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Tallahassee, Florida

To

The Financial Crisis Inquiry Commission  
Miami, Florida  
September 21, 2010

On behalf of Attorney General Bill McCollum, I wish to extend our thanks to the Commission for being invited here today to testify about the role of the Florida Attorney General's Office in combating mortgage fraud. I am the chief of an internal task force formed by the Attorney General in 2007 to use our resources as effectively as possible to deal with the mortgage-fraud related matters within our jurisdiction.

Historically, the Attorney General of Florida has been given the authority to pursue fraud civilly through Florida's Unfair and Deceptive Trade Practices Act (FUDTPA). FUDTPA allows the Attorney General to seek damages, penalties, restitution, dissolution and other equitable remedies on behalf of consumers. Since the late 1980's, the Office of Statewide Prosecution has been housed within the Attorney General's office and has the authority to pursue multi-judicial circuit criminal cases including those crimes that would be charged in the prosecution of mortgage fraud cases.

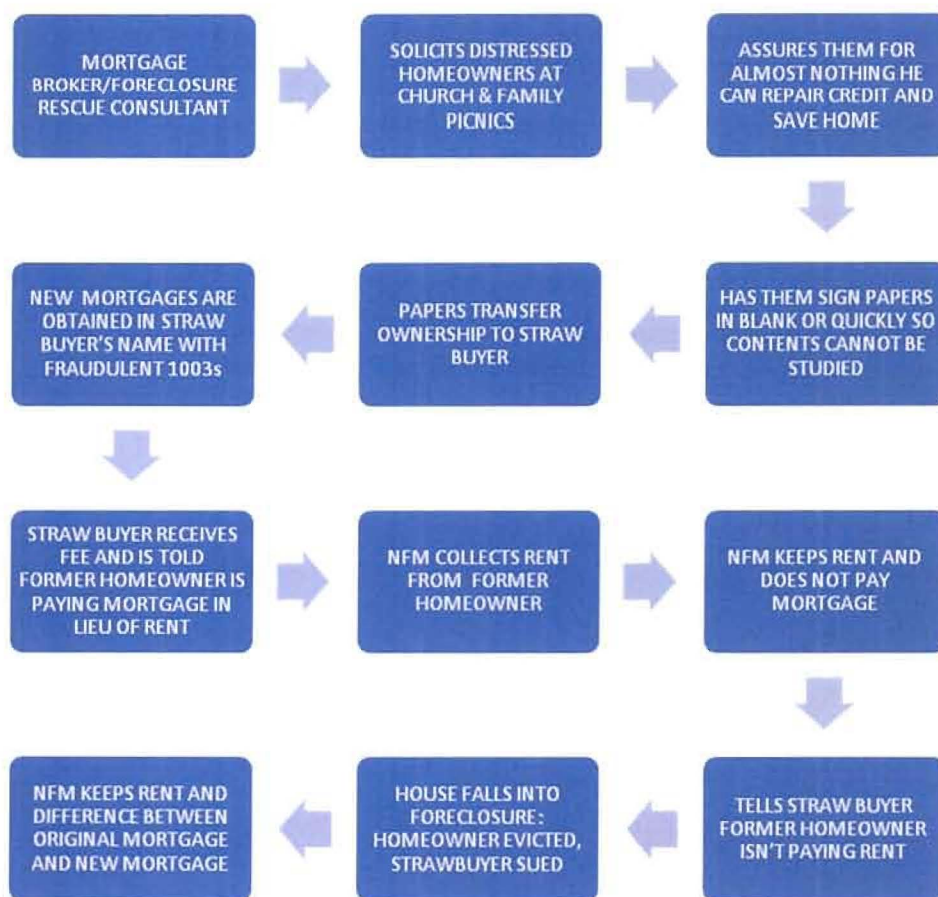
Mortgage fraud, in its many incarnations, came most forcefully to the attention of the Florida Attorney General's Office in the middle of 2007. Our office maintains a consumer hotline where consumer complaints are taken and referred to the various divisions within the office. A noticeable increase in complaints involving mortgage foreclosure rescue operations as well as an uptick in information received regarding questionable real estate deals began to emerge in the summer of 2007 as the economy began to deteriorate. Complaints about predatory lending practices also surfaced, with concerns about the mortgage lender Countrywide leading the way. The information received concerning questionable real estate deals typically involved properties that appeared to sell well beyond a fair market value, and the complaints about Countrywide increasingly tended to center on the company's apparent failure to disclose pivotal information concerning loan terms and borrower obligations under those terms.

