

# ALERT FRAUD

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## Offshore Banks: Let the Banker Beware

Governments may issue warnings about banks operating illegally in their countries, but it is up to each bank to perform its own due diligence before getting involved in direct transactions with offshore banks.

Many legitimate offshore banks operate in the United States and abroad, so it would be improper to suggest that domestic banks avoid transactions with offshore banks. However, the FDIC suggests that any domestic bank considering a transaction involving an offshore bank do so with caution.

For example, banks should use prudence when making loans on the strength of a borrower's financial statement that reflects major investments or

deposits in offshore banks.

In addition to normal credit checks performed on the borrower, any transactions involving an offshore bank should include reviews of the financial condition of the institution and the background of anyone involved with the institution. Check references from other banks that may have had experience with the institution.

Most inquiries to the FDIC come from (1) bankers curious about solicitations from offshore banks for correspondent relationships with domestic banks and (2) questions about the legitimacy of certain instruments issued by offshore banks.

Despite the laws governing licensing

and operation of banks in this country, people have been able to open "banks" without authorization from state or federal regulatory authorities. Some of these operations have used names similar to large, well-known banks in hopes of remaining undetected while deceiving unsuspecting customers, including banks.

Some have relied on such tactics as unusually high interest rates to lure deposits while others have been created solely to defraud legitimate banks through the issuance of worthless drafts, certificates of deposit, letters of credit and so on. Banks have accepted in good faith these instruments for deposit, or as collateral for loans, or other business transactions.

Frequently, state and federal authorities are unaware of the activities of these entities until complaints are received from legitimate banking organizations and the public. When state or federal regulators become aware of these bogus banks, steps are taken to suspend or terminate their operations.

Many of these operations, however, simply move to another location and continue to operate until they come to the attention of regulators in another state.

The FDIC deals with the questions raised about offshore banks' activities through its Financial Institution Letters (FILs). The FILs contain names of unlicensed banks and names of institutions which have issued obligations such as checks, drafts, certificates of deposit or letters of credit that have not been honored.

### *Upfront Fees Don't Buy Loans or Deposits*

*Brokered loan schemes seem to surface when the economy is not performing well or lending gets tight. These conditions have led to another round of reports of potential borrowers and banks being bilked by brokers who promise loans or deposits at low interest rates.*

*The offers of cheap money come with expensive hidden strings: fees that are suddenly demanded by the broker. But more important, the fees are paid out for money that never materializes.*

*While not a new scheme, it has taken on international proportions as recent press accounts detail. It also has become more anonymous with the advent of the fax machine.*

*These schemes to collect advance fees were discussed with The FDIC Fraud Alert by FDIC Review Examiner Eugene Seitz.*

**FA:** *Why would a bank become involved in a brokered-loan scheme? Because there are a lot of banks that have an abundance of deposits, but loan demand is light. Another possibility is that brokers often offer attractive fees for handling their loans. Most of the time, the broker dir-*

*(Please see page 3)*

# Phantom Ginnie Maes Creating Bogus Capital and Collateral

Law enforcement officials are tracking a sophisticated ring of con artists who are renting Ginnie Mae registration numbers to financial institutions attempting to improve the appearance of their capital standing.

Investigations into what may soon become a nationwide scandal are under way in seven states. Federal investigators say that a ring of con artists have obtained the registration or CUSIP numbers of the Government National Mortgage Association securities, and sometimes rent them to borrowers who have used them to get millions in loans.

As originally reported in *National Mortgage News*, investigators say it is not clear how the GNMA registration numbers are obtained.

As of early September, some \$50 million in loans had been obtained by using the bogus pool numbers as collateral.

The stolen Ginnie Mae pool numbers, say investigators, also are being used by ailing insurance companies, and perhaps by thrifts to shore up sagging capital bases, the newspaper reported.

A similar scam, involving Ginnie Mae's, occurred several years ago in Great Britain, said Robert Kalish, GNMA executive vice president. Kalish said, "these types of scams come up from time to time. It's a matter for law enforcement officials."

Five men were indicted last year in New Orleans in connection with \$2.76 million in loans obtained through stolen GNMA numbers.

The Federal Bureau of Investigation is trying to determine why some banks would lend money to borrowers who would only post the CUSIP number without posting the actual security as collateral.

Custodians of the securities, such as New York's Chemical Bank, will verify Ginnie Mae numbers to lenders, but will not provide ownership information, said U.S. Attorney Joe Cage of Shreveport, La.

"Logically this scam should break down on several levels but it didn't and we're still trying to find out why," Cage told the newspaper.

Federal probes are under way in California, New Jersey, New Mexico, New York, Texas, Utah and Wisconsin. Investigators say that some of the suspects under investigation are also the subject of bank and thrift fraud probes. "We're up to our necks in these kinds of cases: bank fraud, securities fraud, insurance companies," Mr. Cage said. "We haven't seen any thing like this since the S&L crisis hit us."

