

The Economic Club of New York

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404th Meeting

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Program

GUEST OF HONOR

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Introductions

GLENN HUBBARD: It's my pleasure to invite you and welcome you to this 404th meeting of the Economic Club of New York in our 102nd year. I'm Glenn Hubbard the Chairman of the club. The club is the nations leading non-partisan speaking forum on the economy and business. More than a 1000 guest speakers have appeared before this group over the past century and their names are listed in your program. They establish a very strong tradition of excellence and big ideas in the Economic Club of New York roster. I'd also like to recognize the members of our Centennial Society. Several dedicated club members sparked the formation of the society in order to ensure the ongoing financial viability of the organization. The 110 members of the society are also listed in your program.

We are, of course, honored as a club today to hear from Robert Mueller, the Director of the FBI. He is the sixth director of the agency and nominated by President George W Bush. He was sworn in as director on September 4th 2001, just a week before 9/11. After receiving his undergraduate degree at Princeton University and his master's degree in international relations from New York University the director joined the Marine Corps. He served as a marine officer for three years and led a rifle platoon of the Third Marine Division in Vietnam for one year. For his service he received the bronze star, two Navy commendation medals, the Purple Heart and the Vietnamese Cross of Gallantry.

Following his career in the Marines the director went on to earn his law degree from the University of Virginia Law School. He has served as a litigator, a United States Attorney and acting Deputy Attorney General for the Department of Justice. He'll speak to us today about a

very, very important topic in the economy generally and to this city in particular, financial crime. Director Mueller you have the floor thank you.

ROBERT MUELLER: Thank you all and good afternoon. It's a pleasure to be with you here today. A few months ago the Economist magazine announced plans to build an entertainment venue that, in their words, would continue the magic of a theme park with the excitement of macroeconomics. Among the planned rides were the currency high roller where one could float like a butterfly with the euro or sink like a stone with the pound. The chamber of horrors where one could tremble with fear in the face of distressed debt. And lastly my favorite, the fiscal fantasy land where one could watch the economy shrink down to nothing right before their very eyes. It did take me a minute to note the date on the press release which happened to be April 1st and to realize that this was only an April fool's joke. Unfortunately, however, the currency high roller, the chamber of horrors and the fiscal fantasy land are not so far from the truth in describing some of the issues confronting the financial sector.

This is, by no means, the first financial crisis we have had. Nor is it the first instance of bad business judgment or unadulterated greed. In a State of the Union address a President once warned against businessmen of great knowledge, but of temperament both unscrupulous and reckless. He stated that where the conditions are such that they act without supervision or control they may delude many innocent people into making investments or embarking in kinds of business that are unsound. These words of warning could have been given yesterday, but in fact Teddy Roosevelt delivered them more than a century ago in 1907, the same year your club held

its first meeting. Roosevelt knew that money and power were too often flanked by dishonesty and self dealing. And it is perhaps no coincidence that he created the FBI just one year later.

Today I want to talk about the FBI's role in combating white collar crime. We will talk about the need for integrity in the market place, in the boardroom and in government, and we'll touch on our distinct roles in this ethical calculus. In the wake of September 11th counter terrorism became the FBI's top priority. And yet at the same time we were confronted with a rash of corporate wrong doing from Enron to WorldCom to Qwest. We had to prioritize and we did. Today we continue to balance the risk of terrorist attack as evidenced by the planned attacks on synagogues in the Bronx against the growing risk to our economy and our communities from financial fraud and violent crime as well. Unfortunately, we do not have the personnel to investigate every criminal threat. We must focus our limited resources where we have the most impact.

In Los Angeles or Miami, for example, we might shift resources to combat gang activity. In Chicago to organized crime or corruption and here in New York we have shifted resources to address white collar crime. We have moved from a quantitative to a qualitative approach and we are using intelligence to pinpoint the greatest threats to each of our communities and working hard to prevent those threats from becoming reality.

Turning to the FBI's role in combating white collar crime there are many lenses through which to view the current financial crisis. From financial institutions that traded in risk itself, to lenders and real estate professionals who side stepped standard rules of practice, to homeowners whose

purchases exceeded their pocketbooks. Risk is, quite obviously, central to this crisis. In truth much of what led to the financial meltdown was the result of a failure to properly assess the risks—risk to businesses, risk to investors, risk to homeowners, risk to the economy at large.

