ALL HAT, NO CATTLE

What the AML Professional Needs to Know About Cattle Fraud

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Executive Summary

Consider these recent headlines: “21st Century Cow Rustler Held on $1.5 Million Fraud Charge” (Cederlof, 2018); “Missouri Man Pleads Guilty to $4.7 Million Cattle Ponzi Scheme” (Bechtel, 2018); and “Texan Who Put Up Phantom Cattle as Collateral Jailed in $5.8 Million Fraud Case” (Gross, 2018).

Cattle fraud is an increasingly large source of illicit funds, much of which is subsequently laundered through financial institutions. This report explores some recent and significant cattle frauds, as well as how financial institutions can guard against fraudsters attempting to conduct money laundering through the financial system.

Cattle fraud is not new. Cases are documented throughout history, and include frauds identified in the 1800s and early 1900s (Beattie, 2017; Correa, 2018). A significant number of high profile cases were noted in the early 2000s, including the $166 million Ponzi scheme perpetrated by George Young and Kathleen McConnell (Zippay, 2004); Eastern Livestock’s $130 million bad check fraud (Seachirst, 2013); Rock McMahan’s $5.5 million loan default (Ulloa, 2018); and the identification by the Justice Department of two Mexican cattle ranches that were fronts for drug cartels (Hedges, 2005). This report includes an overview of some of the larger frauds uncovered or prosecuted in 2017 and 2018, as well as information for anti-money laundering (AML) professionals to consider in developing or refining an AML program that addresses cattle fraud. Although cattle fraud occurs around the globe, the scope and availability of information in the U.S. market will primarily serve to illustrate key concerns.

In Texas, saying someone is “all hat, no cattle” is to describe him as a phony, a poseur. He may have the Stetson hat, the Justin boots, and the pickup truck, but the closest he’s ever been to a cow is the meat case at the grocery store.

Throughout this report, references are made to law enforcement and industry sources. Information was gained through extensive interviews with subject matter experts; to protect the confidentiality of investigation and customer records, specific information is not attributed to any particular source.

Note that this report does not delve into securities or futures fraud concerns. These frauds certainly exist and can significantly impact a financial institution; however, that subject matter is outside the scope of this report.
Introduction: History

Cattle have been part of human lives for thousands of years. Cattle were domesticated in the eastern Sahara at least 9,000 years ago (Hirst, 2018) and brought to the New World by Columbus in 1493. Cortez took descendants of that same herd to Mexico 25 years later (Oregon State University, 2019). The first cow arrived in the Jamestown colony in 1611.

Recent DNA studies indicate that all of the world’s cattle not only came from the same area (what is now Iran) but also from the same small herd of approximately 80 animals (University College London, 2012).

From the earliest days, cattle have been treated as things of value, even as a form of currency (Davies & Bank, 2002). As a result, like all other forms of currency, cattle have often been the subject of theft and fraud. One of the more famous historical cases involved Daniel Drew in the mid-1800s, who started his disreputable activities by heavily watering his cattle prior to weighing for sale, thus inflating their weight in order to get paid more for them (Beattie, 2017). In 1903, in a broadly-published case at the time, John Coble embezzled funds by “buying” nonexistent cattle (Correa, 2018). Given today’s increased access to real-time news sources and data analysis tools, a modern AML professional could be forgiven for thinking that cattle fraud would be a dying crime. Unfortunately, cattle fraud continues to be a high impact and expensive crime in the 21st century. Indeed, cattle fraud can pose a serious money laundering risk to a financial institution.

Global Perspective and Capacity

All cows are cattle—but not all cattle are cows. “Cattle” is generally made up of heifers, cows, calves, steers, and bulls. Heifers are females that have never had a calf. Cows are females that have had at least one calf. Calves can be either male or female, but are less than a year old. Steers are neutered male cattle, and bulls are intact male cattle. (Crable, 2018)
Cattle are raised in virtually every country across the world and in every state in the United States. In the top-five cattle countries, there are more cows than people (National Agricultural Statistical Services, 2018).