Law enforcement and insurance investigators seem most concerned about insurance companies that rent Ginnie Mae numbers and post them as capital on their books. But they also worry about other securities that are rented by insurance companies and banks as a means of artificially inflating capital.

## Rights of Privacy Not a Barrier to Criminal Referrals

*Prosecutors involved in criminal referrals say that many in banking are still laboring under the perception that the Right to Financial Privacy Act (RFPA) prohibits them from providing authorities with the information in a customer's financial records without notice to the customer, even when there is a reasonable suspicion the customer may be involved in criminal activity. In fact, the RFPA contains important exceptions authorizing bank employees to notify authorities of suspected illegal conduct and provide information on the suspicious activity without notifying customers.*

*First, FDIC-regulated bankers must remember they are legally bound to report apparent criminal acts to the Federal Bureau of Investigation, the United States Attorney, and the FDIC. The obligation to report suspicious activity is not limited by the RFPA. In fact, the RFPA contains a provision exempting its applicability to information required to be reported in accordance with federal law. Simply put, bankers cannot use the RFPA as an excuse not to make criminal referrals.*

*Moreover, where the suspects are insiders, the RFPA does not apply. In 1988, the RFPA was changed to permit depository institutions to release financial records to authorities when there is suspected criminal activity by insiders or major borrowers. Thus, where insiders or major borrowers are involved, financial institutions may go one step further than simply making a criminal referral—they may actually release the suspect's financial records to authorities without regard to RFPA restrictions.*

*Finally, the RFPA specifically provides that employees may provide information including the name of the person, corporation, account number, and the nature of the suspicious activity regarding customer accounts to authorities.*

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## RTC Sees \$300 million in Fraud at ComFed SB

Investigators for the RTC expect the total loss resulting from fraud at ComFed Savings Bank, Lowell, Mass., to approach \$300 million. Thus far investigators have made 119 criminal referrals to the Department of Justice and more referrals are expected.

The thrift was taken over by the RTC nearly two years ago. Earlier this year Domonick Manning, Bernard McCaffrey and Andrew Forelli, former employees of ComFed Mortgage, pled guilty to charges resulting from their involvement in the conspiracy to defraud ComFed Savings Bank by making false statements on mortgage applications. A fourth employee has been indicted on 11 counts of fraud.

In other unrelated fraud cases, these sentences were handed down:

—Eric Freedlander, the former owner of three mortgage companies, has been convicted of 79 charges of fraud and conspiracy. Freedlander was sentenced to nine years in prison and ordered to pay \$70 million in restitution to the thrift institutions that lost at least that much in a scheme involving \$500 million in

mortgage-backed loans.

—John E. Coles, former president of the defunct Peoples Savings and Loan of Hampton, Va., was sentenced to over 11 years in prison after his conviction on 23 counts of fraud. Coles was also ordered to pay more than \$500,000 in restitution based on documents provided by the Resolution Trust Corporation's criminal coordinator.

—Alan Ross Rothery, former owner and chairman of Trinity Valley S&L, Cleveland, Tex., was sentenced to 12 years in prison on three counts of bank fraud. Rothery was ordered to pay the RTC \$1.7 million in restitution and also was fined \$50,000.

—Guilty verdicts were handed up in St. Paul, Minn., against four former senior executives of Midwest Federal S&L, Minneapolis. They were found guilty of felony charges stemming from the thrift's collapse in February 1989. Among the charges brought were violations of the Racketeer Influenced and Corrupt Organizations Act (RICO). Under RICO's provisions the jury awarded the RTC approximately \$4 mil-

lion.

—James R. Cruce, former head of Peoples Heritage Federal S&L, Salina, Kan., was sentenced to 14 years in prison and ordered to pay \$8 million in restitution after pleading guilty to bank fraud. Thomas A. Burger, a former senior loan officer at Peoples Heritage, received a 12-year prison term and was ordered to pay \$6 million in restitution after pleading guilty to charges of fraud and conspiracy. Thomas D. Dunn, the former chairman of Peoples Heritage, was sentenced to eight years, fined \$20,000 and ordered to pay \$5.4 million in restitution. The three were among 10 persons indicted in a case involving \$105 million in fraudulently obtained loans from the failed thrift.

—Gary B. Hobbs, who indirectly owned and controlled Cross Roads S&L, Checotah, Okla., was sentenced to seven and one-half years and ordered to pay \$10 million in restitution. Hobbs pleaded guilty to 18 counts of fraud that led to more than \$15 million in losses at the thrift, which ultimately failed.

### *Upfront Fees Don't Buy Loans or Deposits*

(Cont'd. from page 1)

—ectly approaches a bank customer about loan services and the customer takes the proposal to the banker who may view it as an opportunity to help the customer.

