

## IN THE NEWS

VOLUME 1 ISSUE 19

AUGUST 3, 2008

### Austere Budgets Ahead

**F**oreword: There will be much said about the efforts to help the working poor achieve the American dream of home ownership. Concurrent with this humanitarian goal is the subprime crisis. For example, an Adjustable Rate Mortgage (ARM), a subprime, is a riskier type of mortgage, perhaps best described by the current Fed Chairman: *Subprime mortgages are loans made to borrowers who are perceived to have high credit risk, often because they lack a strong credit history or have other characteristics that are associated with high probabilities of default* [2]. With relaxation in mortgage practices came increases in fraud. It was estimated that from 2003 to 2006 mortgage fraud more than doubled with \$1 to 6 billion for 2005 alone [2]. With the costs of the mortgage bailout still an unknown, the question is how long can we continue to fund various Government programs?

The White House is projecting a Federal budget deficit of \$482 billion with Treasury Bill borrowing totaling \$555 billion [3]. The total public debt is currently \$ 9.5 trillion [4]. As bad as the Federal deficit is; the trade deficit is growing faster at approximately \$2 billion per day [5]. Consider the trade deficit is greater than \$7 trillion.



This later is a redistribution of wealth that will make funding the Government more challenging as the tax base continues to plummet. This is like having 7 million millionaires leave the country. Moreover, during the past week, General Motors reported their third largest quarterly loss of \$15.5 billion [6]. The question is how will Government continue to pay its bills? Past approaches included budget cuts and increased taxes. However, the trade deficit shows no sign of dramatic improvement so there will be less wealth to tax. In effect, we continue to allow countries such as China and Japan to improve their tax basis. This leaves only budget reductions. And, amongst the first items to get cut are quality and security.

1. Bernake, Ben S., 43rd Annual Conference on Bank Structure and Competition, *The subprime mortgage market*, May 17, 2007.

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### Identity Theft

**W**hen a person is a victim of identity theft, it may be difficult to determine the source of the data breach. After receiving multiple letters from financial and medical institutions that my personal information has been compromised; how would I

determine which of the may compromises was the culprit? And in a growing number of cases, bad actors are exploiting a person's identity without an actual data breach. For example, one report indicates that criminals are opening home equity lines of credit un-

knownst to home owners [1]. The personal computer has made identity theft easier. Consider that when you write a check it includes your signature and bank information. These can easily be forged. To illustrate the ease, consider one Utah woman created 83

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#### Special points of interest:

- Regulators close another bank

# Austere Budgets Ahead

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2. Trehan, Veena, NPR (Your Money), *The Mortgage Market: What Happened?*, April 26, 2007.
3. Pelofsky, Jeremy, and Lawder, David, Reuters, *White House sees record budget gap in 2009*, July 28, 2008.

4. Department of Treasury, [www.treasurydirect.gov/NP/BPDLogin?](http://www.treasurydirect.gov/NP/BPDLogin?application=np)



5. [www.bea.gov/newsreleases/international/trade/2008/pdf/trad0508.pdf](http://www.bea.gov/newsreleases/international/trade/2008/pdf/trad0508.pdf)
6. Krisher, Tom, and Durbin, Dee-Ann, AP, *GM posts \$15.5B 2Q loss, 3rd-worst in its history*, August 1, 2008.

## Cyber-Crime

By one estimate, 41 % of the Internet is still vulnerable to the recent DNS cache poisoning attack [1]. One report suggests that in the first six months of 2008, 75% of legitimate websites were compromised [2].

So what might we expect next from cyber criminals? Cyber criminals have let loose a virus called Limbo 2 Trojan designed to steal on-line banking logon information [3]. Cyber criminals have more tools available to exploit their victims. Consider

one report indicates that malicious software (malware) has risen by 278 percent this year [4].

To predict what to expect next we can look overseas. In Korea 9 million credit records were obtained by a Chinese hacker and sold to Korean loan sharks for over \$2 million [5].

1. Markoff, John, New York Times, *With Security at Risk, a Push to Patch the Web*, July 30, 3008.
2. Ashford, Warwick, Computer Weekly, *Hackers exploit website reputations,*

*says Websense*, July 30, 2008.

3. Magee, Bill, The Scotsman (UK), *Banks warned of computer 'super bug' that can change identity*, July 27, 2008.
4. Jowitt, Tom, CIO/Techworld, *Study finds huge rise in malware this year*, July 21, 2008.
5. Leyden, John, The Register (UK), *Korean loan sharks feed on hacked data*, July 28, 2008.