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Cattle</th>
<th>People</th>
<th>Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Uruguay</td>
<td>11,845,000</td>
<td>3,444,071</td>
<td>3.44</td>
</tr>
<tr>
<td>2</td>
<td>New Zealand</td>
<td>9,903,000</td>
<td>4,565,185</td>
<td>2.17</td>
</tr>
<tr>
<td>3</td>
<td>Argentina</td>
<td>53,515,000</td>
<td>43,847,277</td>
<td>1.22</td>
</tr>
<tr>
<td>4</td>
<td>Australia</td>
<td>27,750,000</td>
<td>24,309,330</td>
<td>1.14</td>
</tr>
<tr>
<td>5</td>
<td>Brazil</td>
<td>226,037,000</td>
<td>209,567,920</td>
<td>1.08</td>
</tr>
<tr>
<td>6</td>
<td>Belarus</td>
<td>4,320,000</td>
<td>9,481,521</td>
<td>0.46</td>
</tr>
<tr>
<td>7</td>
<td>Canada</td>
<td>12,100,000</td>
<td>36,286,378</td>
<td>0.33</td>
</tr>
<tr>
<td>8</td>
<td>United States</td>
<td>95,500,000</td>
<td>324,118,787</td>
<td>0.29</td>
</tr>
<tr>
<td>9</td>
<td>India</td>
<td>303,350,000</td>
<td>1,326,801,576</td>
<td>0.23</td>
</tr>
<tr>
<td>10</td>
<td>Turkey</td>
<td>14,047,000</td>
<td>79,622,062</td>
<td>0.18</td>
</tr>
<tr>
<td></td>
<td><strong>WORLD</strong></td>
<td><strong>9,983,130,000</strong></td>
<td><strong>7,400,000,000</strong></td>
<td><strong>0.13</strong></td>
</tr>
</tbody>
</table>

In the United States, Texas ranks first for the number of total cattle, with more than 13% of the U.S. cattle population. The top-nine states have more than three million head of cattle each. (National Agricultural Statistical Services, 2018):
<table>
<thead>
<tr>
<th>Rank</th>
<th>State</th>
<th>2018 (000)</th>
<th>% of US</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Texas</td>
<td>12,500</td>
<td>13.24</td>
</tr>
<tr>
<td>2</td>
<td>Nebraska</td>
<td>6,800</td>
<td>7.2</td>
</tr>
<tr>
<td>3</td>
<td>Kansas</td>
<td>6,300</td>
<td>6.67</td>
</tr>
<tr>
<td>4</td>
<td>California</td>
<td>5,200</td>
<td>5.51</td>
</tr>
<tr>
<td>5</td>
<td>Oklahoma</td>
<td>5,100</td>
<td>5.4</td>
</tr>
<tr>
<td>6</td>
<td>Missouri</td>
<td>4,450</td>
<td>4.71</td>
</tr>
<tr>
<td>7</td>
<td>Iowa</td>
<td>4,000</td>
<td>4.24</td>
</tr>
<tr>
<td>8</td>
<td>South Dakota</td>
<td>4,000</td>
<td>4.24</td>
</tr>
<tr>
<td>9</td>
<td>Wisconsin</td>
<td>3,500</td>
<td>3.71</td>
</tr>
<tr>
<td>10</td>
<td>Colorado</td>
<td>2,850</td>
<td>3.02</td>
</tr>
</tbody>
</table>

To give a more graphic representation of the number and spread of cattle across the United States, consider this map from 2012 (National Agricultural Statistical Services, 2012):
As shown by the data above, the potential for cattle fraud is facilitated by the sheer number of cattle around the world and across the United States. It is further exacerbated by the value placed on those cattle. The Oklahoma Department of Agriculture Food and Forestry Special Agents have stated that “(Cattle) rustling is an extremely lucrative crime. Where other stolen items are sold for pennies on the dollar, cattle are worth the same price whether sold by the owners or thieves” (Rapp, 2017). Cattle production accounted for $78.2 billion in annual cash receipts during 2015, as compared to $272.9 thousand in 1900 (approximately $7.7 million when adjusted for inflation to 2015 prices) (National Agricultural Statistical Services, 2016; National Bureau of Economic Research, 2019; Bureau of Labor Statistics, n.d.).

As cattle become a more valuable commodity, so does the potential for those who seek to profit from them, both legally and illicitly. Sociologist William Graham Sumner is said to have written that “Undoubtedly there are... cases of fraud, swindling, and other financial crimes; that is to say, the greed and selfishness of men are perpetual” (BrainyQuote, n.d.). Former Federal Reserve Chairman Alan Greenspan echoed that sentiment in saying “Corruption, embezzlement, fraud, these are all characteristics which exist everywhere. It is regrettably the
way human nature functions, whether we like it or not. What successful economies do is keep it to a minimum. No one has ever eliminated any of that stuff” (BrainyQuote, n.d.).

Once a fraud is perpetrated, what happens to the money? Fraud and money laundering are intrinsically linked, as the fraudster’s attempt to take advantage of ill-gotten gains becomes money laundering (Jadavji, 2011). Money laundering, at its core, becomes a question of the source of funds; funds stemming from a cattle fraud, an illegal activity, therefore clearly become a concern for AML efforts. The Internet and improved communications systems make it even easier for cattle fraudsters to reach a larger market of unsuspecting targets and to move money more quickly.