Yes, there are those who intended to defraud others. But in part the subprime lending crisis may have been more a matter of group think and of greed. The prevailing thought process seemed to be everyone is making money, why should we miss the boat? But few ever believed that the boat might sink, and when it did some tried to patch the holes with duct tape, bail out the water with Dixie cups while the orchestra continued to play on the top deck. The FBI plays a role in addressing this financial crisis and we do so in two distinct ways. First, we are investigating those with criminal responsibility for aspects of the current crisis. And second, we are using intelligence to prevent new threats on the horizon. And in this way we can better promote and protect the health of the economy.

Let me start by talking about mortgage fraud. We are currently investigating more than 2400 mortgage fraud matters; more than double the number from just two years ago, and we've doubled the number of agents working on these cases throughout the country. We are investigating industry insiders; both those who knowingly participated in fraudulent transactions and those who knew the risks and intentionally misrepresented those risks to homeowners and investors. We have developed new ways to detect and combat mortgage fraud. We are collecting and analyzing data to spot emerging trends and patterns, and we are using the full array of investigative techniques to find and stop criminals before the fact rather than after the damage has been done.

For example, this past April in Maryland we charged five defendants in a \$70 million mortgage fraud Ponzi scheme. These defendants allegedly tricked homeowners into pouring money into the defendants business with a false promise that revenue from that business would be used to pay off the homeowners' mortgages. In San Diego we charged 24 individuals under the racketeering statute in connection with a scheme that included more than 220 properties valued at more than \$100 million. The alleged leader of this group is a documented member of a well established and violent street gang. And in a case with a unique twist we worked with our partners in the Milwaukee police department to investigate a mortgage fraud scheme orchestrated by a convicted drug dealer.

Michael Lock and his conspirators ran a classic house flipping scheme with straw buyers, phony appraisals and forged bank records. They would obtain the loan money and divide the proceeds. Loans would then go into default and the homes into foreclosure. But the criminal activity did not end there. When Lock sold one of the houses in question the bodies of two suspected drug dealers were discovered buried under concrete slabs in the back yard. Lock is now serving two life sentences on homicide and kidnapping convictions and has been convicted of wire fraud arising out of the mortgage fraud scheme. We have cases similar to these across the country, and by that I mean the mortgage frauds, not necessarily the bodies that were found in the back yard.

Turning to corporate fraud, unfortunately, the picture is not any prettier when it comes to corporate fraud. Like mortgage fraud economic crimes are crimes of opportunity. New schemes are revealed every day with losses that once would have been unthinkable, but now are becoming commonplace. Currently we are investigating more than 580 corporate fraud cases and we have

more than 1300 securities fraud cases under investigation including the many Ponzi schemes so prevalent in the news today—from the high profile financiers such as Bernie Madoff to seemingly ordinary individuals from Arizona, Arkansas or Massachusetts, even Minnesota.

We are targeting accounting fraud, insider trading and deceptive sales practices. Once we identify the key players, we investigate and bring the appropriate charges. Agents and analysts on our corporate fraud response team, as an example, are specially trained to conduct complex investigations in a very short timeframe and they can be deployed at a moments notice across the country.

We do not take these investigations lightly nor do we open cases without careful consideration. We do recognize the impact that public disclosure of a criminal investigation may have on a company's reputation and on the market as a whole. These investigations further emphasize though the need for independent board members, auditors and outside counsel. Shareholders rely on a Board of Directors to serve as the corporate watchdog. But often we see conflicts of interest in the corporate suites.

We all understand that it is better for a company to self-report and to remediate its own wrong doing before the FBI and the Department of Justice become involved. Executives who let the situation escalate to the point of a sudden restatement and a resulting loss of shareholder confidence often do greater harm to the companies they are trying to protect than if they had exercised early intervention.

In my days in private practice I represented a number of executives who could rationalize every bad decision. None of them would have likened themselves to an organized criminal or a street thief. They would claim it was business as usual, that they were playing by the same rules as everyone else. They would say they were acting in the best interests of the company given the financial constraints and the pressures of running a business. And I would think to myself, you broke about 14 laws before breakfast how could you fail to see that what you were doing was wrong? I've also seen executives who did not start out intending to break the law, but they began to believe their own explanations. And it is a very slippery slope from behavior that skirts ethical or legal boundaries to behavior that crosses the line completely.

We in the FBI are best at our jobs when we have the trust of the American people. And the same can be said for the business community. If this financial crisis has taught us anything it may be that it is time for a cultural shift; a back to basics approach that incorporates sound business judgment, risk assessment and integrity from the top down.

