examining the prevention and recovery side of the TARP program and all efforts to stabilize the economy. Mainly, I want to know what we can do with our criminal laws to deter and prevent wrongdoing. I also want to focus on how our civil fraud laws can be used to recover taxpayers' money if it's fraudulently gotten. I think today's panel will help shed some light on potential criminal activity that have occurred in these housing markets and things involved with the TARP program if it's not used appropriately. They will also be able to discuss the danger that unscrupulous individuals pose to a successful recovery.

Finally, this hearing provides an opportunity to discuss the important legislation that you, chairman, and I have introduced under your leadership to provide important fraud fighting resources, and particularly in an area I'm interested in, strengthening the Federal False Claims Act.

So I thank you for that and the courtesy that -- cooperating with me in that effort. Thank you very much, Mr. Chairman. I didn't read my whole statement. I'd like to put the whole statement in the record.

SEN. LEAHY: And, of course, I will, and I appreciate you being here, and I know you're going to come back as soon as you can, and join with you and Senator Kaufman to put this legislation I think on the question of increased fraud enforcement. This is not a partisan issue. This is something the Republicans and Democrats should certainly agree on. More importantly, the American people --

SEN. GRASSLEY: Absolutely.

SEN. LEAHY: -- agree on it. We have to find out how you protect the money that's being spent on the road to recovery of this economy. We've already spent hundreds of billions of dollars to stabilize our banking system. We're going to spend hundreds of billions of dollars more, staggering amounts of money. We tossed the figures around, but it's a staggering, staggering amount of money. We finally improved the American Recovery and Reinvestment Act in the Senate to boost the economy and create jobs.

I don't think we've paid enough attention to the mortgage and financial fraud that has so dramatically contributed to the economic downturn. I was here a couple decades ago when we had the savings and loan crises. And just like this one, we had to rebuild and strengthen the Justice Department's ability to enforce federal fraud laws partly to recover the billions of dollars in real estate and securities schemes, but also, to set a deterrent factor so it doesn't happen again.

We have to ensure against a diversion of money, especially these huge amounts of money that are going to be necessary to rebuild our economy, provide jobs.

And so many Americans have lost their jobs, and then subsequently lost their homes. They expect us to at least find out what happened. And we know that there have been unscrupulous mortgage brokers and some Wall Street financiers who contributed to this crisis worse than last fall. I called upon federal law enforcement to track down and punish those responsible for the financial mortgage frauds. So we're going to learn more about what tools we actually have to do that and more about what the Justice Department might be able to do.

As I said, it's not a -- this is not a partisan issue. Senator Grassley, who just spoke -- Senator Kaufman is here. The three of us introduced the Fraud Enforcement Recovery Act. We want to strengthen fraud enforcement at the Justice Department, the FBI, the Office of Inspector General, the Department of Housing and Urban Development, and even the Postal Inspection Service.

One thing I learned as a prosecutor in an earlier career -- you have all the laws in the world in the books, but if you're unable to enforce them, if you don't have the resources to enforce the laws and actually go after people who've broken the laws, they're meaningless. And our bill would actually give new tools for prosecutors to use in their fight against fraud. And Senators Schumer and Shelby introduced a complimentary bill calling for additional FBI agents and assistant U.S. attorney and staff at the Securities and Exchange Commission.

We do know that banks and private mortgage companies relaxed their standards for loans and approving ever riskier mortgage, less and less due diligence, that it's almost like opening a door and saying hey, come on in. Fraud is welcome. Private mortgage brokers and lending businesses came to dominate the home housing market. These companies didn't have the same kind of bank and oversight and internal regulations that have always been in place to help prevent fraud.

Now we see what happened with this lax supervision, and we have problems that are rippling not only throughout our country, but around the world. In the last two weeks the Justice Department announced prosecutions involving more than \$100 million lost to mortgage and real estate frauds. The FBI estimates might be as much as \$2 billion lost each year. In my own state of Vermont -- we saw a crooked mortgage broker who was convicted of defrauding homeowners and banks, came in, used this -- of a million dollars in deals related to more than 200 homes in Vermont and rural upstate New York. Now, a million dollars doesn't seem like a lot when -- all the things we're talking about. In a small area like mine it's a huge amount of money, and 200 homes are -- it's a huge amount.

And it's not just mortgage products. I mean, we had home mortgages packaged together. They were turned into securities, or bought and sold in largely unregulated markets on Wall Street. Of course, the value of the mortgage started to decline with falling housing prices. These securities unraveled. Some on Wall Street were not honest about those securities. That led to more fraud, victimized investors nationwide, I might say in some instances worldwide.

So we have an unprecedented collapse in the mortgage-backed securities market. In the past year, banks and financial institutions in the United States alone suffered more than \$500 billion in losses associated with the subprime mortgage industry. And some of our nation's largest financial institutions collapsed as a result, and that's not even going into things like the Madoff scandal, a \$50 billion ponzi scheme. If you were writing a book about something like this, everybody would say it would be too far-fetched to be real.

So let's give our law enforcement agencies the tools and resources they need. After all, ordinary Americans who have suffered the brunt of this want to know that we're doing everything possible to find those who committed the fraud. Our witnesses this morning are Deputy FBI Director John Pistole and Rita Glavin. Is it Glavin (pronounced "Glahvin") or Glavin (pronounced "Glayvin")?

MS. GLAVIN: Glavin. (pronounced "Glayvin").

SEN. LEAHY: Glavin. I'm sorry. I apologize. John, I hope I pronounce your --

MR. PISTOLE: Very close -- (off mike).

SEN. LEAHY: Thank you. The acting head of the -- Rita Glavin is the acting head of the Justice Department's Criminal Division. Neil Barofsky is a new special inspector general for the Troubled Assets Relief Program. You're going to be a busy person. So I'm going to go to -- Senator Kaufman, did you want to add anything to this before we start?

SEN. EDWARD E. KAUFMAN (D-DE): Yeah, I just have a -- I have a longer statement I'll ask to be put in the record, but --

SEN. LEAHY: And I'll put my full statement in the record too.

SEN. KAUFMAN: Yeah. Mr. Chairman, the behavior of Wall Street executives, investment bankers, the credit agencies, mortgage brokers and other players in the recent financial meltdown was complicated, tangled, a confluence of many factors, in the end, devastating the financial and economic wellbeing of millions of Americans.

For the purpose of the hearing, I just have really one overriding question, and that is was any of this behavior illegal? The question itself is a complicated answer, so I think one of the things we really want to work on is to ensure that the Justice Department, the FBI, and the regulatory agencies have all the resources and tools they need.

As Attorney General Holder said at his swearing in, "only by drilling down can federal law enforcement understand the various transactions that took place. Investigate the actions and behaviors of persons and firms who engage in suspected illegal activity, and prosecute those whom the Justice Department or regulatory agents believe to have engaged in criminal activity." I hope this hearing -- and I'm convinced this hearing will help move the ball forward in trying to answer the question, and that is, during this time was there -- any of this behavior illegal?

Thank you. I'm looking forward to your testimony.

SEN. LEAHY: Thank you. Our first witness will be John Pistole, who began working with the FBI as a special agent in 1983. Served in Minneapolis, New York, FBI headquarters before becoming a field supervisor of White Collar Crime and Civil Rights Squad, Indianapolis, Indiana. There he created a healthcare fraud task force, a public corruption task force, then served as assistant special agent in charge of Boston and oversight of all white collar crime investigations in Massachusetts, Maine, New Hampshire, Rhode Island.