Given the potential for cattle fraud across the world, the inherent link to money laundering, and the rising impacts of such fraud on financial institutions, it behooves the well-informed AML professional to be aware of the potential for fraud, risks, and mitigating factors which should be considered.
Types and Impact of Frauds in Recent Years

To provide some color around the types and impact of recent cattle frauds, the following table presents a quick summary of significant cases prosecuted or uncovered in 2017 and 2018:

<table>
<thead>
<tr>
<th>Time Frame</th>
<th>Fraudster</th>
<th>Summary</th>
<th>Financial Impact</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 2017</td>
<td>Tony Lyon</td>
<td>Created false invoices and reimbursed himself for sales on cattle that never existed</td>
<td>$87 million</td>
<td>Bell Nunnnelly &amp; Martin LLP, 2017</td>
</tr>
<tr>
<td>July 2017</td>
<td>Brian Jones</td>
<td>Ponzi scheme</td>
<td>$473,000</td>
<td>AG Daily, 2018</td>
</tr>
<tr>
<td>September 2017</td>
<td>Clint Hager</td>
<td>Embezzlement of investor funds</td>
<td>$4.7 million</td>
<td>Bechtel (1), 2018</td>
</tr>
<tr>
<td>December 2017</td>
<td>Justin Greer</td>
<td>Cattle theft, investment fraud, embezzlement</td>
<td>$1.5 million</td>
<td>Cederlof, 2018</td>
</tr>
<tr>
<td>April 2018</td>
<td>Marty Maahs</td>
<td>Defaulted on loans secured by cattle, sold cattle out of trust, embezzled livestock funds</td>
<td>$1 million</td>
<td>Franklin, 2018</td>
</tr>
<tr>
<td>June 2018</td>
<td>Howard Hinkle</td>
<td>Defaulted on loans secured by cattle that never existed</td>
<td>$5.8 million</td>
<td>Gross, 2018</td>
</tr>
<tr>
<td>July 2018</td>
<td>Aaron Podzimek</td>
<td>Theft of cattle and embezzlement of feed checks</td>
<td>$350,000</td>
<td>Pfankuch, 2018</td>
</tr>
<tr>
<td>August 2018</td>
<td>Darrell Hartley</td>
<td>Wire fraud and falsified records for loan secured by cattle that did not exist</td>
<td>$2.1 million</td>
<td>Bechtel (2), 2018</td>
</tr>
<tr>
<td>September 2018</td>
<td>Seth Nichols</td>
<td>Money missing from stockyard accounts and line of credit</td>
<td>$3.3 million</td>
<td>Prendergast, 2018</td>
</tr>
<tr>
<td>September 2018</td>
<td>Chakota Snow</td>
<td>Bad checks for cattle purchases</td>
<td>$427,000</td>
<td>TSCRA, 2018</td>
</tr>
<tr>
<td>December 2018</td>
<td>Dwight Cox</td>
<td>False invoices submitted for reimbursement</td>
<td>$2.4 million</td>
<td>U.S. Attorney’s Office, 2018</td>
</tr>
<tr>
<td>December 2018</td>
<td>NA</td>
<td>Falsified records and accounts <em>(currently under investigation, litigation pending)</em></td>
<td>$15 million</td>
<td>NA</td>
</tr>
</tbody>
</table>

Additional details by type of fraud are shown below:
No Cows *(fictitious cattle used as collateral for a scheme)*

Tony Lyon defrauded Midwestern Cattle in 133 false transactions, involving over 50,000 head of cattle sold to the fictitious George Cattle Company. Lyon handled purchase, payment, and alleged delivery of the fictitious cattle, and was able to issue large checks from the George Cattle Company account which he would then recoup with a check drawn on Midwestern Cattle. Things fell apart when a $5 million check bounced. Lyon was subsequently charged with check and wire fraud. A jury unanimously awarded Midwestern $23.1 million in the January 2017 trial. (Bell Nunnally & Martin, 2017)

Clinton Hager convinced victims to invest $4.7 million in a fund he claimed would be purchasing cattle for resale at a profit. Instead, Hager diverted funds for his personal use, paying his mortgage, buying new trucks, and depositing money into his own accounts. Hager was convicted of money laundering and wire fraud. This case also involved Robert Hawkins posing as a veterinarian to falsify cattle inspections. (Bechtel, 2018)

Similarly, Darrell Hartley falsified loan records and wire transfer documents that allegedly supported his cattle business. Hartley borrowed $8 million, purportedly to support his operations in multiple states. However, in 2015, he started overstating the number of cattle he owned. When the bankers began asking to see the operations in 2017, Hartley admitted he had been falsifying the numbers for over two years. Hartley was convicted of wire fraud. (Bechtel, 2018)

