

## **The U.S. Trustee Program’s Civil Enforcement Activity Targets Mortgage Fraud and Mortgage Rescue Schemes**

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Combating mortgage fraud and mortgage rescue fraud is one of the top priorities of the United States Trustee Program (“USTP” or “Program”). Over the last several years, the Program has dedicated significant civil and criminal enforcement resources to identifying and taking action against mortgage and mortgage rescue fraud and abuse. Internal detection by the USTP of such schemes, as well as Program investigations of referrals from the bankruptcy court, trustees, bankruptcy clerks and other third parties, have enabled the Program to uncover potential wrongdoing and pursue appropriate civil enforcement actions against those who prey upon vulnerable consumers. When criminal conduct is suspected, the Program refers the alleged perpetrators and provides assistance to the Program’s law enforcement partners, as more fully discussed in two articles recently published in the *ABI Journal*.<sup>1</sup>

As part of its civil and criminal enforcement efforts, the Program also serves on several interagency working groups of national task forces such as the Financial Fraud Enforcement Task Force established by President Obama in November 2009. Led by Attorney General Eric Holder, the Task Force brings together civil and criminal resources at all levels of government to hold perpetrators of financial fraud accountable. The Program’s participation on national and local working groups further enhances the Program’s ability to detect and fight schemes that utilize a federal court system as a tool in victimizing those in financial distress.

### **Bankruptcy-Related Mortgage Fraud and Rescue Fraud Schemes**

The Federal Bureau of Investigation defines “mortgage fraud” as “a material misstatement, misrepresentation or omission relied upon by an underwriter or lender to fund, purchase or insure a loan.” This definition focuses on conduct that harms lenders, such as providing false information on loan applications.

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<sup>1</sup> “USTP Initiative Combats Bankruptcy-related Mortgage and Real Estate Fraud,” by Sandra R. Klein, *ABI Journal*, July-August 2009, p. 18; “USTP’s Report on Criminal Referrals Highlights Criminal Enforcement Activity,” by Sandra R. Klein and Philip Crewson, *ABI Journal*, November 2009, p. 20.

The terms “mortgage foreclosure rescue fraud” and “rescue fraud” are used to cover a wide variety of schemes that target and harm consumers who are in jeopardy of losing their homes to foreclosure or are facing eviction. The perpetrators of rescue fraud schemes use the federal bankruptcy court system as a tool to defraud vulnerable consumers. Often, the perpetrators take advantage of the automatic stay in bankruptcy, using it to give consumers the impression that the perpetrators’ false promises are true, because collection activities cease – temporarily. In some schemes, perpetrators use the bankruptcy system by recommending to consumers that they file bankruptcy to eliminate their unsecured debt, and thereby position themselves to buy back their houses as part of a sale-lease back scheme. Furthermore, sometimes the perpetrators themselves file bankruptcy to discharge the debt they incurred as part of their mortgage fraud schemes.

Three types of bankruptcy-related mortgage fraud and rescue fraud – financial consultant schemes, sale-lease back schemes and reverse mortgage schemes – are explained below

### Financial Consultant Schemes

The financial consultant scheme is one of the most common mortgage rescue frauds encountered in bankruptcy. In this scenario, the perpetrators falsely tell desperate homeowners that, for a fee, they can help the homeowners save their homes by working with their lenders to stop the foreclosures and modify or refinance their loans. Homeowners are told to make their mortgage payments to the perpetrators or are required to pay the perpetrators a monthly consulting fee. Perpetrators identify homeowners through advertising on TV, radio, in local newspapers or on the Internet; through connections with churches and other affinity-based ethnic groups; or through foreclosure lists available from local governmental agencies.

Of course, the perpetrators do not contact the lenders. Instead, they file serial fraudulent bankruptcy cases in the homeowners’ names, sometimes without the homeowners’ knowledge or consent, to use the automatic stay to stop the foreclosure. In a variation of this scheme, homeowners are directed by the perpetrators to quitclaim fractional interests in their homes to fictitious individuals or businesses. Bankruptcy cases are then filed serially in the names of the fictitious individuals or businesses, to continue the operation of the automatic stay. Under either scenario, homeowners mistakenly believe that the perpetrators have fulfilled their false promises, and continue to pay the perpetrators.

### Sale-Lease Back Schemes

In the sale-lease back scheme, the perpetrator gains control of an individual’s home and skims real or manufactured equity from the property. The perpetrator tells the homeowner that the home can be saved by selling it to a third-party purchaser chosen by the perpetrator – also known as a “straw purchaser” – and then renting it back from the purchaser for an amount less than the homeowner’s current mortgage payment. Frequently the perpetrator promises that the homeowner can buy back the home within a certain period at the same price at which it was sold, thus protecting the homeowner’s “equity.” In some schemes, the perpetrator persuades the

homeowner to file bankruptcy in order to repair the homeowner's credit and place him or her in a better position to obtain financing to buy back the home.