Now let me spend a brief moment talking about another aspect of financial crime, economic crime, white collar crime and that is public corruption. Unfortunately, the private sector has, by no means, cornered the market on greed. Public corruption is the FBI's top priority and indeed has been the top priority in the criminal arena since September 11th. It is our top priority because public corruption strikes at the heart of good government. And while the vast numbers, the vast majority of public officials are honest in their work and are committed to serving their fellow citizens there are others some who have abused the public trust. We currently have more than

2500 public corruption investigations. In the last two years alone we have convicted nearly 1700 federal, state and local officials for abuse of the public trust.

For a nation that is built on the rule of law we can and we should do better. Whether the matter is local, national or international; whether it concerns millions of dollars or merely hundreds, there is no level of acceptable corruption. The violation of the trust is the same; the damage to the taxpayers is the same. One might ask what can the business community do to address public corruption? We can start by making every effort to recognize corruption when it is seen either at home, overseas, refuse to participate in corruption of any kind and finally you can call us. We're always anxious and willing to receive your calls.

One last question, and that is what do we see in the future? We and our counterparts in other agencies are working to prevent what has the potential to be the next wave of cases. Fraud and corruption related to the TARP funds and the stimulus package. These funds are inherently vulnerable to bribery, fraud, conflicts of interest and inclusion. There is an old adage that where there is money to made, fraud is not far behind like bees to honey. We faced a similar challenge with relief funding related to Hurricane Katrina. In the wake of that storm we created a task force to investigate cases of fraud and corruption and to identify areas where abuse was most likely to take place. And through the work of that task force we have 246 convictions in Mississippi and Louisiana.

But today we face a much different kind of storm, but the opportunities for criminal behavior, and indeed, the underlying greed remain the same. With trillions of dollars at stake from the

purchase of troubled assets to improvements in infrastructure, healthcare, energy, education even a small percentage of fraud would result in substantial taxpayer losses. We must collect the intelligence necessary to target the potential wastes and abuse at all levels and we must do so before it fully develops. And to that end we must be able to follow the money all the way down the line. We are working with the SEC, the Inspector General for the TARP, other multi-agency task forces and Inspectors General to identify where these funds are going and for what purpose. We want to ensure that these funds will be appropriately utilized and we will investigate and prosecute where necessary.

Our goal is to protect the financial services industry, and by extension, the economy. And to that end we will continue to target those with the opportunity and the intent to harm investor confidence and the public at large. One certainly does not need to be a Roosevelt scholar to know that in his opinion common sense was as important as education, courage of ones conviction's should always prevail and that integrity was the cornerstone of any endeavor; public or private.

In the past century we have seen great change for better and for worse, and while the players, the technology and the resulting damages may be novel corporate fraud and corruption are as old as time. And the best tools at our disposal are the same as those espoused by Roosevelt—hard work, credibility, courage and character. And it is my hope that by working together we can minimize fraud and corruption. We each have a role to play and together we can bring to light the wrong doing that threatens our economy, our security and the welfare of our nation. And

together we can strengthen our culture, the United States culture, of integrity. Thank you for having me today and God bless.

GLENN HUBBARD: Thank you very much. As is our...Assistant Managing Editor of the Wall Street Journal, Jules the first question to the Director comes from you.

JULES: Thank you Mr. Director, and thank for the work that you perform for our country. That's the easy part. I want to focus on two areas. Number one, the focus on financial fraud and raise some questions having to do with the FBI as a prevent organization or the FBI as a crime fighting organization. My second question will deal with the whole counter terrorism issue and the role the FBI should most effectively play; the crime fighting piece versus the intelligence piece. An issue that I know you're very familiar with and have been very involved in examining and considering.

ROBERT MUELLER: So to the first question, from my own experience, which is, of course, in the corporate sector, I find that there are certain organizations by culture, by orientation and by training are better at prevention than detection. I would say that's true of the auditing profession in my view. The FBI has a great and well earned reputation as a crime fighting organization, and one of the issues I would pose to you is who is going to own the responsibility? I know there are task forces and there committees which are inherently difficult to manage, but just looking at the TARP funds, the TAO funds and what will be taking place in the disposition of many so called toxic assets. There's going to be a huge sum of money moving around and opportunities for fraud.

Why is the FBI focused on the preventative piece when we have many other organizations in the private and public sector who, in my view, are better equipped? Most people in the room probably don't know how few special agents there are. You have a limited amount of manpower, and so my question specifically is prevention versus detection versus both and your policy setting as the head of the bureau.