In response to this disturbing trend, the Attorney General formed an internal mortgage fraud task force to evaluate the situation and take appropriate action. The task force consisted of several attorneys and investigators from the Antitrust and Economic Crimes Divisions. Because resources were limited, mortgage fraud investigations had to be added to the normal responsibilities of each participant. Members of the task force conducted a thorough analysis of pending complaints, preliminarily investigated those that required additional review, and evaluated and referred any promising cases, as appropriate, to either local prosecutorial or investigative agencies or internally to members of the task force itself.

Many complaints centered on mortgage foreclosure rescue scams, a form of fraud targeting vulnerable homeowners facing foreclosure and using their misfortune for pecuniary gain. Initially, these schemes were often relatively complex:

Among the first cases prosecuted by the Attorney General's task force was a case involving a company called National Foreclosure Management (NFM). NFM was representative of the worst kind of affinity fraud. In the company's scheme, agents of NFM, a mortgage broker, preyed upon fellow Haitian countrymen in South Florida, identifying potential foreclosures among the Haitian population, particularly those homes with significant amounts of equity available. The agents then attended church functions and even family picnics to befriend those whose mortgages were being foreclosed upon and offered them help to avoid foreclosure and to fix their credit. The victims were taken to the mortgage company and asked to sign paperwork without examining it. The paperwork transferred ownership of the property to a straw buyer. Fraudulent mortgage applications were then prepared by the broker in the straw buyer's name and mortgage loans were obtained in amounts up to the market value of the home. Sometimes the original mortgages were paid off, sometimes they were not. The straw buyer was

often told that the occupant of the home was paying the mortgage payment in lieu of rent. While NFM charged the victim rent, it pocketed it, and, not surprisingly, failed to pay the mortgage. Eventually, the home fell into foreclosure, a judgment was obtained against the straw buyer, and the original homeowner was evicted. The original homeowner lost his home and equity and the straw buyer's credit was ruined, while NFM absconded with the proceeds of the mortgage loan and the accumulated rent. A schematic of how the scam worked follows:



The Attorney General's Office pursued the case civilly, obtaining injunctions and judgments against the perpetrators and referring the case for criminal prosecution.

Another complex mortgage foreclosure rescue scheme pursued by the Attorney General's Office involved a company called the Florida Housing Council (FHC). In that case, once again, homeowners, with equity in their homes, but facing foreclosure, were solicited with promises

that they could be rescued from foreclosure. Most of the homeowners were advised to stop all communication with their mortgage company while FHC handled the negotiations that would allow the homeowners to avoid foreclosure. This tactic immediately cut off access to possible refinancing options. As part of the scheme, the distressed property was conveyed to a trust in which FHC was a 50% beneficial owner and the homeowner a 50% beneficial owner. While arrearages were typically paid off, the homeowner was assessed outrageous fees for FHC's services and was required to rent the home back from the trust. In the meantime, a mutually agreed upon value of the home was determined, one that was typically far below the actual market value. The homeowner had the right to repurchase the home at the end of one year at its fair market value, typically a much higher price than the mutually agreed upon value. The homeowner also lost his homestead exemption as a result of the scheme, resulting in a higher tax liability. A typical example of the form used to calculate the fees assessed in the scheme follows:

## et TRUST™ CALCULATION 1

Partnership Trust No. 3606

<b>City Lien</b> \$0.00 <b>Arrears - H/O Association</b> \$1,000.00 <b>Arrears - Mortgage(s)</b> \$5,000.00 <b>Contingency- H/O Association</b> \$1,250.00 <b>Arrears - Tax -2004 + 2005</b> \$0.00 <b>Contingency -Mortgage</b> \$4,200.00 <b>Investor Retainer-</b> \$3,975.00 <b>Trust Setup-See Details Below</b> \$5,075.00 <b>Facilitation - 1 Year</b> \$3,950.00 <b>Payment Reduction -</b> \$3,000.00 <b>Trust Admin. - Attorney/Trustee</b> 1,800.00 <b>Trust- Attorney Costs</b> \$200.00  <b>Total</b> <b>\$29,250.00</b>		<b>Payment Circulation</b> <b>Mtg. 1st</b> \$832.00 <b>Mtg. 2nd</b> \$0.00 <b>Taxes/Ins.</b> \$0.00 <b>Maintenance</b> \$250.00 <b>Pmt. Assist</b> (\$250.00) <b>Monthly Dues</b> <b>\$832.00</b>
<b>Mutually Agreed to Value</b> \$164,000.00 <b>Total beginning Encumbrances</b> \$121,000.00 <b>Net Equity at start</b> \$43,000.00 <b>Contributions- [REDACTED]</b> 13,750.00 <b>Contributions- Investor</b> 28,250.00		<b>Trust Setup Related</b>  <b>Trust Setup</b> \$250.00 <b>Paralegal</b> \$150.00 <b>EICM, Inc.</b> \$4,675.00 <b>Total</b> <b>\$5,075.00</b>
<b>Title Search</b> \$0.00 <b>Document Prep.</b> \$0.00 <b>Information Collection</b> \$0.00 <b>Document Signing</b> \$0.00 <b>Client Must Bring 1 month's payment to Signing of Docs.</b> \$32 <b>Monthly payment will be</b> <b>\$832.00</b> <b>Make payable to:</b> [REDACTED]		I agree & accept these figures to be correct. Signature: [REDACTED] Date: 3/3/06 Social Security No.: [REDACTED]

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In this particular case the fees generated by FHC were:

- Actual funds expended: \$6,000
- Fees and contingencies: \$23,250
- MAV \$164,000
- Appraised Value \$250,000

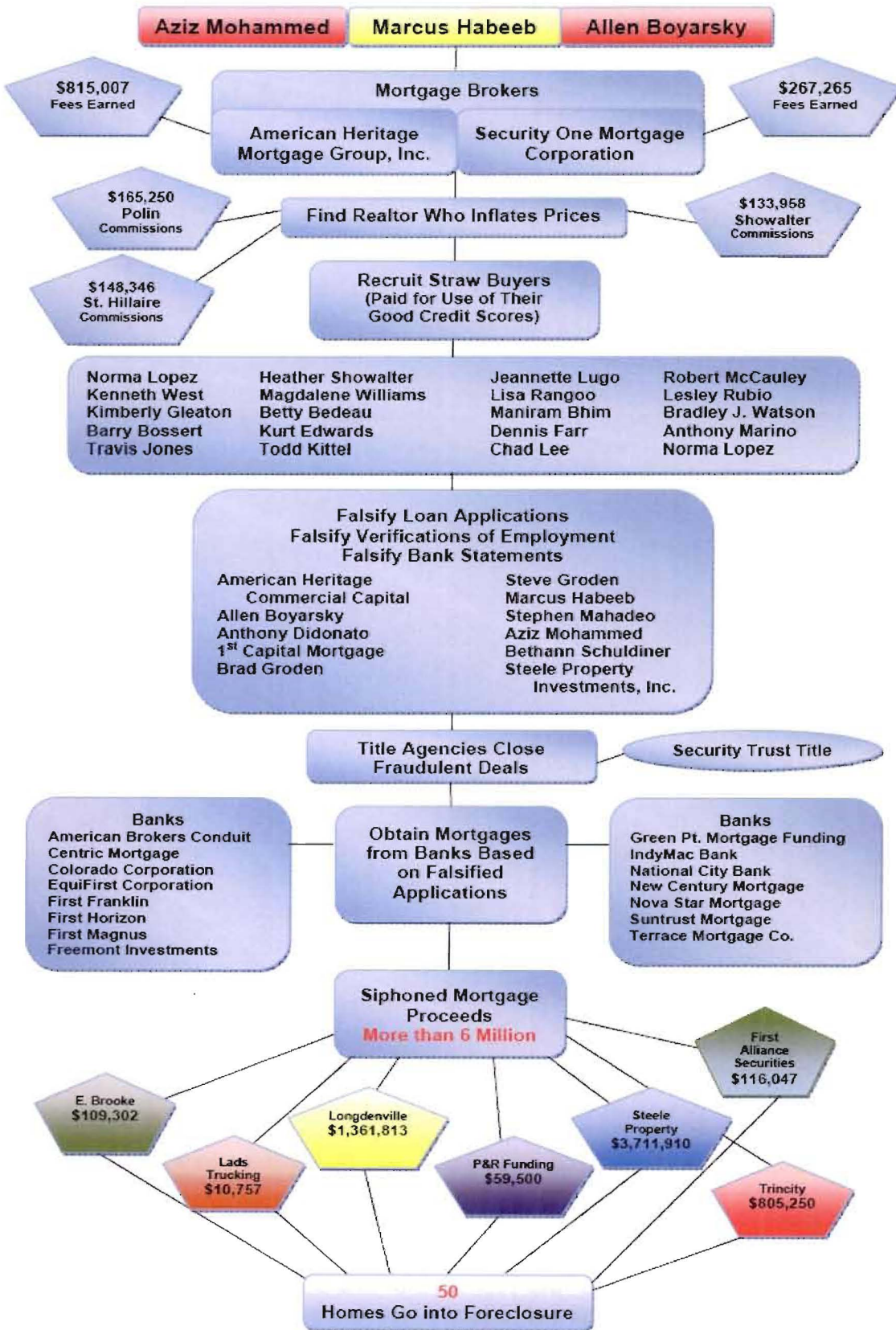
- Upon repurchase, FHC and other co-conspirators stood to collect:  $\$23,250 + 50\%$  of  $(\$250,000 - \$164,000 - \$13,750) = \$59,375$  on a \$6,000 investment or a gain of 989%.