The perpetrators of these schemes profit by gaining control of the properties and obtaining fraudulent loans in the straw purchasers' names based on inflated appraisals of the properties' values. The inflated sales price creates a significant amount of "fake" equity that the perpetrators take through fees that are included in the closing payoffs. Moreover, the perpetrators may arrange to have any remaining sales proceeds signed over to them, rather than to the homeowners. Finally, the straw purchasers usually receive some money at closing for each property purchased. Eventually the straw purchasers file bankruptcy to discharge the mortgage debt incurred in their names. Usually, they do not disclose these payments in their bankruptcy documents. In the end, the homeowners lose their homes.

### Reverse Mortgage Schemes

A scheme that is becoming more widespread involves federally insured home equity conversion mortgages ("HECMs"), which are sometimes referred to as reverse mortgages. An individual 62 years or older who owns or seeks to acquire a primary residence that he or she will occupy may borrow the equity in the home without incurring any mortgage payments. Before taking out a loan, the borrower must participate in a consumer information session given by an approved HECM counselor. Unlike traditional mortgages, HECMs do not have any income, credit or employment requirement. The borrower has the option of receiving a monthly payment from the lender or taking the equity loan in a lump sum, and is required to maintain the property and pay the taxes. Upon the homeowner's death, the property is sold by the lender to repay the loan.

Perpetrators of HECM schemes may be organized rescue fraud rings, neighbors or even members of the homeowner's family. In many cases, the borrowers are in poor health and may suffer from memory loss. These vulnerable homeowners are persuaded to sign paperwork prepared by the perpetrator, including power of attorney authorizations. Once the perpetrator obtains the necessary signatures, the perpetrator takes control of the borrowing process and selects the lump sum payment option. If the homeowner does not have equity in the home, the perpetrator typically generates a false appraisal to manufacture equity. The perpetrator pockets the loan proceeds, and the homeowner loses the equity and may be unable to retain the home. In some situations, the perpetrator may also file bankruptcy on behalf of the homeowner, to extinguish unsecured debt the perpetrator may have incurred in the homeowner's name or to stop other related collection activities.

### **Civil Enforcement – Detection and Response**

As part of its civil enforcement efforts, the USTP employs a variety of strategies to detect and pursue mortgage fraud and mortgage fraud rescue schemes that utilize the bankruptcy system. Through internal screening protocols, trustee referrals and other third-party contacts, potential schemes are identified and evaluated for appropriate civil enforcement action. Curiosity and awareness are keys to detection. Bankruptcy documents that present an incomplete or

confusing financial picture, debtors' statements suggesting they may be victims of a scheme or creditors' claims that they were victimized by the debtor all may warrant further inquiry. Asking a few additional questions, requesting more information or investigating complaints can lead to finding and potentially stopping a mortgage fraud or mortgage rescue fraud scheme.

When apparent abuse is detected, the Program has a variety of civil enforcement options that may be appropriate to pursue. Motions and adversary proceedings pursuant to 11 U.S.C. sections 110, 526, 527 and 528 are brought against both disclosed and undisclosed petition preparers, seeking return of fees, damages, fines and injunctive relief. Civil contempt actions are pursued for violations of court orders or injunctions. Denial or revocation of discharge complaints under section 727 are filed against straw purchasers and scheme perpetrators based on concealment, false statements and inability to satisfactorily explain loss of assets. Actions such as section 329 motions relating to attorney compensation or requests for sanctions under Fed. Bankr. R. 9011 are brought against lawyers who fail to disclose their relationships with petition preparers or are otherwise participants in a scheme. Of course, whenever the USTP believes criminal conduct is involved, a criminal referral is made to our law enforcement partners.

The following examples are illustrative of the Program's civil enforcement activities against bankruptcy-related mortgage fraud and mortgage rescue fraud.

A member of the Program's staff attended a section 341 meeting of creditors to question a debtor. Information collected at the section 341 meeting, from tips, and from the U.S. Trustee's further investigation revealed the rescue scheme. The perpetrators ran television commercials offering to help people who were facing foreclosure. When the homeowners responded to the advertisements they were told to file chapter 13 cases to stop the foreclosure. Bare-bones bankruptcy petitions and other documents were prepared by the perpetrators in the homeowners' names and were filed under chapter 13. Once in bankruptcy, the perpetrators filed a number of fraudulent documents in furtherance of their scheme without the homeowners' knowledge. While the cases were pending, quit claim deeds were executed transferring the homeowners' properties to one of the perpetrators. Once the perpetrators gained control of the properties, they took the equity out in cash for themselves.