He also helped lead the Information Security Working Group on the Robert Hansen espionage case, something that I recall being fully briefed -- both in open aspects of it and the classified aspects of it, a intriguing case. After 9-11, he served in various leadership capacities in the FBI's Counterterrorism Division, including executive assistant director. He was promoted to be deputy director of the FBI in October, 2004.

His undergraduate degree from Anderson University, his J.D. from the Indiana University School of Law in Indianapolis. Please go ahead, Mr. Pistole.

MR. PISTOLE: And thank you, Chairman Leahy, Senator Kaufman, other members of the committee that may be here. Appreciate the invitation to be here today to talk on these critical issues; mortgage fraud and other economic crimes. Today what I'd like to do is just give a very brief overview of the law enforcement challenge facing us and describe the FBI's current efforts in this regard.

Since 2005, we have addressed a significant increase in mortgage fraud and related cases. In fact, we had 200 -- 721 investigations in that year, and now we have over 1,800 investigations currently. And, of course, we expect an upward trend to continue. Our work in mortgage fraud and related crimes generally appear in two distinct areas, the first being fraud for profit, of course, which, Senator Kaufman and chairman, you were referring to. These are individuals who falsely inflate the value of property, or issue loans related to fictitious properties. Many schemes rely, of course, on industry insiders, those appraisers, accountants, mortgage brokers and other professionals who override lender controls designed to prevent this type of crime from happening.

The second area we refer to is fraud for housing in which an individual borrower, typically with the assistance of a real estate professional, acquires a house under false pretenses. This usually involves a borrower misrepresenting his or her income or employment history to qualify for a loan, which they would normally obtain. Obviously, many of these loans end up in default, and there is a resulting financial loss -- sometimes substantial -- to the institutions involved, and as we have seen, ultimately the taxpayer.

The FBI is currently working to address this environment in several ways. First, we have shifted resources such that over 240 FBI agents are currently assigned to mortgage fraud and related investigations, and another 100 plus agents worked in corporate fraud matters. We sponsor 55 mortgage fraud task forces or working groups around the country to further leverage available resources in our communities. We established an FBI's headquarters based national fraud -- national mortgage fraud team to coordinate and prioritize the FBI efforts across the country, and to provide tools to identify the most egregious fraud perpetrators, and to work even more effectively with our counterparts in law enforcement, regulatory, and industry leaders.

Even before the creation of this national initiative, we were seeing results from our increased focus in this area. For example, last June we completed the initial phases of what we called Operation Malicious Mortgage involving the arrest of more than 400 defendants nationwide believed to be responsible for over \$1 billion in estimated losses. This initiative has (focus ?) on three types of mortgage fraud; lending, of course, mortgage rescue schemes, and mortgage-related bankruptcy schemes. To date, there have been 164 convictions and forfeitures or seizures of more than \$60 million in assets. Our work in that initiative and others continues.

In closing, it is clear to Director Mueller and me and our law enforcement partners that more must be done to protect our country and our economy from those who try to enrich

themselves through illegal financial transactions. We are committed to doing so and thank you for your support.

SEN. LEAHY: Thank you very much, deputy director. And Neil Barofsky is the special inspector general for the Troubled Assets Relief Program at the Treasury Department. It is confirmed by the Senate at the beginning of last December I believe unanimously. Prior to his position as special inspector general, he worked as a federal prosecutor in the United States Attorney's Office for the Southern District of New York. While in New York, Mr. Barofsky was a senior trial counsel, heading the office's Mortgage Fraud Group. He had extensive experience as a line prosecutor in the office's Securities and Commodities Fraud Unit where his successful prosecution of the president and CEO of Refco earned him the attorney general's John Marshall Award.

Graduated magnum cum laude from New York University's School of Law. Mr. Barofsky, we're glad to have you hear. Please go ahead, sir.

MR. BAROFSKY: Thank you, chairman, and thank you for that kind introduction. Chairman Leahy, Senator Kaufman, it is an honor to appear before you today. My office, the Office of Special Inspector General for the Troubled Asset Relief Program, or as we call it, SIGTARP, began operations on December 15th, 2008, the day I was sworn into office. And as we indicated in our initial report, which we delivered to each of you and each member of Congress earlier this week, nearly \$300 billion has already gone out the door on TARP.

And yesterday, Secretary Geithner outline's Treasury's plans for the remaining balance of the \$700 billion in TARP funds. The total amount of government money at risk in this program, as well as the other programs operated by the Federal Reserve, will total in the trillions. These huge investments of taxpayer money made over a relatively short period of time will require close oversight and will invariably provide an incentive to those seeking to criminally profit.

Responding to these challenges has been and will continue to be a focus of my office. Of the four primary oversight bodies born from the Economic Recovery Act, we stand alone as the sole TARP oversight body charged with criminal law enforcement authority, the cop on the beat. And this is one of our most important functions.

As we expand our Investigations Division, we have focused on building central relationships with law enforcement and prosecutorial agencies. For example, I've joined the President's corporate fraud task force, and we've initiated relationships and cases with the FBI, the IRS, the Criminal Division of the Department of Justice, the New York State Attorney General's Office, and numerous U.S. attorneys offices around the country.

Through the TARP IG Counsel, which I founded and chair, we coordinate with the other inspectors general, whose responsibility include oversight of TARP related matters. We've already opened several criminal investigations, and we've teamed up with the SEC in recently helping them to shut down a securities fraud scam in Tennessee where

someone was illegally trading on the TARP name and reaped millions of dollars of ill-gotten profits.

We've begun outreach to potential whistleblowers and those who may have tips about ongoing fraud, waste and abuse. Our hotline and website are up and running, and plans are being formulated to help develop a fraud awareness program to let potential whistleblowers know who we are, how they can reach us, and how we can protect them.

This proactive cooperation and coordination that's at the heart of our investigative strategy is resource-intensive, and we cannot shoulder this burden alone. We must work closely with our law enforcement partners. Based on my experience as an (assisting ?) United States attorney in the southern district of New York from 2000 to 2008 where I prosecuted securities fraud and founded and built our district's Mortgage Fraud Group, I saw firsthand the understandable shift since September 11, 2001 in law enforcement and resources away from white collar crimes to terrorism. We saw areas of coverage shrink and prosecutorial thresholds rise.

The Department of Justice's recent shift of focus to resource-intensive mortgage fraud investigation has further left other white collar investigative efforts under funded and under prosecuted. Now, with trillions of dollars going out the door under TARP, associated Federal Reserve facilities, and potentially more through the proposed stimulus bill, we stand on the precipice of the largest infusion of government funds over the shortest period of time in our nation's history.

And unfortunately, our history teaches us that spending so much money in such a short period of time will inevitably draw those who seek to profit criminally. One need not look any further than the recent efforts of hurricane relief, Iraq reconstruction, and the savings and loan meltdown to learn important lessons. To fully address this potential criminal vulnerability, it is essential that the appropriate resources be dedicated to meet the challenges of both deterring and prosecuting fraud.