## Identity Theft

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fraudulent checks using her PC; including one check for a Salt Lake County deputy district attorney [2].

In California, the FBI arrested a former Countrywide employee for an alleged scheme going back 2 years to sell sensitive information on up to 2 million mortgage applications [3]. So far, 19,000 Countrywide customers have been notified their identity was stolen [4]. An interesting point is that the Countrywide identity theft goes back two years, just before the subprime crisis. Now that law enforce-

ment is focusing more on mortgage related crimes, we are starting to see the types of crime that have been ongoing but not detected.

Stolen laptops, containing personal information on employees continues. Employees of Bush Gardens were informed that laptops with their SSNs and other private information were stolen [5].

1. Tedeschi, Bob, New York Times, *Thieves Tap Into Home Equity*, July 29, 2008.
2. Manson, Pamela, The Salt Lake Tribune, *Prison*

*for woman who forged DA's name as part ID theft ring*, July 31, 2008.

3. Reckard, E. Scott, and Menn, Joseph, Los Angeles Times, *Countrywide insider stole mortgage applicants' data, FBI says*, August 2, 2008.
4. Watkins, Thomas, AP/San Francisco Chronicle, *Two charged in scam to sell Countrywide data*, August 1, 2008.
5. WTSP, *Busch Gardens employees victims of identity theft*, July 31, 2008.

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*Thieves from outside can be guarded against, but how to handle the ones inside?—Anonymous*

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## Mortgage Fraud

Mortgage fraud is rapidly becoming a major focus for law enforcement. Case in point, in Texas, U.S. Attorneys have identified mortgage fraud as a top priority [1]. Not surprisingly, in New York City, Rochester, and Long Island, where subprime mortgages were most common; mortgage fraud is up [2].

In Florida, three businessmen and a lawyer were indicted in a \$83 million mortgage fraud [3]. In New Jersey, the ringleader pleaded guilty to a \$20 million bank fraud scheme [4]. In Massachusetts, banking officials accused the president of a mortgage company, of forging signatures and destroying documents [5].

In Colorado, police led a raid on five homes and businesses as part of a large mortgage fraud investigation [6]. The focus of the investigation was forged documents, inflated home appraisals and fraudulently completed mortgage applications [7].

It seems that a number of people are getting caught up in mortgage fraud. For exam-

ple, in South Florida, police arrested three people in a \$284,000 mortgage scheme; including a convicted felon who served time for bank fraud [8]. Also in Florida, a jury convicted a former executive of mortgage fraud in connection with 130 loans worth \$13 million [9].

Perhaps the real story is not that mortgage fraud is on the rise but the problem is now being recognized. With the losses within the financial industry, there is now a close examination of the mortgage practices. What investigators are discovering is a large amount of fraud. Does this mean the fraud was always there, just never detected or is this something new? This is a classic example of responding to a problem after it has reached a crisis stage. Readers may recall that during the early days of identity theft, victims had a terrible time trying to get their records improved. As the frequency increased, victims are treated far better.

1. Flood, Mary, Houston Chronicle, *State's U.S. Attorneys: Mortgage fraud top priority*, July 31, 2008.

2. WCBS, *Mortgage Fraud Up in New York City, Long Island*, July 31, 2008.
3. Tampa Bay Journal, *Developers, lawyer indicted in \$83M mortgage fraud probe*, July 28, 2008.
4. FBI, *Ringleader of \$20 Million Bank Fraud Scheme Pleads Guilty*, July 28, 2008.
5. AP/Boston Globe, *President of mortgage companies denies fraud*, August 1, 2008.
6. KCNC/AP, *Police Raid Businesses For Alleged Mortgage Fraud*, August 1, 2008.
7. KUSA (9News), *Police raid homes, businesses in mortgage fraud investigation*, July 31, 2008.
8. WTVJ (NBC6), *Police Arrest 3 In Alleged Mortgage Fraud*, July 31, 2008.
9. AP, *Florida Jury Convicts Former Executive Of Mortgage Fraud*, July 31, 2008.

## Security Controls

Laptops continue to be a challenge in protecting information. Most of the sensitive information on Government laptops is unencrypted [1].

One approach to security is to ensure the latest security patches are applied. Patch management has become a major topic. However, with the rush to fix security exploits comes the realization that sometimes the fix does not work or introduces problems elsewhere. Case in point, reports indicate the

Apple's patch for the MacOS does not quite fix the problem [2].

The Black Hat hacker convention will take place next week in Las Vegas [3]. There researchers at Black Hat will demonstrate malicious software they developed to bypass security and take over web accounts [4]. That researchers should expend effort in developing code capable of exploiting security illustrates the challenges in applying a security program.