The Program's Baltimore office filed adversary proceedings against the four perpetrators alleging numerous violations of section 110, conspiracy, and fraud, and referred the matter to federal law enforcement for potential criminal investigation and prosecution. In November 2009, the Bankruptcy Court for the District of Maryland granted the USTP's motion for partial summary judgment against the perpetrators for their actions in the rescue scheme. The court entered judgment pursuant to section 110 for actual damages of over \$650,000, imposed fines of \$285,000, issued injunctive relief and found for the USTP on the issue of liability for violations of the automatic stay and of prior injunctions. The Baltimore and Greenbelt, Maryland, offices also assisted the U.S. Attorney and federal law enforcement with the criminal investigation and successful prosecution of all four perpetrators.

In another case, the Program's San Diego office filed section 110 motions and complaints that included requests for injunctive relief in a consolidated proceeding involving 71 cases. Through Fed. Bankr. R. 2004 examinations of a bankruptcy petition preparer and some homeowners, the USTP discovered that the petition preparer targeted Spanish-speaking individuals who were in jeopardy of losing their homes to foreclosure. The petition preparer charged individuals to attend seminars, during which he purportedly claimed that he could assist with loan modifications. As part of the scheme, the petition preparer filed chapter 13 petitions, schedules and statements of financial affairs in the homeowners' names. Because the homeowners did not understand the obligations of a chapter 13 debtor, their cases were dismissed. The petition preparer also told some homeowners not to disclose his assistance with their bankruptcy filings or the amount that they paid to him.

After the Program proved its case, the Bankruptcy Court for the Southern District of California entered default judgments fining the petition preparer more than \$100,000, directing him to pay a total of \$35,252 to multiple debtors and permanently enjoining him from conducting business as a bankruptcy petition preparer in the district. In addition, the court found that the petition preparer had committed fraudulent, unfair or deceptive actions pursuant to section 110 by failing to disclose his identity as a bankruptcy petition preparer.

The USTP's office in Jackson, Mississippi, uncovered a rescue scheme through a series of civil enforcement actions filed in the District of Mississippi. In successfully pursuing several motions to dismiss *pro se* corporate cases pursuant to sections 707(a)(3), 105 and 349, and eventually seeking injunctive relief against the corporate debtors, the Program discovered that their assets consisted of properties transferred to them by homeowners at risk of foreclosure, including former chapter 13 debtors. The perpetrators represented to the homeowners that, in exchange for transferring their homes and making monthly rental payments, the perpetrators would negotiate or refinance the mortgages to allow the homeowners to remain in their homes. The perpetrators also obtained fraudulent loans on the transferred properties, taking the loan proceeds. The perpetrators then placed some of the properties in bankruptcy without the homeowners' knowledge. Eventually, the homes were either foreclosed upon or transferred to straw purchasers via fraudulent loans that resulted in the perpetrators obtaining cash from the sales. The Program also referred the matter to federal law enforcement for possible criminal investigation and prosecution, and a Trial Attorney serving as a Special Assistant U.S. Attorney assisted in the prosecution of the two perpetrators. Both defendants pleaded guilty and were sentenced in 2009.

A section 727 complaint to deny discharge was filed by the Program's Boston office against a debtor based, in part, on her alleged active participation in a sale-lease back rescue scheme involving at least 30 properties. According to the complaint, the perpetrators identified financially desperate homeowners through published foreclosure notices and contacted them claiming they could help save their homes. Homeowners were persuaded to transfer their properties to the debtor or her associates with the promise that they could rent their homes and repurchase them in two years. Property title searches revealed that a number of homeowners transferred their homes to the debtor or other scheme participants. The debtor, along with the other perpetrators, allegedly stripped the equity from the properties by obtaining mortgages

against the transferred homes. Over a two-month period, the debtor applied for and received \$1.2 million in mortgage loans. The Bankruptcy Court for the District of Massachusetts entered a default judgment against the debtor/perpetrator, preventing her from discharging nearly \$1.3 million in unsecured debt.

In another case, the Bankruptcy Court for the Eastern District of Wisconsin sustained the objection of the Program's Milwaukee office to the chapter 7 discharge of a straw purchaser in a scheme involving mortgage fraud. The evidence at trial demonstrated that the debtor purchased several rental properties at the request of one of the scheme's perpetrators and obtained mortgage financing using false loan applications prepared by the perpetrator. The debtor claimed she had not reviewed any of the documents submitted to the lenders, she trusted the perpetrator and she was, in essence, a victim. At trial she also acknowledged that in her bankruptcy case she failed to disclose one of the properties as well as the money she received for participating in the scheme. Although the court agreed she was a victim, it found that she was not an "innocent" victim.

## **Conclusion**

The Program, through internal detection and tips from third parties, has successfully identified and pursued civil enforcement actions against those involved in mortgage fraud and mortgage rescue schemes. To build on these successes, the USTP recently established an internal working group dedicated to assisting field offices in identifying these schemes and pursuing civil enforcement actions. This new resource will enable the Program to further streamline detection methods and to refine best litigation practices in its continuing fight against bankruptcy-related mortgage and mortgage rescue fraud and abuse.