Dwight Cox was in partnership with the Texas Beef Cattle Company. Texas Beef would put up the money for Cox to buy cattle at auction, which he was to raise, and then ship to Texas when they reached a certain weight. Upon sale, Cox was to split the profit with Texas Beef to repay their investment. Beginning in 2017, Cox provided Texas Beef with 35 invoices indicating he had purchased 3,250 head of cattle for $2.6 million. However, Cox told prosecutors that he actually bought 147 head for about $155 thousand and pocketed the difference. This fraud fell apart in February 2018, when Texas Beef asked Cox to deliver the nonexistent cattle. (U.S. Attorney's Office, 2018)

An industry source reported a case that is being investigated at the time of this report’s development that is estimated at $15 million and climbing. In this case, money was being wired or deposited by check into a variety of financial institutions, with notations referencing various head of cattle being “purchased.” The funds were either left dormant for an extended period of time, or transferred to an apparently unrelated third party, and eventually wired to Mexico. Investigations have uncovered that no cattle were actually transferred, and the monies were used to fund drug activities in Mexico. *Because this is an active investigation, no names are provided at this time.*
Wrong Cows (there are cows, but they don’t belong to the borrower)

Justin Greer, a cattle broker and herd manager, was arrested in December 2017. Greer’s fraud combined both fictitious cows and misleading cows—cows that existed but were not his to offer as collateral or to sell. The fraud began to unravel when Greer could not meet his loan payments in the spring of 2017, and investors began to grow suspicious. Greer had multiple accounts at various financial institutions and was able to conceal his fraud for a time by moving money through them. (Cederlof, 2018)

In a similar case, Howard Hinkle led a bank to believe he had multiple herds in various locations. Hinkle took out almost $6 million in loans secured by these cattle. Similar to Greer, the case was uncovered when the borrower fell behind in loan payments, and the account officers soon discovered that the collateral herds did not actually belong to Hinkle. Hinkle alleged he was in partnership with the actual owners, but the bank did not follow up sufficiently at the time the loan was originated, and the real owners had no idea that Hinkle was getting loans secured by their cattle. When the bank sent someone to collect the cattle, they were met by the actual owners, who had never heard of Hinkle, and the bank was left with no collateral to repay their loans. (Gross, 2018)

Birth and Death Frauds

In birth fraud, often known as DNA fraud, a rancher purchases bull semen from a champion bull or a stronger breed than he is currently raising. Problems are typically not noted until several years later, when calves produced by the purchased semen do not evidence the traits for which the rancher was breeding, and DNA tests determine that the buyer did not receive what he paid for and expected. Cases of this type may also involve falsification of records, either by veterinarians or by labs.

In a somewhat different twist, law enforcement described what they referred to as “cattle laundering.” In this scenario, cows are stolen and pastured in a remote location. Over the years, these cattle are bred to produce an ongoing supply of calves. The fraudster never sells the original cows, which may be branded or tagged. Instead, the fraudster sells off the calves, which are not marked. Law enforcement refers to this as cattle laundering because it is a renewable resource of “clean” cattle and funds.

In death, or slaughter, fraud, law enforcement and industry sources reported cases in which ranchers falsely reported death and made claims to their insurance company. In one case described by law enforcement, the rancher provided ears allegedly from the deceased cattle. It was later determined that the rancher had been buying ears from the slaughter yard, and the collateral cattle sold “off the books” elsewhere. In another case discussed by an industry insider, a borrower told the financial institution that several of the cattle used to secure a loan...
had been killed in a lightning strike. Investigation later revealed that the cattle were sold in another state; prosecution of the case was hampered by the fact that the institution had not required proof of evidence that the cattle had been killed.

**Bad Actors**

An example of a fraud perpetrated by a bad actor is the Marana Stockyards & Livestock Market case involving Seth Nichols. Office manager Nichols admitted to using the Stockyard’s line of credit to buy cattle at auctions on behalf of his family’s company; the cattle were then sold off but he kept the proceeds, instead of making the Stockyard whole. Additionally, Nichols paid his family’s company directly from the Stockyard’s bank account. He attempted to conceal the fraud with dummy wire transfer records, and falsified financial statements to give the appearance that the Stockyard was fully solvent. Total value of cattle and funds stolen was estimated at approximately $3 million. Nichols has been convicted of bank fraud, and the Stockyard is reportedly in severe financial distress. (Prendergast, 2018)

Industry sources note that cattle brokers and sale barns often represent additional exposure for fraud. These businesses do not hold the cattle themselves; they buy and sell for other people, which can present numerous opportunities for fraud. Large amounts of money move in and out of the accounts quickly, and there is frequently no stock on hand to inspect or take as collateral. Multiple banks may be involved, which muddies the trail, and no single institution is getting the full picture.

