

FRAUD ALERT

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FDIC Investigators Sift Banks' Records for Fraud and Negligence

When a bank fails, the chartering agency goes in first to revoke the charter. Within minutes the FDIC's closing team is in the bank, preparing to turn it over to a new owner or pay off depositors. Investigators from the FDIC's Division of Liquidation are a vital part of that group.

Their job is to sift through the bank's records to determine whether there is a basis to pursue civil liability claims against bank employees, officers, directors and others. Contrary to popular misconception, the FDIC does not sue officers and directors in all bank failures. Suits against officers and directors grow out of about 20 to 25 percent of failed banks. Whenever investigators discover evidence of criminal conduct, they turn it over to the U.S. Department of Justice.

The FDIC recognizes that public confidence in the safety and soundness of the banking system is enhanced by bringing to justice those who abuse the system. The FDIC is also looking to recoup money as the receiver for the failed institution. One method of doing so is for the FDIC to seek restitution from those convicted of criminal activity.

Fraud Alert spoke with S. Kay Northern, Assistant Director for Investigations in the FDIC's Division of Liquidation, and Robert Russell, Senior Counsel in the Criminal Restitution Unit of the FDIC's Legal Division about these criminal investigations.

FRAUD ALERT: How many FDIC investigators are involved in these sorts of investigations?

NORTHERN: There are approximately 250 investigators assigned to Investigation Units around the country. All 250 have been trained in fraud investigations. Of those investigators, 18 to 20 have been designated criminal coordinators.

FRAUD ALERT: How many lawyers are involved?

RUSSELL: There are approximately 20 criminal coordinators in the regions and six lawyers in the Criminal Restitution Unit in Washington. As is the case with the investigators, the attorneys receive specialized training.

FRAUD ALERT: Do investigators go into every bank that fails?

NORTHERN: Yes. A team of investigators is sent in immediately after the institution fails. Their duties include everything from boxing and inventorying microfiche to securing the official bank records and analyzing the bank's insurance coverage. One of the most important things an investigator must accomplish during the closing is to gain a complete understanding of the bank's operations, its policies and procedures, as well as the lending process, and correspondent relationships—an overall working knowledge of the institution. Where evidence of criminal behavior is found, a criminal referral is made to the Justice Department.

FRAUD ALERT: What role do the lawyers play after a referral is made?

RUSSELL: The lawyers provide legal advice and guidance in dealing with the Justice Department. The FDIC does not have the authority to prosecute bank fraud. That's not our role. We do, however, have an interest in getting the offenders prosecuted. For one thing, it is a deterrent to others who may think of engaging in bank fraud. For another, as the successor to the failed institution, the FDIC is the victim of the fraud and stands to receive restitution if there is a conviction.

FRAUD ALERT: Are other federal agencies involved?

NORTHERN: At times it can be a very crowded playing field. In addition to the Justice Department, the Securities and Exchange Commission, the Internal Revenue Service and the Secret Service are charged with different responsibilities and may have their own investigations.

We often share the records of the failed institutions and work closely with other agencies, but the civil claims we develop during our investigations are claims on behalf of the FDIC.

RUSSELL: In addition, the Office of Thrift Supervision could be involved in the case of a failed thrift. And our own Division of Supervision could have an enforce-

Continued on page 2

FDIC Investigators Sift Banks' Records for Fraud and Negligence

Continued from page 1

ment proceeding arising out of a failed bank. Congress has provided an enhanced arsenal of weapons that can be used against those who have abused insured institutions. But they have to be used in a comprehensive, coordinated fashion. The FDIC criminal coordinators throughout the system help provide that coordination.

FRAUD ALERT: How long are investigators in a bank once the charter has been revoked? Is speed of the essence in getting the investigation completed?

NORTHERN: Speed is of the essence. Investigators may spend several months in an institution or a matter of weeks. We have 17 consolidated offices around the country. Each office has an investigation department. The majority of the on-going investigations are handled by these offices.

FRAUD ALERT: Are you looking for fraud against the bank or fraud against the FDIC?

RUSSELL: We are talking about suspected criminal behavior that occurred before the failure. As Kay said, the people who engaged in this behavior are referred to the Justice Department. At their request, we will assist the Justice Department by explaining the transactions and by providing them with the documentation they need to put their case together.

If there is a conviction, the FDIC as the victim of the fraud will ask the judge to require the defendant to pay back the receiver for the losses caused by his criminal behavior. That's very important to us.

Criminal Referrals Computerized

Federal banking regulators and the Treasury Department's Financial Crime Enforcement Network (FinCEN) have designed a computerized criminal referral system to enhance the ability of federal regulatory and law enforcement agencies to track and coordinate criminal and administrative cases.

