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The Assault on Financial Institutions Fraud and the Federal Prosecutor Leading the Charge

Ira H. Raphaelson was tapped by President Bush in 1991 to serve as the first Special Counsel for Financial Institutions Fraud at the Department of Justice. Congress created the position in 1990 as part of the Crime Control Act, which lawmakers drafted in part to marshal federal law enforcement agencies against those who would defraud depository institutions. Raphaelson comes to the job after fighting corruption in Chicago city government and supervising FBI undercover probes of the Chicago commodities markets as a United States Attorney. Fraud Alert spoke with Raphaelson about the concerted federal effort to prosecute fraud at banks, credit unions and S&Ls.

Would you explain your role as special counsel for financial institutions fraud?

Raphaelson: My job falls within the deputy attorney general's office for a couple of reasons. One, because [former] Attorney General [Dick] Thornburgh thought it was important to show both the Justice Department and the regulatory community the significance he attached to the attack on financial institution fraud (FIF). Second, Congress agreed with him by passing the statute.

My job is to make sure the department's resources are focused where they can do the most good. And to coordinate the efforts of the law enforcement agencies that work with the Justice Department in investigating and prosecuting these cases with the regulatory community's efforts.

About how many people in federal agencies are working on financial institutions fraud?

Raphaelson: I can't tell you how many are in the bank regulatory agencies. I know there are about 100 Secret Service agents dedicated to major FIF prosecutions. More than 100 Internal Revenue Service agents are spending some time doing that. About 850 man years are coming from the FBI now. You've got some 350 Assistant United States Attorneys who were added by the 1989 Financial Institutions Reform Recovery and Enforcement Act (FIRREA) and the Crime Control Act. We had a baseline of around 125 Assistant United States Attorneys. So, it's 350 on top of that. By and large the resources are in the field in the 93 U.S. Attorneys' offices.

Why are there Financial Institution Fraud Task Forces in New England and Dallas?

Raphaelson: Well, the Dallas Task Force evolved to deal with the S&L crisis. In New England the six state U.S. Attorneys were seeing a large number of FDIC liquidation people being brought into the Boston office. The U.S. Attorneys formulated a task force that would be ready in the event that an influx of referrals came in. At the same time they beefed up their own staffs to deal with the existing inventory. Task forces work in some parts of the country and not in others.

Is there any correlation between the task force and the number of bank failures in New England?

Raphaelson: A rash of failures is expected in New England. With the exception of Boston, none of the U.S. Attorneys' offices has a large staff. And these cases are labor-intensive. A well-staffed U.S. Attorney's office can more easily divert significant resources to a particular criminal problem than a series of small offices.

Who are the majority of the people being prosecuted?

Raphaelson: In the S&L cases, 29.4 percent of the defendants prosecuted between 1989 and '91 were insiders. That is, directors, officers, CEOs, chairmen of the board and

presidents. The majority were outsiders. There are a couple of ways of looking at this. One is that almost a third of those prosecuted in S&L cases in fiscal 1989-91 were insiders, while outsiders represented more than two-thirds. However, insider cases represented about 60 percent of the volume of the money stolen.

Again, if you look at the major bank prosecutions, 31.6 percent of those prosecuted are insiders. A smaller percentage of the presidents, CEOs, chairmen of the board, and a larger percentage of the directors and officers than in the S&L cases, but again roughly 30 percent. The split is roughly 30-70.

If you look at credit unions, the cases are almost the reverse—58.9 percent of those prosecuted are insiders. Now the vast majority of them are directors and officers. But statistically the numbers are much smaller because you have fewer than 100 of those prosecutions across the country.

Overall, in the first three years that we've been counting these beans, the insiders are responsible for 61.7 percent of the charged losses. That is roughly $6.1 billion versus $3.2 billion for all other FIF defendants.

Why are there more convictions at banks? Most people thought there was more fraud in the S&Ls.

Raphaelson: There are a lot more banks than S&Ls, that's number one. So, while I don't find it an anomaly that there are more bank cases than S&L cases, you've got to look at what kind they are. The S&L defendants account for $10.5 billion in losses in our prosecutions, over the past three and one-quarter years. Bank defendants are at $2.7 billion. What that tells me is that I'm prosecuting more people for smaller dollar losses in the bank arena than I am in the S&L arena. That also tells me that the S&L cases are the failure-driven cases, whereas the bank cases are the more routine embezzlement-type cases. Now that may change over time.

What do you mean by failure cases?