Ponzi schemes have also been noted. For example, Brian Jones bought bull calves from dairy farms in Wisconsin, where they were not needed to increase the dairy herds, and then sold them to ranches in Texas and Missouri for beef or breeding operations. Starting in 2015, he sought outside investors for his operations, promising substantive profits on their initial shares. Instead of investing the funds in cattle, he used the money for gambling, and to pay off some of the early investors to give the appearance that the business was functional – a classic hallmark of a Ponzi scheme. (AGDAILY, 2018)

Clearly, with the increasingly large cattle frauds being perpetrated, it is in the best interest of the cattle industry, law enforcement, and financial institutions to work together to minimize the exposure and impact of such frauds. AML professionals can and should provide support to their institutions to prevent and identify early warning signs of cattle frauds.

**Risk Assessment**

AML officers working with financial institutions operating in or nearby agricultural areas should routinely include consideration of the potential for cattle fraud in BSA/AML risk assessments. The *FFIEC BSA/AML Examination Manual* states that “a well-developed risk
assessment will assist in identifying the bank’s BSA/AML risk profile. Understanding the risk profile enables the bank to apply appropriate risk management processes to the BSA/AML compliance program to mitigate risk. This risk assessment process enables management to better identify and mitigate gaps in the bank’s controls. The risk assessment should provide a comprehensive analysis of the BSA/AML risks in a concise and organized presentation, and should be shared and communicated with all business lines across the bank, board of directors, management, and appropriate staff” (Federal Financial Institutions Examination Council, 2010). Even institutions which do not specifically make loans secured by cattle may find they have underestimated exposure in other business with cattlemen and related entities and suppliers. As discussed above, cattle operations represent significant exposure, and frauds can present multimillion dollar risks to financial institutions operating in or adjacent to this sector.

Mitigation efforts should start with the account officer but must also include AML officers to the extent necessary. Some key mitigating factors, stressed by both law enforcement and industry participants who have fallen victim to cattle fraud, include:

A) **Knowing the customer and their business** bears emphasizing as it is the most basic preventative available. The financial institution should thoroughly understand the following information:

- The operation’s background, history, reputation, and management structure
- Geographic locations, trade area, and scale of operations
- Herd size, type, and herd management practices
- Finances, including other borrowing lines and exposures
- Vendors, suppliers, customers, and employees and
- Any other relevant factors

Lack of understanding of the business, which can translate into deficiencies in understanding of the AML risks, should result in the account opening being delayed or made conditional. All information should be documented within the institution’s files, with as much specific detail as possible—an area that law enforcement responsible for investigating cattle fraud says has been deficient in many of the cases they have reviewed in the past. Some of the elements specifically recommended by law enforcement for documentation include the following actions:

- Geocoding the field locations and listing the number and types of cattle managed
- Obtaining information on who owns the land and whether there is a lease agreement with the rancher with whom the institution is doing business (a key factor in the Hinkle case)
• Conducting background searches, engaging in conversation with peers, calling industry experts, and obtaining references from other financial institutions prior to committing to substantive relationships with new cattle operations
• Inquiring as to the source and ages of new cattle, which may identify a potential fraud and money laundering scheme in the initial stages (Ranchers who unintentionally purchase stolen cattle online, particularly in mixed-age lots, were confirmed as an increasing concern by other financial industry sources [Rapp, 2017].)

The institution may wish to consider implementing added safeguards if it is lending on cattle, such as requiring branding and more frequent, surprise inspections, or taking additional collateral. If dealing with a broker or sale barn where there is significant movement of both cattle and funds, the institution can offset the risk of transient collateral by requiring the customer to either maintain corresponding pledged deposits or to have a secured line of credit with collateral other than the cattle.

Caution should be taken with new customers. If this is a new or unusual venture for the financial institution, management should carefully consider the capacity to adequately manage risks associated with this line of business, including the AML risks. Adding additional cross-checks, documentation requirements, and follow-through by account officers can help to prevent fraud and subsequent money laundering from being initiated or continued at the institution.

B) Understand the business in the context of what is considered normal for the area in which the institution or the customer is operating. During ongoing customer due diligence and suspicious activity monitoring, AML professionals should consider whether the transactions occurring in and through the account make sense for the industry and for the stated business. For example, some questions that may arise are:

• Are fund transfers overly complicated or routed through multiple financial institutions?
• Is the rancher new to the area or does he have established contacts in the area?
• If the rancher is new to the area or seems to be suddenly managing a new large herd or a different breed, does the rancher have the background and experience necessary to appropriately manage the activity?