The regulators, who make up the National Bank Fraud Working Group (NBFWG), and Treasury officials have spent several years developing the system to receive and process criminal referrals made by financial institutions. Last fall federal bank and thrift regulators adopted a common form to be used to report suspected criminal activities.

The FinCEN will use the information on the forms as well as in the agencies' computer systems as the data base. The FinCen system is expected to be operational early this year.

In addition to tracking and coordinating criminal referrals, the new system will also make it easier for banks and thrifts to comply with criminal activity reporting requirements and law enforcement agencies to investigate criminal referrals.

We have an obligation to seek every possible avenue of recovery on behalf of the receiver. I should add that doesn't mean we'll get every penny the judge orders because sometimes these defendants just do not have it. We will, nonetheless, seek restitution orders and then work with the Department of Justice to collect whatever money is available.

FRAUD ALERT: How do you gather information in building a case? Is it from the bank records, the employees or other sources?

NORTHERN: Cases involving bank fraud are built by the Justice Department. Justice usually proceeds by issuing a grand jury subpoena for the bank records that make up a significant part of the evidence used to build the case. Investigators are often requested to authenticate these documents, explain the bank's operations, policies and procedures and even to testify before the grand jury.

FRAUD ALERT: How do you measure the success? Is it through sentencing or restitution?

NORTHERN: The recovery of funds through restitution orders allows the FDIC to recoup losses to the Bank Insurance Fund, but I think convictions set an example for others.

FRAUD ALERT: Will the number of these kinds of cases continue to grow?

RUSSELL: They are cresting. I think they'll be around for a while and there will be a substantial number of cases. But I do not think we'll see the kind of growth in criminal referrals and criminal cases we saw in the late 1980s and early '90s.

FRAUD ALERT: Do more civil cases than criminal cases grow out of bank failures?

NORTHERN: There are more civil claims primarily due to the collection efforts on the assets of the failed bank, as well as negligence claims against officers, directors, and others.

RUSSELL: But that is not surprising. The burden of proof for a criminal case is much higher—proof beyond a reasonable doubt. So the evidence has to be stronger. Moreover, the type of violation has to be more severe. Mere negligence doesn't make it in a criminal case. ■

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S&L Operators Given Stiff Prison Sentences for Fraud

Federal judges have handed down lengthy prison terms for two Texas savings and loan operators convicted of fraud that led to the downfall of three S&Ls.

The two cases highlight recent court activity involving fraud prosecution. The courts' actions follow.

Lancaster First Federal S&LA, Lancaster, Tex., and Bell Savings Banc, Belton, Tex. - Paul Arlin Jensen, who controlled the two S&Ls, was sentenced to 20 years in prison for his part in a scheme to defraud the two institutions of millions of dollars.

Jensen's control of the two thrifts resulted in loans to an ill-fated condominium project east of Dallas. The loans were based on inflated land values and led to the collapse of five financial institutions, prosecutors contend. Jensen, and three others involved in the scheme, were said to have pocketed \$126 million in misdirected loan proceeds.

Sunbelt Savings Association, Dallas - Edwin T. McBirney, III, was sentenced to a maximum of 15 years in prison on fraud charges that grew out of the failure of Sunbelt. McBirney, a former chairman of Sunbelt, pleaded guilty to defrauding the thrift. He then helped federal investigators by testifying in other S&L trials and supplying documentary evidence.

At the February sentencing in Dallas, U.S. District Judge Robert Maloney imposed the maximum sentence for fraud, saying that McBirney had "carried the phrase 'other people's money' to the extreme."

"You became a high roller," Judge Maloney said. "The fact that you used millions of other peoples' money did not seem to bother you." Sunbelt Savings Association failed in August 1988.

Hill Financial Savings Association, Red Hill, Pa. - Hill Financial's former president, Alfred J. Lutz, Jr., pleaded guilty in October to three counts of misapplication of funds.

Lincoln S&LA, Irvine, Calif. - The compensatory damages previously ordered against Charles H. Keating, Jr., and two other defendants were reduced to \$288.7 million by U.S. District Judge Richard Bilby in Tucson.

The judge took the action after the jury disregarded his instruction on the level of damages that could be assessed.

The trial grew out of the massive fraud case involving Keating's failed Lincoln Savings. A jury in July had ordered \$600 million each in damages against Keating and an Atlanta development company, Continental Southern, and \$518 million against Arizona developer Conley Wolfswinkel.

Bilby also halved the \$1.5 billion in punitive damages against Keating, because the judge thought it was too much. Bilby also eliminated punitive damages of \$410 million against Wolfswinkel and \$500 million against Continental Southern.

Peoples Heritage FS&LA, Salina, Kan. - A \$2.85 million cash settlement was completed in October with Mrs. Thomas Dunn, the wife of a former senior loan officer at Peoples, and the Dunn Children Trust. The money was credited to Thomas Dunn's restitution order. A total of \$3.3 million in restitution has been collected.