As a taxpayer who is heavily invested in these programs, as a former federal prosecutor who got a firsthand look at corporate greed and in my current position, I applaud the efforts of this committee to introduce bipartisan legislation, such as the chairman and Senator Kaufman's Fraud Enforcement Recovery Act and Senator Schumer's and Senator Shelby's Safe Markets Act. These will help ensure that enforcement has the necessary resources to meet the daunting challenges that lay ahead. Such measures will greatly assist us and our partners as we engage in this historic effort to deter and prosecute those who would seek to criminally profit from a national crisis.

Chairman Leahy, members of the committee, this concludes my statement, and I'd be happy and look forward to answering any questions that you may have.

SEN. LEAHY: Thank you very much, and our next witness will be Rita Glavin, who is currently the acting assistant attorney general for the Criminal Division, Department of Justice. She joined the Criminal Division as acting principle deputy assistant attorney

general in June of last year. She began her tenure with the Department in 1998 as a trial attorney in the Public Integrity section where she prosecuted public corruption cases for five years. She then became an assistant U.S. attorney of the southern district of New York where she conducted complex white collar investigation trials and appeals.

Ms. Glavin received her bachelor of arts degree from Middlebury College, which, of course, is in Middlebury, Vermont, one of our finest institutions. My daughter-in-law graduated from there too. And her J.D. from Fordham University's School of Law where she served as editor-in-chief of the Fordham Law Review. Ms. Glavin, glad to have you here. Please go ahead.

MS. GLAVIN: Good morning, Mr. Chairman, Senator Kaufman, and other members of the committee. Thank you for your invitation to address the committee today. The Justice Department welcomes this opportunity to testify on fraud enforcement and in support of the Fraud Enforcement and Recovery Act of 2009, which I will be referring to as FERA, or the act. It's also a pleasure for me to be here testifying with FBI Deputy Director John Pistole, and alongside my good friend and former colleague from New York, Neil Barofsky.

This nation's economic crisis, as you know, has had devastating effects on mortgage markets, credit markets, commodities and securities markets, and the banking system. The financial crisis demands an aggressive and comprehensive law enforcement response, including vigorous fraud investigations and prosecutions of any entities and individuals that have defrauded their customers and the American taxpayer, or otherwise placed billions of dollars of private and public money at risk.

Furthermore, a strategic and proactive approach for detecting and preventing fraud is needed. The Department, through its Criminal Division, the FBI, the U.S. attorney community, and other components has been investigating and prosecuting financial crimes aggressively. As the attorney general has stated, we still must reinvigorate the traditional missions of the Department, and we must embrace the Department's historic role in fighting crime and ensuring fairness in the marketplace.

This proposed FERA legislation gives us some of the tools we need to aggressively fight fraud in the current economic climate, and the Department thanks this committee and Senators Leahy and Grassley for their leadership on this bill. The proposed legislation will provide key statutory enhancements that will insist in ensuring that those who have committed fraud are held accountable. FERA will also provide needed resources to investigate and prosecute those responsible for such misdeeds.

It is clear that along with widespread mortgage delinquencies and foreclosures, lender failures, massive losses by investors in mortgage-backed securities and turbulence in the credit markets, there's been an alarming increase in mortgage fraud. Yet, even before this current crisis, the Department was responding to such fraud. For years we've been waging an aggressive campaign against mortgage fraudsters through vigorous investigation and

prosecution, and we've deployed a broad array of enforcement strategies that ensured optimal news of our investigative and prosecutorial resources to maximize deterrents.

We've conducted nationwide sweeps in mortgage fraud cases, formed local and regional task forces and working groups and engaged in major undercover operations. We're also working to undercover rescue scams that target desperate homeowners trying to avoid foreclosure.

As just one example, which Deputy Director Pistole just mentioned, in partnership with the FBI and numerous other law enforcement agencies, last year the Department conducted a nationwide sweep, Operation Malicious Mortgage, resulting in charges against more than 400 defendants across the country. It was brought by many as the more than 45 local and regional task forces and working groups currently targeting mortgage fraud. By fully utilizing these task forces and working groups, we've leveraged our limited resources by joining forces with state and local, federal law enforcement and regulatory partners, and we've ensured a coordinated and comprehensive response.

Because of the complexity and creativity of these criminal schemes, the Department has embraced a collaborative approach. We work closely with many different law enforcement agencies to bring these prosecutions. For example, in a case investigated by the Secret Service and the FBI and prosecuted by the U.S. Attorney's Office for the Northern District of Georgia, a defendant agreed to purchase properties from two owners, assume their identities, attained further mortgages on the properties, used the identities of the homeowners and others to purchase vehicles, open bank accounts, obtain passports, which he then used to travel to Jamaica, Italy and Greece while a federal fugitive.

His crimes resulted in clouded property titles in several states, a trail of over 100 victims, and millions of dollars in losses. That defendant was sentenced to 26 years in prison, ordered to pay restitution of almost \$6 million, and the government obtained a forfeiture judgment of \$6 million, access to the defendant's book and movie rights, and the right to sell the defendant's paintings on eBay in order to restore money to the victims.

In a very recent example of the Department's collaborative efforts, just last week, my colleagues in the southern district of New York working with the FBI, the New York City Police Department, and the U.S. Department of Homeland Securities, Office of Immigration and Customs Enforcement, obtained the conviction of an attorney involved in a multi-million dollar mortgage fraud scam that used the kind of fraudulent property flipping practices that have become common with mortgage fraud. Twenty-five other people have pleaded guilty in connection with that same massive mortgage fraud scheme.

But not just the criminal prosecutions that the Justice Department focus on. Department's also addressing the problems through vigorous civil enforcement, including under the False Claims Act. The Department's recoveries under the FCA with the assistance of private whistleblowers has reached record levels. In eight of the last nine years the Department's recoveries have exceeded \$1 billion. Moreover, since 1986, the

Department, working with government agencies and private citizens, has returned more than \$21 billion in public monies to government programs and the Treasury.

The Department has always been committed to fighting fraud. And as we suffer through the current economic crisis, we are committed to redoubling our efforts. This act is an important and timely step in the process, and we applaud the initiative of this committee in proposing this act.

I'd be happy to answer any questions from the committee.

SEN. LEAHY: Thank you. I found it interesting -- the idea of selling the paintings of the defendant on eBay. That's --

MS. GLAVIN: We get creative. (laughs)

SEN. LEAHY: Well, we didn't have such things back when -- when I was prosecuting cases. I may want to talk to you privately more about that. But Deputy Director Pistole, we had -- we've seen, obviously, this wave of mortgages, security frauds. Makes the whole method of recovery that much more difficult. I understand (there are a number ?) of suspicious activity reports filed by banks alleging mortgage and other frauds has climbed considerably. I'm told -- the note that I have is in 2002 there were fewer than 6,000 reports alleging mortgage fraud. In 2008, there were 60,000 such reports, tenfold increase. And since the collapse of some of the large Wall Street investment banks -- a spike in security fraud as well.

You were involved in investigating the savings and loan crises of the '80s. How serious is the crisis today, to put that in perspective?

MR. PISTOLE: Thank you, Mr. Chairman. The savings and loan crisis, obviously, went on for a number of years from roughly '86 to '95 depending on who you talked to, and obviously involved hundreds of millions of dollars of losses and number of institutions. This obviously dwarfs that in terms of potential fraud, and that's what we are trying to identify in these -- the stages we are right now.

What we have seen is that the potential that has been made reference to in terms of the billions, the tens of billions, the hundreds of billions of dollars that is already out there under TARP, the \$300 billion, and additional money that is being made available makes it a significant challenge.