AML professionals should work closely with the account officer to ensure that a full understanding of the customer’s business allows them to recognize unusual or suspicious activity, including warning signs which may not flow through an account at the institution. The institution should request copies of purchase and sale invoices and shipping documentation to support lines of credit and patterns of deposit activity, as well as any required state or federal forms, such as vaccination and inspection records, slaughter receipts, etc. Conducting surprise
counts of herds and having appraisals and inspections done on a regular basis by qualified, independent individuals will provide additional assurances that the business is not being used to perpetrate or continue fraud and money laundering. Customer and account risk scoring, monitoring, and AML training should routinely include cattle fraud.

Law enforcement and industry sources also emphasize that the institution should not rely solely or even primarily on assessment of character—some of the largest frauds were perpetrated because the con man was charming and likeable or told a good story.

Cattle operations are regulated by the Packers & Stockyards Program, a division of the Grain Inspection, Packers, and Stockyards Administration, which is in turn an agency within the U.S. Department of Agriculture (USDA). Under this program, agents may conduct inspections and investigations, and have the authority to issue letters of complaint and fines against operations deemed not in compliance (National Agricultural Law Center, 2019). These letters and fines are made public on the USDA’s website and may be researched or referenced during ongoing due diligence and account monitoring.

Several industry insiders noted that falling cattle prices in 2015 coupled with a rising drug problem in Oklahoma was the impetus for small rancher fraud, as families struggled to deal with a child’s or grandchild’s addiction, so AML officers should be familiar with industry pricing trends. Industry insiders and law enforcement also caution financial institutions to watch for customers who appear to be living beyond their means. This was a warning sign in both the Greer and Hager cases.

C) Insurance considerations should recognize that insurance can be both a fraud prevention tool and an incentive to commit fraud; knowing what animals are covered and for how much can help to provide a framework around activity. Developing and maintaining a good working relationship with the insurance agent assigned to the customer and sharing information regularly can help to prevent or recognize fraud and money laundering at an early stage.

D) Staffing and training at the institution should address cattle fraud and the potential for money laundering. Fraud and loss prevention are often much more costly after the fact than in properly applying initial preventative measures. The AML officer must have sufficient information and access to be aware of cattle fraud exposure, as well as sufficient authority to manage an effective AML compliance program appropriate to the institution’s risk profile. Management should ensure that the AML officer is kept apprised of information that may identify cattle fraud, and has both the stature and authority to implement sufficient measures to minimize the institution’s exposure.

E) Internal review, appraisers, and independent auditors should specifically evaluate the institution’s risk for cattle fraud when performing reviews of transactions, records, and
documents. Financial institution management should ensure review, appraisal, and audit staff are independent of the lines of business involved and have sufficient knowledge or expertise prior to being engaged. The Hartley case, for example, was at least partially identified as a result of an internal audit. To ensure sufficient review of AML, as noted in the FFIEC Examination Manual, the review should include appropriate risk-based transaction testing, evaluation of the effectiveness of the AML monitoring system, and an assessment of identification and reporting of suspicious activity. (Federal Financial Institutions, 2010)

Potential for Money Laundering

The University of New England (Australia) has published a fact sheet covering crime prevention on farms that lays out the situation clearly: “The excellent prices received for cattle...makes stock theft a very lucrative business. Not only do producers incur significant financial losses, there is the loss of future breeding herds and bloodlines. Police emphasize the importance of stock identification and accurate farm records for tracing stolen stock” (School of Behavioural..., n.d.). Cattle fraud can affect a financial institution at multiple levels, as the fraudster attempts to deposit, move, and/or remove illicit funds from a financial institution. Financial institutions, therefore, should consider the implications of cattle fraud at a variety of checkpoints in the AML process.

Experienced AML officers may be thinking, “Cattle fraud sounds suspiciously like trade-based money laundering (TBML).” In fact, cattle fraud could be considered TBML, provided that the activity involves two or more countries. Even in a domestic scenario, cattle fraud can look a lot like TBML, as it often involves moving stolen goods, fabricating, or altering documentation, and misrepresenting trade-based activity for the purpose of hiding criminal proceeds, all of which are hallmarks of TBML. (DHS, 2018)

The following points, broken down by line of business, may be useful in potentially identifying cattle fraud and associated money laundering:

A) Transaction Accounts – The number of parties involved in cattle transactions increases the potential for money laundering and the ability to hide ongoing fraudulent behavior. Cattle operations often include breeders, ranchers, farmhands, leaseholders, cattle brokers, lenders, feed suppliers, sale barns, and transportation companies, all of which may be subject to fraud or abuse. Identifying all of the players may take time but can provide valuable insight into operations and patterns of money movement. Additionally, identifying businesses which have overlapping interests may identify exposure, such as in the Lyon case, when the fact that Lyon was both an owner of vendor George Cattle and someone with account signing authority over Midwestern operations should have raised red flags.
Similarly, the sheer volume of transactions involved in normal cattle ranching operations makes it easy for illicit activity to be hidden within the legal transactions and to avoid detection. Normal operations, including source and use of funds, as well as the cause for sudden changes in amounts, volume, or direction of transactions, should be documented and well understood.