Continental Savings, Bellaire, Tex. - A judge has ruled for the Resolution Trust Corp. on its motion for the forfeiture of \$1.83 million that was seized from Sansend Financial Consultants, Ltd., a British firm. The Sansend case involves a civil action brought for the forfeiture of property gained through violations of federal law.

Sansend Financial Consultants, Ltd., is registered in the Channel Islands of the United Kingdom and was a part of a scheme to defraud a number of federally insured financial institutions. Other participants in the plan were foreign and

Continued on page 4

First Conviction Recorded Under "Financial Crime Kingpin" Law

A jury in Manhattan returned guilty verdicts recently in the first case brought under the new "financial crime kingpin" provision of the Crime Control Act of 1990.

Roy William Harris, the former head of the now-defunct Arochem Corp., of Stamford, Conn., was convicted of defrauding the oil company's banks of about \$200 million and lying about Arochem's poor financial condition.

The Crime Control Act defines a "financial crime kingpin" as a person who organizes, manages or supervises a continuing financial crimes enterprise and who receives at least \$5 million in gross receipts in a 24-month period. Upon conviction, a kingpin faces fines of up to \$10 million and imprisonment of 10 years to life.

Arochem's bank group, led by Chase Manhattan, accused Har-

ris of speculating with the banks' \$200 million line of credit and concealing losses.

The federal district court jury found Harris guilty of one count of conspiracy, seven counts of bank fraud, one count of money laundering, 12 counts of wire fraud, and one count of continuing financial crimes.

S&L Operators Given Stiff Prison Sentences for Fraud

Continued from page 3

domestic corporations as well as William M. Adkinson, Robert L. Collins and Keith Allen Cox.

The three men have been indicted in Florida for criminal activities related to this scheme. Adkinson and Collins were convicted in Florida for their roles in a \$100 million-plus loan fraud scheme that contributed to the failure of Hill Financial Savings Association of Red Hill, Penna., and Vision Banc of Kingsville, Tex.

The Texas scheme included the acquisition of the Meyerland Corp. of Texas, which owned the Meyerland Plaza shopping center in Houston. Through fictitious transactions, Meyerland's value was artificially inflated so it would appear to be a creditworthy prospective borrower from targeted banks and thrifts. After submitting false financial statements with loan applications, Meyerland obtained \$83 million in loans from three institutions. One of the lenders, Continental Savings Association in Houston, took a superior lien on the tract covered by Sandsend's deed of trust and collateral assignment of rents. Continental eventually foreclosed its lien, after which Sandsend notified the tenant, J.C. Penney, that all future lease payments should be made to Sandsend. J.C. Penney sued Sandsend and Continental as adverse claimants to its rent payments. The Justice Department filed a motion for the forfeiture of the lease payment fund, because of Sandsend's fraudulent activities. The RTC, as the victim of the fraud, then asked the court that it be given the \$1.83 million in forfeiture proceeds.

Cornerstone FSA, Houston, Tex. - A federal grand jury indicted six men, including former Cornerstone Chairman Robert Hopkins, on bank fraud and conspiracy charges arising from the failure of Cornerstone and the Bank of Los Gatos, California. Hopkins is also charged with misapplica-

tion of funds.

The five other defendants are: Woodward Kingman, former associate director of the U.S. Information Agency; Thomas Oliver, president of the Pebble Beach Co.; businessmen Robert Bonner and William Lane; and Pebble Beach surgeon Blynn Shideler. Former Assistant Controller Vera Warford was convicted in December of defrauding the thrift of \$21,000.

First FSB, Diamondville, Wyo. - Former president Everett Cassidy has been indicted on charges of conspiracy to misapply bank funds and acceptance of a bribe.

James D. Joiner entered into a plea agreement with the U.S. Attorney in November. Joiner, a former principal with the company First Southern, was a party to a conspiracy to defraud First Federal. He will plead to one count of aiding and abetting misapplication of bank funds and one count of corruptly giving a reward to a bank president.

David A. Kavalin entered into an immunity agreement with the U.S. Attorney in October. Kavalin also is a former First Southern principal and a party to the conspiracy to defraud First Federal. The immunity agreement calls for Kavalin to cooperate with the criminal investigation, and with the government in the First Southern civil suit. He also is to forfeit assets gained from his criminal activity.

Skokie Federal Savings, Skokie, Ill. - Stephen M. Mullins, a tax-shelter packager; Paul A. Brown, an accountant; and Jeffrey C. Rubenstein, an attorney, agreed to pay \$1.1 million to settle charges that they filed false financial statements with Skokie Federal and Ohio Valley S&LA. The case is notable because the professionals were charged as individuals, not corporate entities and for the size of the penalty.

In November, Donald M. Martin, a principal in Skokie Federal, entered a guilty plea to three counts of fraud. ■

FDIC

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