To give you some kind of context, during the height of the S&L crisis the FBI had approximately 1,000 agents and then analysts and other financial analysts and others working on the S&L crisis through a series of 27 strike forces around the country, as you're familiar with.

Today, as I mentioned, we have about 240 agents, and then there's another -- equivalent number of task force officers from other agencies, such as the others have mentioned. So

probably around 500, but in terms of FBI, around 240 plus agents just on the mortgage fraud related matters. When we add in the additional -- the financial analysts, the intelligence analysts and things, it's a higher number, but you can see the challenge that we have.

SEN. LEAHY: It's only a fraction of what you had before.

(Yes, sir ?).

MR. PISTOLE: A fraction. That's right.

SEN. LEAHY: I mean, what do you think is being lost to mortgages, security frauds annually?

MR. PISTOLE: In terms of a dollar amount?

SEN. LEAHY: Yeah.

MR. PISTOLE: It's really impossible for us to say. The SARs that you mentioned, the SARs, obviously only represent a small portion of the overall potential fraud out there. It's just those institutions, financial institutions that have depository requirements and obligations that are required to file the SARs, so there's a number of other institutions that are not required to file, and, of course, when they file, many times they don't know the -- either the exact amount of fraud, or the potential fraud involved.

So it's very difficult to give you any type of number in terms of potential other than say the larger the dollar amount that is being funneled in through, for example, the \$300 billion, the higher the potential there.

SEN. LEAHY: It certainly dwarfs the savings and loan.

MR. PISTOLE: Certainly does.

SEN. LEAHY

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: Thank you. In fact, Inspector General Barofsky, you worked on the mortgage fraud cases. Did the fraud itself contribute to the instability of near collapse of some of our markets and banking system?

MR. BAROFSKY: I think that's a difficult question to answer. Certainly, a lot of the mortgage --

SEN. LEAHY: That's why I asked it.

MR. BAROFSKY: I've been getting used to difficult questions. But I think that if you look at the collapse of mortgage-backed securities, obviously the collateral underlying those securities are mortgages, and the extent of mortgage fraud -- I think it is difficult to put a number on it, but then you have to take that number and multiply because whatever the actual dollar amount of pure fraud, the bigger impact that it has on communities and surrounding areas.

Dealing with victims when I was head of the southern district's Mortgage Fraud Group -- you would see that when a fraud hit a neighborhood, if it took out eight or nine properties and ended up getting foreclosed because of a foreclosure rescue scam where they steal the houses out from under homeowners, the ripple effect it has on the community is tremendous. It is a cyclical effect. It's a chain reaction of foreclosures because properties get over valued in the community. Then they're abandoned and foreclosed and you have, you know, abandoned houses, squatters. Neighborhoods deteriorate. All of this contributed to the financial crisis and reduction in the value of those securities, and ultimately the housing crisis.

So, Mr. Chairman, I'm not an economist and just really don't have the scope and breadth that my colleagues do here, but I think -- yes, I think it has contributed.

SEN. LEAHY: Well -- and then lastly -- my time is up. I do want to ask this one question of Ms. Glavin. We're talking about the legislation that Senator Grassley, Senator Kaufman and I have introduced. And I realize the Justice Department is still studying it. It does authorize the additional resources for Justice and the FBI and the Inspector General at Department of Housing and Urban Development, also Inspection Service and so on.

Do you have any preliminary views on it? Do you -- at least ask you this part. I don't want to get you out ahead of your own department, but do we need these additional resources? I mean, Senator Schumer and Senator Shelby have also proposed additional resources.

MS. GLAVIN: Senator, we're going to see a demand -- the demands on law enforcement over the next few years really increase when you see \$700 billion outlaid through the TARP program and see the economic stimulus package. Demands are going to increase, and with the demands that are going to increase on law enforcement and the Justice Department to follow up and investigate, we're going to need resources. And so to the extent this committee is wanting to give resources to law enforcement, we are always appreciative of those efforts and welcome those efforts and support those efforts.

SEN. LEAHY: I'm going to be discussing the legislation with Attorney General Holder also, but I just -- most people are honest. The ones who are not honest in this field are creating economic havoc. And I want to make sure that we're able to go after them. And I

want to make sure that, one, we can recover whatever assets we can, but I want to see people prosecuted. I want to see people who committed such fraud and the havoc it's caused to this country -- frankly, I want to see them go to jail.

Senator Kaufman.

SEN. KAUFMAN: Mr. Pistole, clearly, you don't have enough FBI agents. Can you talk a little bit about the fact that this is a very different kind of a crime than what most of the FBI is -- what's your capability, and how do you see them ramping up to get FBI to have sufficient knowledge of the financial markets and these kinds of things?

MR. PISTOLE: Thank you, senator. I think I would respond in two ways. One is we have had a long history, obviously, of financial institution frauds, bank frauds and things like that. The Enron type investigations also helped hone and refine our investigative abilities along with our partner agencies and obviously the U.S. attorneys offices in terms of investigating and prosecuting complex financial frauds, a number of other corporate frauds involved also.

So I think our cadre of people are well prepared in dealing with some of these complex investigations. It is really a scope and breadth of what -- really trying to manage the expectations of the American people of what we can do with what we are currently addressing. Now, we've done a scrub of all our criminal investigative resources, and as you know, after 9/11 we moved almost 2,000 criminal investigative resources over to national security matters, particularly counter terrorism. We have been gradually moving those back and have done that in terms of priority areas such as this mortgage fraud and the corporate fraud area, which is potentially as significant in terms of the long-term, complex investigations.

We are taking a slightly different approach than we did, for example, on Enron which involved trying to decipher every potential illegal transaction and looking at it more, for example, like a traditional organized crime or even a drug investigation. We're trying to identify people in different levels and eliciting their cooperation and then moving along, as opposed to trying to prove every single transaction that may be illegal.

SEN. KAUFMAN: Great. Mr. Barofsky, let me go back, and not in your present position but kind of when you were a prosecutor. It seems to me you believe that there was fraud that went on. If you were starting to prosecute cases, what's kind of a low hanging fruit? What do you think are the most obvious cases that you'd move on quickly to try to get the most number of prosecutions and put most of the bad people away?

MR. BAROFSKY: Well, when I started up the mortgage fraud group in the southern district, we focused to have what I believe would have the greatest and quickest impact, not only on putting people in jail but as importantly, creating deterrents was going after the licensed professionals. For most of your fraud for profit schemes, which because of limited resources we focused on exclusively, the gatekeepers, the lawyers, the appraisers, the licensed mortgage brokers -- the trial conviction that Ms. Glavin just referred to was a

case that came out of our group. And the person who was convicted was an attorney -- and making examples of those and letting their colleagues know that criminal behavior in these types of mortgage frauds is unacceptable, because they have the most to lose.

Your run of the mill fraudster will go from fraud to fraud. We see securities fraud defendants who are convicted and did their time; they're all over the mortgage fraud markets, especially the unregulated side. But where you could have, I think, the biggest impact is focusing on those licensed professionals. They have the most to lose, but they're most likely to flip, and they make the best examples.