In the Lyon case, the fraud detection was triggered by review of a bounced check. AML monitoring tools should therefore routinely include both transactional analysis and review of checks returned or submitted twice due to insufficient funds. USDA inspections also include periodic reviews over financial operations and may identify weaknesses that have not yet been uncovered at the financial institution. AML and fraud monitoring systems which identify rapid money movement should be tuned to ensure cattle operations are accurately recognized and analyzed.

B) Loan Accounts – As noted in the Greer, Hinkle, Maahs, and Nichols cases, missed payments eventually exposed the fraud, and as a result, AML monitoring should include late or missed payments with an eye to the potential for cattle fraud. However, note that cattle fraud often combines both trade and finance elements. Financial institutions can miss red flags and money laundering indicators by incorrectly assuming that a transaction monitoring system will sufficiently identify concerns. AML and lending staff should work together to promote transparency and proactive measures such as requiring herd inspections, leaseholder agreements, and consistent branding to prevent cattle from being used in fraudulent schemes or to discourage fraudsters from operating through the institution. Where lines of credit are in use, the amount and thoroughness of the information needed to support draws or to trigger repayment should be documented and understood by all parties. Completed inspections should be compared to borrowing bases, similar to management of motor vehicle floor plan financing. Documentation and policy exceptions, borrowing base requirements, and covenant compliance should be explained in the institution’s policies and agreements and consistently monitored. Regular and routine updates of customer and cattle information should be performed and shared with appropriate staff and departments.

C) Fund Transfers – Several of the cases noted above include wire fraud as a part of the prosecution. The volume and speed at which transactions occur contributes to the difficulties in tracking the flow of funds and livestock, particularly in the case of auction/sale barns and cattle brokers. A thorough understanding and documentation of the nature and purpose of the transfers, as well as the source or use of funds, should be an integral part of the financial institution’s procedures. Similar to the point made above for transaction accounts, the number of parties with whom funds transfers may be initiated or received can obscure illicit activity.

A red flag which may indicate illicit transfers is consistent round-dollar or repetitive amounts. Because of the industry standard use of weight to calculate prices, coupled with the varying
prices paid for different types of cattle, it would be unusual for legitimate cattle transactions to include frequent or recurring round-dollar transfers or repeated transfers for identical amounts. Accounts which frequently have round-dollar or repetitive amount wire transfers should therefore receive additional scrutiny and may trigger a request for supporting documentation.

D) **Risk Scoring** – Where financial institutions assign or apply risk scoring thresholds, the potential for fraud in the cattle industry should be taken into consideration. Transaction monitoring systems should be customized to the extent possible to track and report red flags, such as rapid movement of funds and introduction of new vendors, buyers, or wire recipients. Cattle operations and vulnerable products may warrant additional points to elevate risk profiles. Scoring and monitoring should extend beyond simple transaction monitoring, and should incorporate red flags such as missed loan payments, documentation exceptions, results of inspections and appraisals, and the presence of leaseholder agreements. If the institution utilizes a list search to identify negative news or other public information, the USDA’s list of fines and letters of warning under the Packers & Stockyard Act should be included in the reference material.

E) **Training** – Staff throughout the bank should be trained to consider the AML implications of cattle operations to aid in properly risk scoring customers and identifying unusual activity or red flags. Account officers and financial institution management with customers in or around the cattle industry should especially be made aware of the potential for fraud and money laundering. Independent support and expertise should be engaged in the event that in-house staff does not have the knowledge, resources, or experience to ensure the institution is adequately aware of the potential for cattle fraud and money laundering.

**Track Trends and Share Information With Board, Senior Management, and Staff**

Simple awareness of the potential for cattle fraud and money laundering, as well as details of identified frauds and red flags, can minimize the chances the institution will fall victim to such activity. AML officers should be aware of trends in cattle fraud, potential for money laundering, and preventative measures. AML officers should routinely make the board, senior management, and appropriate staff aware of cattle fraud cases and underlying implications or risks to the institution. General awareness of the potential for fraud and money laundering can be a preventative in and of itself. For example, law enforcement noted that Tony Lyon had been charged in 2001 with cattle fraud and served jail time. At the time of his indictment in 2017, Lyon still owed several million dollars in restitution on the 2001 case. Had the financial
institutions been more aware of his past activities, the 2017 case could potentially have been prevented or reduced.