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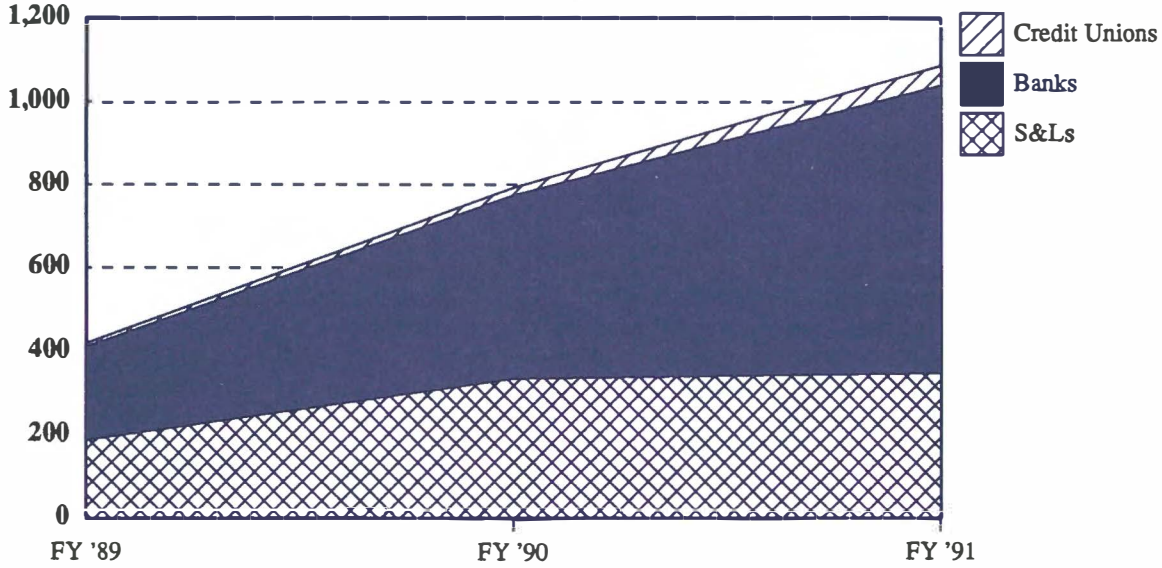
2295 Defendants Charged
Major FIF Prosecutions
Fiscal Years 1989-1991



	FY '89	FY '90	FY '91
S&Ls	187	335	349
Banks	223	439	689
Credit Unions	9	17	47
Total	419	719	1,085

Data for October 1, 1988 - September 30, 1991

Raphaelson: An institution fails by virtue of corrupt management, or in part by corrupt management. The dollars attributable to the corrupt management are going to be high in such a prosecution.

A bank officer walks away with a $1 million. Because you have more bank officers than you have S&L officers you are going to have more of those kinds of cases.

The thrift cases appear to be failure driven, while the bank cases appear to be other kinds of fraud at work. That may change over time. There may be more bank failure-driven cases, in which case the dollars may start to even out. But right now the S&L defendants make up the failure cases. And that's an important distinction in terms of the industry.

The industry ought not be panicked that there are more bank defendants than there are S&L defendants. That's not an indicator that the industry is in trouble. That's the problems with statistics. You don't want people looking at cold statistics and saying, "Oh, this is the next wave of S&Ls."

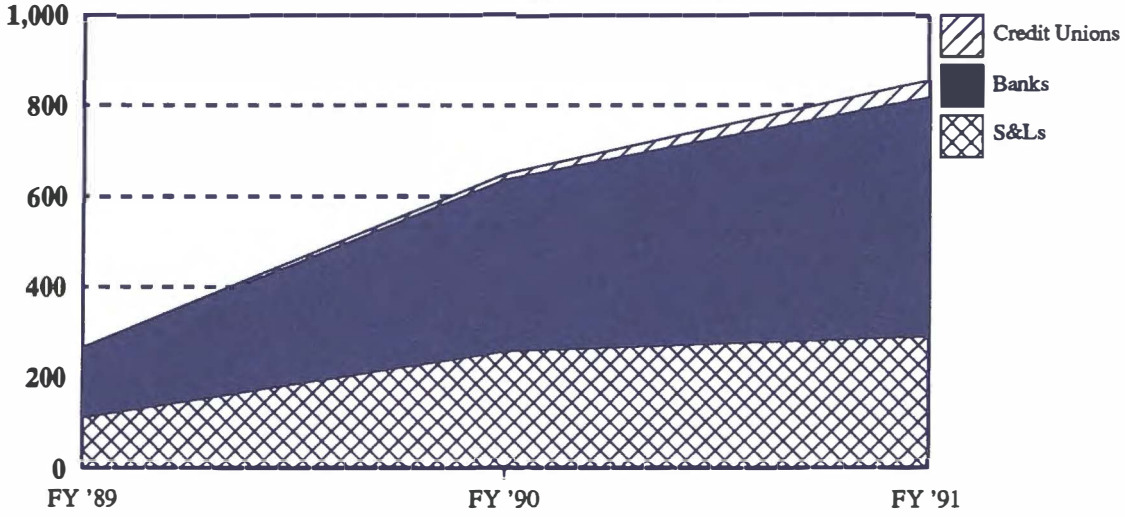
Recently the prosecutions and convictions have been climbing at a fairly steep rate. What does that look like for the next few years? Is that rate going to continue to climb?