ROBERT MUELLER: I tend to look at prevention and detection and conviction along a continuum. And you are more successful in the detection and the conviction if you have been in on the preventive stage. An example being we are working with Inspectors General now, and yes, the Inspectors General have the initial responsibility of putting into place those mechanisms that will prevent fraud, waste and abuse. But in working with them and looking down the road we want to make certain that the accounting mechanisms, the record keeping that is put into place right now is capable of providing us the information we will need when we detect fraud. And so, there are various roles to be played in preventing fraud in the first instance, but also going after the fraud once it occurs. And to the extent that we can incorporate work and task forces and work with the Inspector Generals I believe that we will be much more successful in both preventing fraud but also much successful in identifying that fraud and investigating it and prosecuting it down the road. That's in that white collar criminal arena.

JULES: Can you think of any examples where the FBI, in the context of financial fraud, has played any meaningful role prior to the last 12 months? From a preventative point of view.

ROBERT MUELLER: I think you're making a somewhat artificial distinction of preventive versus investigation. Yes, in the course of investigations, whether it be ourselves or in conjunction with the IG, we've had instances, I can't name one off the top of my head, where together we have identified a fraudulent scheme and terminated it through investigations and prosecution before it could go elsewhere. Across the country over the years we have worked very closely, as you well know, with the Inspectors General on government fraud with the other Inspectors General that...HUD and elsewhere to address both from the preventative side, but also from the investigation and conviction.

ALAN MURRAY: I want to go back to your points about mortgage fraud. You talked about a doubling of fraud cases, a doubling of your resources to combat mortgage fraud. I think we all know now that one of the things that happened in the last decade was an extraordinary abandonment of prudent lending standards. Mortgage loans were made with no down payments, mortgage loans were made with negative amortization and people were qualified based on their ability to pay the first year, but not the third year when it ballooned. And most significantly, mortgage loans where there were these no doc loans where you didn't really have to prove you had an income. It seems like all of that was an invitation to fraud, and I wonder how you feel about putting the burden now on the FBI to clean that up if the fundamental problem was ludicrously lax lending standards?

ROBERT MUELLER: Well I think both of my remarks and observers I think we would both say that there are many factors that contribute to the financial plight that we're in now in the mortgage, in the subprime mortgage fraud crisis. A piece of that was intentional fraud that

should be investigated and prosecuted and the individuals responsible go to jail. But it is a slice of it. And what I tried to articulate in my remarks was exactly that, it's a much larger problem than just those individuals who committed fraud.

I'll tell you an agent, anecdotally, an agent I talked to maybe a couple of months ago about he was doing these types of cases back in 2000, 2001, 2002. He said we had some success in addressing these cases. He said then the housing market was going up so fast that even if you found fraud you would find no loss to the investors. And so the continued upturn in the housing market eliminated the loss to investors because you turned around and you could sell it for a higher price. And so fraud was a part of it, but it was not the sole reason for it nor do I think necessarily that it is a principle reason for the economic plight that we're in today.

JULES: Director Mueller let me shift to my second area, which is the fight against counter terrorism. And we have present today Commissioner Kelly and former Commissioner Safir, and I know the partnership has been a terrific partnership. My question is a focus question, and I'm back to prevention and detection but in a different venue. This time the venue is in the area of counterterrorism given the limitation of resources that you have. As a crime fighting organization my own experience is people who are crime fighters tend not to be particularly good at intelligence activities. My personal experience. So my question for you is this: there are other countries around the world who have divided the responsibility for intelligence gathering versus crime fighting. And if you could, could you make the case for why we need to keep both functions inside the bureau when the need for crime fighting will always be substantial?

Whether it's financial fraud, whether it's violence, whatever it is, please make the case for us why the intelligence function should remain inside of one organization from your perspective.

ROBERT MUELLER: You're eluding to domestic intelligence agencies around the world whether it be MI5 or CSIS and the like where there is a separate agency. I think what you will find if you go back and look at a number of these agencies is that they understand there has to be a closer connection with the law enforcement entities. The first reason why we need to have it within our organization is because whenever you pass off a case; if you have developed a case as an intelligence case and then you want to pass it off for a conviction, inevitably there is a drop in the knowledge of the agents or the officers in passing the case on.