FA: Why would a bank pay advance fees for brokered loans?

The bank is often willing to pay the fees to obtain the loans because they just don't have the walk-in traffic that they need to generate loans. As for their customers, it's an opportunity for people who sometimes can't get large loans from other sources to get the money they need. There can be several alleged reasons for the fees. The loan brokers allege there are expenses involved, like documentation, travel, and communications. The broker is also looking for a commission.

FA: Do the brokers initially discuss their intention of collecting fees?

In most cases, they don't discuss all of the fees up front. Generally, they might discuss commissions and out-of-pocket expenses for arranging the loan. Later when the borrower has expressed interest in the loan, the broker may come up with other fees. We're talking about loans from a couple of hundred thousand dollars up to as much as \$100 million, so fees could be substantial.

FA: How should banks go about investigating brokered-loan proposals?

First, they should investigate this like any other proposed loan. If one of the bank's customers is involved, bankers need to know something about the customer's ability to repay the loan outside of any promises from the broker to guarantee or collateralize the loan. Second, they should investigate the people who are allegedly lending the money as well as the broker who is bringing the proposal. If possible, request and check references from other financial institutions allegedly used by the broker. Often, the broker talks about loans from anonymous sources. Frequently, people go through the entire transaction without ever learning the identity of the source of the funds. Usually, the source of funds is said to be a wealthy individual who needs to hide the funds from his government or has an overabundance of funds to invest at a ridiculously low rate. The rates alone should raise a red flag.

FA: Are there clues bankers should look for in order to spot bogus brokered-loan schemes?

The bank should be suspicious if a customer who is having financial problems suddenly comes to the (Please see page 4)

## Upfront Fees Don't Buy Loans or Deposits

(Cont'd. from page 3)  
 bank indicating he has reached an agreement to obtain a substantial loan and needs the bank to handle the incoming funds. Although the bank may not be legally responsible for advising the customer, the bank may become legally liable for its participation in the scheme. If you have an opportunity to look at any of the documents, look for unusually low interest rates and other unusual terms. Note whether the source of funds is identified and the amount of funds available. Often, just prior to the closing date, the broker will come up with "emergency"

expenses that must be covered right away. Those expenses, once they are paid, are never recovered and in most cases, the broker is never heard from again.

In most advance fee schemes, the bank is not the target. Banks usually become involved when they agree to accept the transaction on behalf of a customer. Any communication between the bank and the broker can be used by the broker to lend legitimacy to other pending transactions. Once the broker obtains a copy of the bank's letterhead, he may remove the correspondence and

replace it with his own. Most communications with the broker are by fax machine, so original correspondence is not essential.

Generally, the local contact is an innocent party who is approached about what sounds like a legitimate deal. It could be an attorney, a bank director, or a prominent local businessman who is used to get a foothold into the bank. Local contacts are usually lured into the scheme by the prospect of collecting substantial fees for their participation.

These scams can happen anywhere. We once got a call from a bank with \$10 million in assets that had been approached about handling a \$50 million loan. That is pretty bizarre and shows that the broker randomly picked a bank without consideration for its size and its ability to handle such a transaction.

Brokers may involve banks in one of their schemes in another way. For example, the broker may indicate that he is willing to fund a \$1 million dollar loan fully secured by a time deposit that is large enough that the interest from the deposit will nearly offset the interest on the loan. But to get the large time deposit, the bank may be asked to pay a fee. The broker may also offer outside guarantees on the loan in an attempt to help satisfy the bank that it cannot lose on the deal. In this situation, the bank's customer is asked to pay a fee for the loan and the bank is asked to pay a fee for the deposit. In every case that we know of, neither the loan nor the deposit has ever materialized.

### Electronic Alchemy: Counterfeit Gold Cards

With a little high-tech legerdemain, counterfeiters are copying the premium credit cards of international business executives.

This cloning of Visa and MasterCard gold cards has surfaced in Great Britain and it can be expected to spread across the Atlantic Ocean to North America. The scam, reports the *American Banker*, started in the Far East, where the card-reading equipment used by the counterfeiters is also available.

The equipment picks up account data encoded on a card's magnetic stripe, then copies the data onto another, often stolen, card. The original card is then given back to its owner, who is unaware the account has been compromised, the newspaper reported. Security specialists say the counterfeiting activity is costing British banks millions of dollars each year.

British police recounted one case in which a London businessman's gold card was copied in Europe and the counterfeit used to run up bills. The stores involved presumably checked the fake cards with the issuing bank, but the card details were cleared as genuine, police said.

The counterfeiters duplicate key data from the card if they have it in their possession for a few minutes, say the security experts. All that is needed is "undisturbed access to the card for a couple of minutes in order to reproduce certain features," explained a spokesman for Barclays Bank PLC, Visa International's biggest European member.

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