Management and the board should also understand the potential ramifications of cattle fraud and associated money laundering. In addition to the monetary loss and reputational risk associated with the fraud, financial institutions without sufficient understanding of cattle operations or appropriate mitigating controls may be subject to regulatory criticism. While the banking regulators have not typically issued formal enforcement actions that specifically address cattle fraud, it would not be unexpected in the event that unsafe and unsound practices or procedures were cited in relation to cattle operations. AML programs could very easily be criticized for unidentified or poorly mitigated risks associated with cattle.

**File Suspicious Activity Reports Consistently**

Law enforcement contacts noted that the FBI and state attorneys general often pick up cattle fraud cases but funnel them to specialized law enforcement officers, such as the Texas and Southwestern Cattle Raisers Association Special Rangers and the Oklahoma Department of Agriculture Food and Forestry Special Agents. Early and consistent reporting of suspicious activity involving cattle fraud and associated money laundering increases the potential that a specialized law enforcement unit will be asked to review and potentially investigate the case. Law enforcement stated that the ability to track activity through multiple institutions is often key in obtaining successful prosecutions.

**Additional Potential Solutions Within the Industry**

Across the industry and beyond just financial institutions, there are some things which could be done to help prevent cattle fraud, thereby reducing the potential for money laundering in the industry. These could be supported, encouraged, or required by financial institutions and related parties to aid in preventing fraud and subsequent laundering of illicit funds:

A) **Animal Disease Traceability Registries and Requirements** — Most of the world’s large cattle-producing countries use some form of disease traceability registry, such as the Canadian Livestock Identification Association and the Australian National Livestock Identification Scheme. In January 2019, India’s government required stray cows to be bar coded and tagged with radio-frequency ID tags (Stray cows..., 2019). The U.S. Animal Disease Traceability Registry was initiated in 2010 in response to bovine spongiform encephalopathy, more commonly known as “mad cow disease” (National Agricultural Statistical Services, 2018). Registries typically require identification and tracking of most or all cattle, which could be potentially expanded to use of individual data by purchasers, sellers, lenders, and other interested parties. However, U.S. industry and law enforcement support is mixed at the time of this report. Because the United
States is one of the few large producing countries that does not have a widespread registry system, it may yet become a more pressing requirement to stay in the world market, but it is not seen as a viable prevention of cattle fraud or money laundering in the United States at this time.

B) **The Beef Blockchain** – In July 2018, the *Financial Times* published a story about the use of a new beef blockchain (McLannahan, 2018). In this endeavor, calves are branded and tagged, and the relevant identifying information loaded to the blockchain. The stated goal is to track and prove that the identified cattle have been allowed to feed on the open range, rather than in a feed lot, and ultimately receive a better price per pound. An important side effect is that these cattle can now be positively identified as they move through their lifecycle, which could also serve as a mitigating factor against fraud and use in money laundering. Law enforcement indicated that, in their experience, larger producers are becoming interested in this process, but they believe small producers will continue to be more resistant.

C) **Branding** – Perhaps the easiest tool to prevent cattle fraud and subsequent money laundering arising from the crime, and available to producers of all sizes, is simple branding. One convicted felon stated, and law enforcement echoed, that he specifically targeted unbranded cattle for his thefts because they were not as easy for authorities to identify (Stock Exchange News, 2014). Law enforcement and industry participants alike support consistent use of branding and tagging, although all noted that the inconsistency of U.S. state requirements can be a challenge. Law enforcement noted that cattle sales along the Texas borders are often targeted by fraudsters because surrounding states do not have the same brand requirements as Texas, and it is relatively easy to move cattle across state lines quickly.

D) **Low-tech Solutions** – As discussed above, increased industry adherence to such simple standards as regular counts, inspections, and recording of herd data, requiring better or increased documentation of collateral and activity, and shared information could help to prevent cattle fraud and money laundering.

**Conclusion**

Cattle fraud continues to be a high impact and expensive crime in the 21st century, with multimillion-dollar fraud cases being identified on a regular basis, as noted in the table on page 9. Cattle are raised in virtually every country across the world and in every U.S. state, and the exposure to cattle fraud is exacerbated by the increasing worth of cattle, particularly when stolen or fictitious cattle can be sold at full value. The fraudster then attempts to move or take advantage of illicit gains, which results in money laundering through the financial system. To offset this and to protect the financial industry, AML professionals must become aware of and collaborate to prevent cattle fraud from occurring. Cattle fraud can affect a financial institution
at multiple levels, and institutions should, therefore, consider and address the implications of money laundering associated with cattle fraud at a variety of checkpoints in the AML process, including the risk assessment, development of the compliance program, staffing and training, communication at all levels, filing suspicious activity reports, and internal audit. Increased awareness of the potential for cattle fraud and subsequent money laundering can go a long way to stopping fraudsters from conducting such activity in the financial institution. As the old saying goes, “Trust your neighbor, but brand your cattle” (Stillwell, n.d.).

References / Credits


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Credits

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