And the other thing that is often overlooked, particularly in the United States, is the incentive for that agency to gather intelligence through the criminal justice process. One of the things that you have happening in almost all of our cases around the country is that one or more of the persons in our plea bargaining system will ultimately cooperate and give us intelligence. We would call it, in some circumstances in the past, we'd go to the person who wants to cooperate and say okay what can you tell me about your conspirators in this particular illegal case. Now we go back to them and say what can you tell me about terrorism in the United States or overseas. And so having that continuum; the development of the intelligence, the use of that intelligence to develop a case and then utilizing that case and convicting the person, but also out of that case comes intelligence that feeds back into the cycle is tremendously important.

Another point I'd make on this: if you look at what we are good at as a law enforcement agency we're good at interviews and interrogation. Developing sources, human it would be called in the intelligence community. We're good at wire taps whether it be for national security or criminal, we call it title three or FISA. Better wires, the same type of thing that is done by the NSA. We also do forensics, whether it be DNA, fingerprints and the like. And lastly is surveillance. What we do in all those four arenas is collect information. Now in the past, yes, there is a mentality of you're collecting evidence as opposed to information. But the fact of the matter is you are collecting information, and out of that information you have a much broader view of the gaps that you're missing in terms of identifying threats down the road. And so what we do if you use the intelligence community jargon is we are collectors.

What we have not done well in the past is understand that our domain, we have to identify the threats, understand what we know, identify the gaps in what we know and then collect against those gaps which is a kind of cycle that is seen in the intelligence community. But having it wrapped up in one organization in my mind gives you a much broader capability to identify the threat, fill the gaps of that threat, and then where appropriate, investigate, indict and then start the cycle again.

One last piece of it, and that is, we as an organization believe strongly as a principle that we are there to protect the civil liberties and the privacy rights of individuals. That is inculcated in every agent coming out of Quantico, and it is important that we keep that in mind when we are utilizing intelligence, and our organization, I believe, keeps that foremost in its mind when it's

doing its work, and I am not certain that an untethered separate domestic intelligence agency would have the same appreciation of the importance of those particular elements.

I'll make one last point because Ray Kelly is here, who does this terrific job, and to a certain extent we've learned from Ray. And one of the things, the next time Ray is up here talking, ask him about the necessity of combining intelligence with the operations because he has been one of the foremost advocates of that and has done terrific job at it.

ALAN MURRAY: Mr. Director sticking with counter terrorism, can you talk about how counter terrorism strategy and/or tactics have changed under the new administration? And particularly comment on your recent comments before Congress suggesting that Guantanamo should not be closed after the President said that it should.

ROBERT MUELLER: Let me address the latter first because that was not my testimony at all.

ALAN MURRAY: That will be your longer answer I'm sure.

ROBERT MUELLER: No, it's a short answer, that was not my testimony. I stayed away in my previous testimony from opining on what should happen with regard to Guantanamo, there's a policy decision in the Department of Justice and the Administration and to the extent that there are areas in which we will play a role, we will end up playing a role depending on what is done as a result of the consultations that are ongoing.

I have seen, in terms of the new administration, no diminution whatsoever in the interest of the President or the National Security Council when it comes to addressing terrorism. It has been constant throughout and under each administration I firmly believe that the person in charge has a great and deep understanding of the responsibility to protect the American people. And whether it be the previous President or this President I have seen exactly the same understanding and commitment to protecting the American people.

JULES: If we are going to keep the financial fraud at a level that is more acceptable to the society at a point in time when there are trillions of dollars of decisions and activities going to be taking place, what additional resources do you need to play that role? I know you have announced a mission to hire more agents, particularly with financial and legal backgrounds. What is really going to be required to get the job done, not only in terms of people power, but also in terms of making up for what has historically been a weak IT capability, which will be ever more important given the mission that you've announced that you are undertaking regarding these initiatives?

ROBERT MUELLER: Let me, again, look at the question itself. Our IT capability has improved dramatically since September 11th. We can always use, as could any entity, more resources in that regard. We had to, in the wake of September 11th, to address the threat of attacks that appeared to be imminent at that time. I transferred almost 2000 agents from the criminal side of the house to counterterrorism. And over the years since then to the extent that we've have budget enhancements and increases has been mostly on the national security side.

We have not had an opportunity to backfill those agents that had come from the criminal side, albeit many of them had been doing narcotics cases and smaller white collar criminal cases, but nonetheless as we face the mortgage fraud crisis, the investigations into corporations and the like, we have made requests to Congress and Congress has been providing those resources, and I'm going to testify in a couple days before the Senate Appropriations Committee and will continue the dialogue as to obtaining those additional resources.

GLENN HUBBARD: Thank you very much.

(END)