1. Gross, Grant, PC World, *Most Sensitive Data on*



*Government Laptops Unencrypted*, July 29, 2008.

2. Claburn, Thomas, Information Week, *Apple Security Patch Flubs DNS Fix*, August 1, 2008.
3. Krebs, Brian, Washington Post, *Black Hat Talk on Apple Encryption Flaw Pulled*, August 2, 2008.
4. Weil, Nancy, IDG News service, *Security, Security, More Security*, August 1, 2008.

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Anyone who trades liberty  
for security deserves neither  
liberty nor security—  
Benjamin Franklin

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## Mortgages

The long awaited mortgage bailout bill was signed by President Bush [1]. Without fanfare, the bill was quietly signed the bill that injects \$300 billion to help ease the crisis [2]. The bill is designed to help 400,000 homeowners facing foreclosure [3]. The value to mortgage holders is up to \$7,500 [4]. This comes at a time when Fannie Mae and Freddie Mac are likely to boost loss estimates [5].

Even with the Federal bailout, banks are trying to distance themselves from the mortgage market. Merrill Lynch agreed to sell \$30.6 billion of collateralized debt obligations to Lone Star Funds for \$ 6.7 billion [6]. Likewise, Lehman Brothers is trying to sell of \$30 billion worth of mortgage obligations [7]. Wachovia announced that most of the planned 4,400 job cuts to its mortgage unit will take place in November [8].

As financial institutions tighten the requirements for mortgage lending, getting a mortgage has become harder. Consequently, the number of mortgage applications has hit a yearly low [9].

1. Reuters, *Bush signs housing bill as Fannie Mae grows*, July 31, 2008.
2. Loven, Jennifer, *Bush quietly signs mortgage relief measure*, July 30, 2008.
3. Runnigen, Roger, Bloomberg, *Bush Signs Measure for Homeowners, Fannie, Freddie*, July 30, 2008.



4. Harney, Kenneth R., Los Angeles Times, *Tax credit for home buyers works like an interest-free loan*, August 3, 2008.
5. Yoon, Al, Washington Post, *Fannie, Freddie seen boosting loss estimates, again*, August 1, 2008.
6. Reuters, *Lehman in talks to sell \$30 bln mortgage assets*, August 1, 2008.
7. New York Times, *Lehman Said to Try Mortgage Fire-Sale of Its Own*, August 1, 2008.
8. Winston-Salem Journal, *Wachovia Corp. plans to cut mortgage jobs by November*, August 2, 2008.
9. Bernard, Stephen, and Elphinstone, J.W., AP, *Mortgage application volume hits 2008 low as refinancing gets tougher for strapped homeowners*, July 30, 2008.

## Financials

On the plus side, Chairman Bernanke indicated interest rates won't increase anytime soon [6]. During the week, banks borrowed a record amount from the Fed indicating there is still a lack of liquidity [7].

1. Giannone, Joseph A, and Stempel, Jonathan, Reuters, *Citigroup to be charged by Cuomo, faces SEC probe*, August 1, 2008.
2. Reuters, *Small Florida bank is 8th U.S. failure this year*, August 1, 2008.
3. Atlanta Business Chronicle, *SunTrust buys failed First Priority Bank*, August 1, 2008.
4. Stempel, Jonathan, Reuters, *IndyMac Bancorp files for Chapter 7 bankruptcy*, August 1, 2008.



5. Mishkin, Sarah, Financial Times, *FDIC warns four US banks over liquidity*, August 1, 2008.
6. Cooper, James, Business Week, *Bernanke and the Fed Won't Raise Rates Any Time Soon*, July 31, 2008.
7. Parry, John, Reuters, *Stressed banks borrow record amount from Fed*, July 31, 2008.

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*The reason there are so many imbeciles among imprisoned criminals is that an imbecile is so foolish even a detective can detect him—Austin*

O'Malley

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As if the staggering subprime losses were not enough, New York has accused Citigroup of repeatedly committing fraud and destroying subpoenaed records [1].

In Florida, the First Priority Bank with \$259 million in assets and \$227 million in deposits is the eight bank to fail this year [2]. The bank is being taken over by SunTrust [3].

In other news, IndyMac Bankcorp Inc., once one of the largest mortgage lenders, filed for Chapter 7 bankruptcy protection [4]. The FDIC warned four banks to cover potential loan losses (MetroPacific Bank; Bank Haven; Clarkston State Bank; and Hastings State Bank) [5].