SEN. KAUFMAN: Great. Thank you. Ms. Glavin, there's people that say -- I've talked to a number of people that say look, this is very complex. And really we should leave it to the regulatory agencies, that you know, that criminal justice is kind of a blunt instrument to use in these kind of cases. There's going to be opportunities that people are going to get hurt and the rest of that. Would you comment on that kind of a thought in terms of how we should be proceeding and deal with this whole area?

MS. GLAVIN: The criminal justice system has been out in the forefront on white collar crimes and financial fraud since the early part of this decade. In 2002, you had the Corporate Fraud Task Force; 2003 we have the Enron Fraud Task Force. We have the prosecutions coming out of the WorldCom collapse, accounting fraud, corporate fraud. We see it in Revco, which my colleague, Mr. Barofsky, prosecuted. It is regulation works to one extent, but criminal law enforcement sends a very, very powerful message, and it also has tools that regulatory agents don't have.

And I want to refer back to what Chairman Leahy said a few moments ago. One of the big deterrent effects is people go to jail. And in the criminal justice system, when you steal and when you leave people penniless and there are thousands of victims to a crime that you committed with criminal intent, prosecutors are in the best place to handle that. And we've been equipped to do that and have been doing that for the last 10 years when we've seen some of these major frauds happen. And I also want to point out we're there at the forefront with Hurricane Katrina. We had our task force ready to go, because we knew of the fraud that was going to happen; the National Procurement Fraud Task Force, ready to go. When we saw government money going out, we were ready to prosecute the people that were going to misuse it.

SEN. KAUFMAN: Thank you. I totally agree with you.

SEN. LEAHY: Senator Klobuchar.

SEN. AMY KLOBUCHAR (D-MN): Thank you very much, Mr. Chairman. Thank you to all of you. As I was getting ready for this hearing, I pulled out testimony that I had given to our state legislature many years ago when I was a local prosecutor when we were seeing some increase in white collar crime. And I'd use this John Kenneth Galbraith quote that I think is so -- from the book, *The Great Crash of 1929*, which is so applicable. He said, "In good times, people are relaxed, trusting, and money is plentiful. But even

though money is plentiful, there are always many people who need more. Under these circumstances, the rate of embezzlement grows, and the rate of discovery falls off. In depression, all of this is reversed. Money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise. Audits are penetrating and meticulous. Commercial morality is enormously improved." So you have a big job to improve all of commercial morality.

My question first -- I was reading your testimony, Mr. Barofsky, and you talked about -- which I experienced after September 11th, this great shift which was necessary to the U.S. Attorney's office working on terrorism. And it actually shifted down to the local units. Our Hennepin County attorney's office doubled our white collar group, and it was a great, actually experience, and we did a good job. But as the cases got more complicated, as we got into the mortgage fraud areas and some of these complicated computer crimes and frauds, I found that we didn't have the resources and law enforcement on the local level to really do a good job of investigating those.

So I thought maybe you could talk about this. As you look at these partnerships, we never really got the federal resources we needed for the computer analysis and the kind of things as local prosecutors to handle those cases. How are we going to fix that?

MR. BAROFSKY: Resources, resources, resources, I mean it's a real problem. And we saw within our district -- and we're fortunate. The New York field office is -- I assume is one of the largest field offices for the FBI. We have two districts in New York City, the southern and eastern district, and we had, comparatively speaking, an abundance of resources compared to a lot of my colleagues I work with in other districts.

But even then, once the -- before the mortgage fraud focus after 9/11 we just saw a drop off of the number of cases that we were able to do across the board on white collar fraud. And the focus on mortgage fraud -- and we have, I think, 20 -- when I left there was 20 something agents who were working with us in the eastern district on our mortgage fraud group and their Mortgage Fraud Task Force. But that necessarily draw down on other types of white collar criminal activity, types of bank fraud, computer crime, intellectual property crime. And that's just on the federal level. I'm not really an expert on the local level, but from our task force and working group relationships, there is a need for these types of combined and leveraging of resources to address these problems. They are severe.

SEN. KLOBUCHAR: And maybe Mr. Pistole and Ms. Glavin, you want to comment. But one of these ideas was to have these computer centers where we could use the expertise --

MR. PISTOLE: Right.

SEN. KLOBUCHAR: -- of the FBI and forensic analysis that we didn't have on the local level, because as your threshold levels went up, we were handling more and more complicated cases.

MR. PISTOLE: Yes, senator, and obviously in the FBI we look at the state and local task forces as that force multiplies, not just for the federal government but for state and local task forces and law enforcement across the board, whether for example, in Minnesota and some Indian reservations that we have Safe Trails Task Forces that deal with some of the crimes on Indian Reservations; Safe Street Task Forces in Minneapolis and St. Paul.

In the same fashion, these Mortgage Fraud Task Forces and working groups are designed to leverage the collaborative efforts of everybody in a way that brings more than the sum of the individual parts. In terms of the computer forensic lab, we have 16 of those across the U.S. and trying to really use those in a fashion that does enhance the greatest needs across the country, not just the federal or state or local but looking collectively. And it's our goal to have many more of those as we progress and get funding.

SEN. KLOBUCHAR: Uh-huh.

MR. PISTOLE: Thank you.

SEN. KLOBUCHAR: Very good. How about international crimes, which we started to see a lot of when I was leaving and how -- are there plans to address that in a better way where we have these schemes that go across internationally, and it's very hard to track down these people?

MR. PISTOLE: Yeah. Many of our investigations, both on the criminal side but also in cyber, of course, involve international partners, because many of the crimes are committed by people overseas. There's recent publicity about a \$10 million fraud being committed by a group of individuals in Russia against a particular bank and where people are just using the ATM as their personal wallet, just going up and getting money and just draining them there, \$10 million across the world. So we have 61 offices around the world plus 15 sub offices, 76 offices that act as that liaison with a host of law enforcement and intelligence services to make sure that we have quick exchange of information, chain of custody issues; if we're trying to prosecute back here, to work with the host government to try to prosecute there, if that's appropriate. So we have really had an expanded international focus, particularly since 9/11.

SEN. KLOBUCHAR: Thank you.

SEN. : A couple of different questions. John, good to see you again.

MR. PISTOLE: (Crosstalk) --

SEN. : Pleasure to be with you, sir.

MR. PISTOLE: Good to see you, sir.

SEN. : You reference that the FBI has around 1,600 mortgage fraud investigations that are currently open. I'd like you to -- obviously, you're not going to be able to be very specific about it. But characterize those to some degree, because you can everything from the one-off fraudster who comes in and files his disclosure sheet --

MR. PISTOLE: Right.

SEN. : -- improperly in order to get a mortgage to somebody who is kind of a repeat offender and is a known fraudster and is going to do this over and over again, to somebody who is involved in an organized criminal effort to defraud. And a number like this can look good, but if it's 1600 ordinary folks who don't lead professional lives of crime but did violate the law on their application by filling out the form fraudulently, that's a very different response than 1600 investigations that are really targeting people who are systemic wrongdoers. How would you characterize those 1600 prosecutions along that spectrum?

MR. PISTOLE: Thank you, senator, and good to see you again, sir. Actually, the updated figures are over 1,800 investigations now, and they're largely based on the systemic fraud that we have seen at the professional level that Neil made reference to. There's a small number of those who the individuals who are trying to obtain housing and commit fraud to obtain it, that's very small, because we just don't have the resources to address that. But for example in Rhode Island, it is a matter of looking at those professionals, whether lawyers or mortgage brokers or real estate professionals, appraisers and others, that are systemically trying to defraud the system and getting up not only in the millions but the tens of millions perhaps hundreds of millions of dollars of fraud. So that's the majority of our 1,800 plus. And current investigations are focused on that, to look at that systemic fraud and try to take out those rings, if you will.