Raphaelson: We had a big increase in cases in the mid-1980s. But since then the rate of referrals has remained fairly constant. The rate of prosecution is increasing as resources are applied to the cases that need prosecuting. In the course of these efforts, as you might expect, finishing the cases from the late '80s will take us until the late '90s. That's why Congress extended the statute of limitations. So some cases that came out of failures that occurred between 1985 and 1990 won't be resolved until 1995 or the year 2000.

I think we're going to resolve a larger percentage of those cases more quickly than we did in the past because of the new resources. But nobody should expect us to suddenly disappear in a year or two or three.

We've been there all along. Part of our problem, like part of the industry's problem, is public relations. Prosecutors have been involved in bank fraud since the Butcher brothers ripped off the banks in Tennessee and Penn Square went belly up. In the late '70s we were there. But right now I've got three times the resources I had in '88. And you can expect with three times the resources,

1770 Defendants Convicted
Major FIF Prosecutions
Fiscal Years 1989-1991



	FY '89	FY '90	FY '91
S&Ls	112	259	290
Banks	149	377	528
Credit Unions	5	13	37
Total	266	649	855

Data for October 1, 1988 - September 30, 1991
96.7% conviction rate
77.4% of those convicted sentenced to jail

you're going to produce a lot more cases.

On the other hand, if you look at the kinds of cases we're doing, we're not pushing the envelope. I know that there is concern within the industry that prosecutors with nothing better to do with their time are going to try to criminalize what they view as regulatory mistakes, indiscretions, whatever. If you look at the cases we're bringing, they are traditional criminal activity—stealing from the institution, self-dealing and other forms of embezzlement. Lying to the regulators has always been a crime. There is nothing about FIRREA or the Crime Control Act that has changed that.

How does the FDIC staff in the field help in identifying criminal matters?

Raphaelson: They trigger the referral of cases, although institutions refer more bank fraud cases to us than regulators do. But the institutions refer the outside embezzlement cases, while the regulators refer the inside problems. And regulators are working with us with increasing frequency at an earlier stage. So we're being called in when they begin to get the first whiffs of criminality, and we can get the FBI people working with the bank exam people at an earlier stage to cut short the loss, to cut short the investigative time, cut short the duplication of effort. In other words, we're proceeding in a more coordinated fashion.

How is the FDIC going to benefit from these referrals in terms of forfeiture and restitution?

Raphaelson: The agency will benefit in at least three ways: First, directly from the amount of money that we are able to recover through forfeiture, fines, and restitution; then indirectly from the good will in the public's mind by virtue of helping isolate and prosecute those responsible for what will ultimately be perceived as the great financial institution crisis, not just the S&L crisis; and finally, and most importantly, because I have to believe as a prosecutor that it's true, and my experience tells me it's true—we serve as a deterrent. If a banker knows that manipulating the books, self-dealing, outright embezzlement is going to result in a jail term, he, or she, is less likely to engage in that form of activity.

Could you elaborate on forfeiture, fines and restitution? There are still people who don't understand the difference in the terms.

Raphaelson: What Congress did in FIRREA in 1989 and in son of FIRREA in 1990 was make available for bank crimes—bank is generic for financial institutions—the forfeiture laws of the United States, which have been applied in drug cases for so long. This means that the proceeds of a bank fraud crime can be forfeited to the United States, as an additional penalty that is not a fine or restitution.

So you could be fined for the crime you committed, your proceeds could be forfeited, and you could be ordered to make restitution. Forfeiture is not designed to be a restitution mechanism. There are procedures for making it into a restitution mechanism and we work with the FDIC, Resolution Trust Corporation and the Office of Thrift Supervision so that it can be a restitution mechanism.

But forfeiture is designed as a penalty beyond what we can get in restitution. Restitution is strictly a compensatory process attendant to the criminal process. Forfeiture also has an advantage to us as prosecutors—we can sometimes get the money quicker than we can get the body. So we can attach the house, the car, the swimming pool, the jewelry, the yacht, whatever, and try to go into court and forfeit those assets in advance of the criminal prosecution.

[Editor's note: Raphaelson was recently questioned by members of the Senate Banking Committee on the amount of money that has been collected in fines and restitution orders in major S&L cases. Raphaelson told the Senators, "Much of the money is gone, often because it was never there to begin with. The phrase squeezing blood out of a turnip has been used, but I can assure you we are trying our best."]

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