We do see some limited involvement, if you want to call it organized crime. There's -- almost any ethnic group, of course, you can put that name in front of it, whether it's Italian or Sicilian or Russian or Albanian or whatever. And we have seen some instances of that in terms of an enterprise, if you want to look at from purposes of RICO Statute, a group of individuals associated in fact who are perpetrating these type of frauds. That's where we're trying to focus our resources right now as we try to leverage those resources through the various task forces and working groups we have.

The key is using some fairly sophisticated software tools and working with HUD and others to try to use -- to be intelligence based and an intelligence driven approach, rather than just reacting to FARS coming and saying okay, here's a potential fraud. So really trying to leverage that information that FinCEN puts out through the SARs, taking that, crunching the numbers, doing the analysis to say what is going on. And going back to Minneapolis, there's actually been a very focused effort in that regard, looking at a small group of individuals really who have purchased hundreds of properties and used fraudulent documentation and a number of individuals involved in that to perpetrate a

significant fraud. And so the same thing we're trying to do across the country to work smarter and more efficiently with what resources we have.

SEN. : And you mentioned 38 -- (beeping sound) -- related to the current financial crisis. That sounds like a number that would be small even for the southern district of New York alone by the time this all shakes itself out.

MR. PISTOLE: Right.

SEN. : Where do you expect that number to go in the next year or two, and where would you like to see it? And what resources are needed to meet that demand? I mean, I would assume that number will be in the hundreds before very long.

MR. PISTOLE: It very likely could, senator. And the numbers can be misleading. And of course, as -- who was it -- Disraeli said the thing with numbers, you have to watch out. "There's lies, damn lies, and statistics." So in terms of context, those 38 are significant. These are companies, businesses that everybody knows about. I just can't comment on publically, but these are significantly large, complex investigations not dissimilar to the Enron investigation. We would just use a different approach.

But to specifically answer your question, we see that number potentially rising into the hundreds, and as the number of bank failures -- there's been nine thus far this year -- as those increase, the potential for fraud involved in some of those increases. So it is an exponential potential there.

SEN. : Mr. Barofsky, you have to deal with an awful lot of agencies. Coordinating with the Inspector General might not be their highest priority. Do you feel you have all the authorities that you need by statute in order to generate the cooperation and the support, the information that you need to do your job?

MR. BAROFSKY: Yes, senator, I think we do have the appropriate authorities. And the response and reaction has been very positive and favorable from other Inspectors General. The FBI has been tremendously supportive, and we thank them, especially as we're building up. I want to thank all of you for supporting the Special Inspector General Act for the TARP of 2009, which passed the Senate unanimously. And I look forward to the House also approving of that bill, which will help us meet some of our immediate hiring needs and applies to some of our other authorities. But so far, the reaction has been tremendous from other law enforcement agencies.

SEN. : Good. Mr. Chairman, my time has expired. If we're going to do a second round, I do have one more question.

SEN. LEAHY: (Off mike.) Go ahead and ask the question, senator.

SEN. : Ms. Glavin, I just wanted to ask how the department is structuring itself to meet this need. Is there a task force model, a working group? From a structure point of view, are you setting anything up to meet this anticipated bulge of effort?

MS. GLAVIN: There's a couple of things that we're doing right now. I think one of the most important things that we're doing is that the department has been actively engaged in discussion with Mr. Barofsky about the best ways that we can help in terms of getting referrals from Mr. Barofsky through the investigations and what he's uncovering and then how we go about prosecuting. So the first thing we're doing is we're talking with the SIG TARP.

The second thing is that within the last year or so, we have had a -- the Fraud Section of the Criminal Division has led a Mortgage Fraud Working Group, which is a collection of representatives from various investigative agencies. They speak with U.S. Attorneys' Offices. They find out what's going on in those offices. They talk about best practices. They look at mortgage fraud take downs. They see what can we learn from that; what can we do better the next time.

I know that there has been some discussion about whether to create a National Mortgage Fraud Task Force. And what I can say about that is that it's that the department is studying it, and no decisions have been made with respect to that. And it's just something that's still under discussion in the department as to what we want to do and the best way to coordinate.

SEN. : (Off mike.)

MS. GLAVIN: Yes. And in fact, we still have the standing Corporate Fraud Task Force, which met most recently with our newest member, Mr. Barofsky.

SEN. : (Off mike.)

SEN. LEAHY: Thank you. Senator Grassley is back, and before I turn to him, I just want to note we have written testimony from the Inspector General for the Department of Housing and Urban Development, Kenneth Donohue. Inspector General Donohue warns also that key federal programs, such as the Housing and Economic Recovery Act passed last year to help home buyers avoid foreclosure are also at risk of being exploited by fraud. Ten years ago, his office had more than 130 investigators dedicated to housing frauds. The past (ph) administration made cuts, and now there are none dedicated to housing fraud.

Again, I think most people are honest. We know some people are not. And with the amount of money we are pouring out, we have got to have people out who can investigate for fraud and then prosecute people for fraud and try to recover assets. I will put, without objection, Inspector General Donohue's whole statement in the record. Senator Grassley, again, is a valued co-sponsor of this legislation. I'm glad to have you back. Please go ahead.

SEN. CHARLES GRASSLEY (R-IA): Yeah. Thank you, and once again, thank you for allowing me to work with you on that bill and particularly the part that you put in about the False Claims Act. I'm going to ask some questions to each of you, the first question at least for each of you. I've worked with whistle blowers a lot in my life in Congress. I consider them very courageous people. They bring forth a lot of valuable information. I think Enron in the private sector would be an example of it.

This latest Madoff case of Wall Street would be another example. Usually whistle blowers have a rough time, whether it's in the private sector or in the public sector. They're about as welcome in an organization as skunks are at a picnic. So I believe that as more government money is pumped into the system, be it housing, financial institutions, or any private business, we're going to have more whistle blowers come forth with information of fraud and abuse.

So I want to ask both questions and have you answer each of them. How do you envision working with whistle blowers that come forward with good faith allegations of fraud and abuse of taxpayers' money? And will you work cooperatively with whistle blowers and their counsels, if they have it, to ensure that they are protected from retaliation consistent with federal law? Whoever wants to start out, I'd like to have each of you give short answers, because I have two more questions I want to ask.

MR. PISTOLE: I'll start off, senator. Obviously, anybody who has credible information that can help either predicate or enhance investigation, we look forward to working with and their counsel, so no issues there from our perspective.

MR. BAROFSKY: Senator Grassley, first of all I just want to thank you for your continued support of our office. Its creation and continued support has been invaluable. And whistle blowers are obviously one of the most important things we have for finding cases in the TARP. Our website is up and running. It has a link for whistle blowers to lodge complaints. We have our telephone number, our toll-free, 877-SIG-2009. We're going to promote that with training and awareness programs to encourage whistle blowers to reach out to us with any information they have on any TARP program, whether they're within government or without.

And we are 100 percent committed to protecting whistle blowers. The IG Act makes it very clear that any whistle bower, their information will remain confidential unless under certain circumstances where -- there may some circumstances where it has to be disclosed. But we'll work vigilantly to protect the identity of whistle blowers to the extent they seek that protection. And we will make sure that they're not retaliated against.

SEN. GRASSLEY: Okay.

MS. GLAVIN: Senator, as you know, the department has enjoyed tremendous success in working with whistle blowers under the False Claims Act. We've obtained approximately \$10 billion in the past eight years under the Qui Tam Statute. And we've paid whistle

blowers, who are also called relaters, a substantial amount of those recoveries, \$1.6 billion in rewards under the statute for their laudable efforts.

The department believes that whistle blowers, often insiders, can serve a vital function in our law enforcement efforts in exposing potential fraud in connection with government programs. And we expect that we're going to see some of that with the TARP and whistle blowers will be treated the same way for their laudable efforts that the department has historically treated them and have had a successful relationship.

SEN. GRASSLEY: Okay, thank you. Now Mr. Barofsky, as you know, the bailouts of Bear Stearns, AIG, took place outside of the TARP. In fact, they were orchestrated through Special Purpose Vehicles, which in these cases were Limited Liability Companies, Maiden I, Maiden Lane II, and Maiden III. Secretary Geithner announced yesterday that the revised approach for dissemination of TARP's funds includes the use of financial stability trusts, as well as public, private investment funds. That may sound like Bear Stearns. I have this concern about the use of such vehicles, because they seem to result in less transparency. Enron used an SPV to hide many of its assets. While my Finance Committee staff still has some documents to review from AIG and Bear Stearns bailouts, much of the information is not public.

I think it makes sense to fold oversight of Bear Stearns and AIG bailouts into your office. Do you have any thoughts or concerns about taking on that responsibility? Do you believe that all Special Purpose Vehicles, including those that the Treasury secretary may implement, should be subject to the same filing and disclosure requirements of SEC companies? And lastly, what other ways do you purpose to bring transparency to Maiden Lane SPVs like things that taxpayers' money simply aren't part?

MR. BAROFSKY: We, of course, will follow the lead of Congress in our jurisdiction and of the coverage of areas. Obviously right now, under the existing statute, we're limited to tracing basically TARP related funds. If this Congress wants us to look into and have jurisdiction over other areas, we will follow this Congress' lead, of course. With regards to Special Purpose Vehicles and transparency, I think that is a very serious concern. We addressed it just yesterday.

We've initiated discussions with both the Federal Reserve and with Treasury to get a handle on what their plans are for transparency on the SPV with the TALF program, which is announced now may be as large as a \$1 trillion program. And we look forward to having those discussions, and we're going to make recommendations based on once we have a better sense of exactly what their plans are. A lot of these programs are still works under construction, and we plan on having a role in giving recommendations in their formation as we have to date.

SEN. GRASSLEY: Could I put the rest of my questions --

SEN. LEAHY: (Off mike.)

SEN. GRASSLEY: Okay.

SEN. LEAHY: If the senator from Iowa needs additional time, feel free.

SEN. GRASSLEY: Okay. Maybe then I might ask one more question then. But my unanimous consent was to have for exhibits put in.

SEN. LEAHY: Without objection.

SEN. GRASSLEY: Yeah. Okay, then this will be my last question to Mr. Pistole. Resources at the FBI have been reallocated as core mission of FBI shifting its focus to counter terrorism. At the same time, we've had a dramatic increase in the amount of federal government resources into the private sector to shore up financial institutions, private businesses, other government sponsored enterprises. Given these significant outlays of federal taxpayers' dollars, it would seem wise to make sure that adequate resources are available to investigate fraud. However, the FBI can't simply let up on counter terrorism.

Now, I'm not known around here to be one to simply hand out money, but it seems to me if that if we don't address this head on, we'll have a hard time chasing taxpayers' money.

Question -- two questions, and then answer both of them at the same time. If Congress decides that the FBI needs more resources and agrees to fund them, what sort of controls can we expect to prevent the FBI from simply re-tasking those agents to different areas once they get the money? Would you adhere to any restrictions on the use of funding by Congress? I guess that's two questions, so then one more. If Congress does provide additional funding, will you pledge to comply with any reporting requirements that we include with those resources?

MR. PISTOLE: Senator, we currently have in place similar situations. For example, on our health care fraud investigators and in our Organized Crime and Drug Enforcement Task Force, those in-depth investigators, reimbursable positions that have much greater accountability and oversight than the other positions. But in response to your two-part first question, absolutely. If we are given additional resources to apply to the mortgage fraud problem, that's what we would put them on. We need the bodies there. It is a huge problem that we look forward to addressing as robustly and as aggressively as we can. The 240 agents working now are working very hard. And we've actually looked at our national security resources to see can we incrementally move some of those over without jeopardizing national security.

So we're doing a complete scrub of all available resources to make sure that we are putting those resources where they're needed.

SEN. GRASSLEY: Thank you, Mr. Chairman, for your kindness.

SEN. LEAHY: Thank you very much, and of course all --

SEN. GRASSLEY: And also a letter -- we have something that Senator Specter asked us to put in too.

SEN. LEAHY: And I will keep the record open for anything that any member wishes to add to the record. Senator Kaufman.

SEN. EDWARD KAUFMAN (D-DE): Ms. Glavin, in those areas of finances gone unregulated like derivatives and hedge funds, can you talk about how that makes trying to prosecute forward cases more difficult?

MS. GLAVIN: Well, one of the -- it does and it doesn't. In the areas that have gone unregulated, we still have at our disposal the same tools we've always had in fraud cases, mail fraud, wire fraud. You tell a lie to get money and you use the mail or the wires to do it, we can prosecute you. So to the extent that some areas of the financial industry have gone unregulated, it doesn't mean that we can't prosecute them, and it doesn't mean that we don't have the same tools at our disposal. We're still going to use the basic -- we can use wire taps. We can use grand jury subpoenas. We still have all of our investigative tools at our disposal. And so I don't think that we are particularly hindered just because it's unregulated. I think the unregulated aspect to it could make it more ripe for fraud and a heavier use of our statutes. But I think we can still go after those sectors.

SEN. KAUFMAN: All right. Mr. Barofsky, kind of what are some of the tell tale signs on Wall Street now? We're talking about financial fraud here, that fraud's been committed? In your old days as a prosecutor and now, what kind of things do you look at that just scream out that something's gone wrong here?

MR. BAROFSKY: "We" statements are always good to see, any type of audit qualified opinions and relying on auditors; jumps and shifts that are unexplained or don't make sense. For insider trading, there's a whole bunch of tell tales that we look for. The list is a long one, and we're going to be looking at those very closely, especially with respect to potential frauds and procuring TARP funds from financial institutions.

SEN. KAUFMAN: All right, great. Mr. Pistole, can you kind of go through -- clearly, there's going to have to be some training done here for FBI agents. Can you talk a little bit about how that's going to happen? You're talking about a rather massive scale -up -- how that would happen and what kind of funds are going to be required for that or?

MR. PISTOLE: Yes, senator. There are two aspects to that, the training of our current employees who are both the agents and financial and intelligence analysts who are investigating those. Again, many of those have the experience from the Enron type of the other investigations in terms of the complex corporate fraud. And is much a practical issue that my colleagues, Neil and Rita, know about in terms of trying to take a very complex financial fraud and then making it presentable to a jury in a way that it makes sense. So that's just one of the practical challenges.

The other aspect is the training of new agents and analysts who we are hiring. We actually have a fairly targeted recruiting effort, trying to identify those people with financial skills backgrounds that could be beneficial. So that's a longer term proposal. But we look forward, believing this is going to be a long-term process for us to having those people on board, whether it's six months, nine months, a year from now, to complement those with the current experience. So it's really that two-fold process.

SEN. KAUFMAN: Great. Ms. Glavin, at least I'm starting to hear the old story, look, there were a few bad apples on Wall Street that did this. And they're just bad people and why go to criminal investigations, because it really isn't a deterrent for these for these kind of folks. Can you just talk about that a little bit, how you see criminal investigations and criminal prosecutions as a deterrent to the kind of folks that behaved and the bad behavior in the recent financial crisis?

MS. GLAVIN: I think that you can see historically, through some of the prosecutions that have happened in corporate fraud over the last 10 years -- Adelphia, you saw the people running the company were convicted after embezzling money from the company. It makes your corporate heads aware that they are responsible and that they can't use money for their personal use. I think you saw with the Bernie Ebbers WorldCom prosecution, that had an incredible deterrent effect on what CEOs do with money and what they're supposed to know about what they do with their money.

And so criminal law enforcement, it's a few bad apples -- I can't really speak to that. What I can say is historically, when corporate leaders have been prosecuted such as so with Skilling and Lay and Enron, it makes a difference. And you see the way corporations operate, how they structure themselves, and how the boards want to pay more attention to what's going on in the company. It's effective, because when you have a corporate head who's stealing or lying to the stockholders or participating in falsification of accounting records or reports to the SEC, the stockholders get victimized. And when it's prosecuted criminally, that's what makes a real difference, and that's what can make changes. And I think changes were already made because some of some of those prosecutions.

SEN. KAUFMAN: Thank you. You three have a real challenge in front you. (Laughs.) I'm glad you're doing this, thanks.

SEN. LEAHY: Thank you. Senator Klobuchar.

SEN. KLOBUCHAR: Thank you, Mr. Chairman. I was -- now, do you say your name "Glavin" or "Glavin." Sheldon and I were having a senatorial debate over this fact. "Glavin."

MS. GLAVIN: It's "Glavin."

SEN. KLOBUCHAR: Okay, good. I completely agree with what you've been saying. I saw it in our own cases. We once prosecuted nine pilots for not paying their taxes, and the Minnesota Revenue Department got millions of extra dollars in it because people saw it in the news, and they got very worried. And I think it has a positive effect going forward but a deterrent effect. And one of the things that I'm concerned about is that there hasn't been enough of this, some legitimately because of the transfer of resources over and some because some of the regulatory agencies have been basically asleep at the wheel.

And what comes to, I think, everyone's mind when they think about this is the Madoff case and how this could have happened when a whistle blower came forward. And while I don't expect you to go into the details of that, if you could just give some of your impressions of how that could have gone wrong, why that happened, and how we could not have that happen again.

MS. GLAVIN: I can't really speak to all the particulars of the Madoff case, because I'm not in the weeds on that. What I can say is that I think what we may be starting to see is that as the economy went south, you see these sort of Ponzi schemes that were able to go along for a little while.

And then all the sudden, there's a rush by the victims of the schemes who don't know they're victims yet. And then the money is not there when they go to get the money out. Just last week, our Fraud Section in the District of Minnesota -- (crosstalk) --

SEN. KLOBUCHAR: That was so nice how you brought that up when I -- (crosstalk) --

(Laughter.)

-- very, very smooth. Go on, yes. Go on.

MS. GLAVIN: -- took down a Ponzi scheme involving commodities that were supposed to be pooled into a trading account. And the charges in that case alleged that they weren't really pooled at all. They just ran off with the money.

So I think that, for some of the frauds that we're going to see is that people are going to be exposed because they're going to need their money more now that they've invested. And then all of a sudden, that's going to expose that maybe some lies were told to them to get the money in the first place or that the money just isn't there and was misused.

SEN. KLOBUCHAR: That's why I used that quote at the beginning. They discover it when the times are bad. But Mr. Barofsky, any thoughts on the Madoff case and just your impressions of it, and I'm sure your frustrations when you found out what happened?

MR. BAROFSKY: Well, I'm certainly proud of my former district for prosecuting the case. But I think the lesson is that I think -- and we had just started our hotline and will be dealing with whistle blowers. But I think everyone's going to pay very, very careful

attention to whistle blowers and tips. And I think that will be the one positive result of everything that happened with Madoff is I think everyone will necessarily pay careful attention. And we're considering this. We're designing our hotline program -- one of the things that I've done is I've hired a lawyer to be in charge of all things related to the hotline and review every single case. And we're going to have senior executive review, because we don't want to miss the next Madoff --

SEN. KLOBUCHAR: Because sometimes don't people get overwhelmed with these tips? I mean, we saw that after 9/11; there was many sightings of Osama bin Laden at the Mall of America in Minnesota and things like that. I mean, sometimes you get overwhelmed with these tips. And how are you going to handle that?

MR. BAROFKSKY: We're dedicating a significant portion of our modest resources to dealing with hotlines, because we do think it's so important and such a potential area for significant investigations. And I think that really is the answer, that we're going to have to take some of our precious resources, which we've already done, and address this, because even if there's -- if there's 99 that are not necessarily valid tips, we don't want to miss that one.

SEN. KLOBUCHAR: Uh-huh. And then one last thing, I think both of you referenced the experience after the hurricanes and some of the prosecutions that you were ready to go and did that. Are there things you learned from that that will be helpful with this big influx with the TARP funds and the stimulus funds?

MR. BAROFKSKY: I think what we're trying to do is get out in front as much as we can. I mean, one of the areas of our focus as an office and our oversight function is trying to make the right recommendations for funds before they go out the door, because I think that's going to make fraud prevention easier. It's going to raise deterrent levels. So obviously we didn't come into existence until most of the first tranche was committed or out the door. But we have had an impact on how the money, since we've been there, has gone out and some of the more significant programs, the CitiGroup, and Bank of America, and the auto industry. And I look forward to working with Treasury to put the right conditions and fraud prevention into these programs before the money goes out the door.

SEN. KLOBUCHAR: Okay. Ms. Glavin, do you want to add anything?

MS. GLAVIN: The best response is -- what we learned is coordination, coordination, coordination. You've got to have the law enforcement bodies working together and sharing information. And that's going to make the biggest impact. We have been doing that, and we're going to continue to do that.

SEN. KLOBUCHAR: Okay. Well I just want to thank you as well. And I think these resources are going to be well spent. The public is crying out for accountability. This is a lot of money and as Senator Kaufman said, you have a big job. But I know you're up to it and we just have to be there to help you.

Thank you.

SEN. LEAHY: Thank you. Whatever other questions I have I'll place in the record and we'll leave the record open. I mentioned to all of you, we're trying to learn as much as possible, especially this new legislation. If after you see the transcript of your testimony and think "I should have added," please feel free to do so. Or, if you find any numbers in there as you look at it, on reflection you feel they're wrong, just note that so they can be corrected.

It's not a gotcha hearing, it's a hearing where we're trying to move a significant piece of legislation backed by Democrats and Republicans, and a trend the Congress should return to. You don't have to respond to that, that's my own feeling. So I thank you all very much.

We stand in recess.