Suit was filed against FHC and other co-conspirators, shutting down its operation. Litigation is currently pending.

Another, more traditional mortgage fraud scam is exemplified by a company known as American Heritage Mortgage Group. Our case against this company began when we received an anonymous complaint about a realtor who seemed to be having uncommon success in a bad real estate market.

The realtor sought out properties in distress. The homeowner was told that the realtor had a client willing to pay the asking price for the property. The realtor then relisted the property at a much higher price. An appraisal was obtained at the higher price, a straw buyer was recruited, mortgage applications were falsified, bank statements were created to show fraudulent deposits and 100% financing was obtained on the properties. The difference between the price paid to the seller and the mortgage amount was siphoned off at closing to a corporation not involved in the process and quickly funneled offshore. Sixty (60) homes in the Tampa Bay/Orlando corridor were affected and 50 eventually went into foreclosure. A chart outlining the scheme follows:







Suit was filed under FDUPTA and judgments in excess of \$2,400,000 have been obtained to date. The case has been referred for criminal prosecution.

Over the last few years, the predominant mortgage fraud schemes have become less complex. Mortgage foreclosure rescue companies no longer appear to engage in real estate trusts and lease buybacks. They have typically moved to simpler scams in which they take sizable upfront fees in exchange for promises to rescue homeowners from foreclosure, pocket the fees and do absolutely nothing to help the distressed homeowners. The internal task force eventually opened more than 80 of these cases involving varieties on this theme, shutting down operations and attempting to obtain restitution for the victims. The most prominent of these cases involved Lincoln Lending in Miami, a loose affiliation of attorneys and mortgage brokers that scammed literally hundreds of homeowners out of substantial upfront fees. Our Office obtained an injunction obtained against the company, shutting it down, and freezing its assets.

Many of the mortgages in need of modification to the height of the mortgage crisis emanated from Countrywide Lending. Our office was among the first to open an investigation into Countrywide's lending practices and found that Countrywide:

- Did not follow its own underwriting standards.
- Did not follow industry underwriting standards.
- Placed borrowers into loans it knew they could not afford.
- Failed to properly disclose loan terms.
- Placed borrowers in inappropriate mortgages.
- Compensated underwriters with bonuses for volume of mortgages approved.

Suit was filed by our office in 2008 and, soon after, a settlement was reached with Countrywide's new owner, Bank of America. The settlement provided significant relief to homeowners requiring modification of unconscionable mortgages and, earlier this year, nearly 2,700 Countrywide customers received nearly \$17 million in payments to ameliorate some of the harm caused by Countrywide's practices. Because of a federal preemption of state action against federally chartered banks, the suit had to be filed the day before Bank of America took ownership of Countrywide, otherwise our investigation would have been entirely thwarted.

While the Attorney General's civil prosecutions were progressing, the Office of Statewide Prosecution was pursuing cases criminally. These cases included one in which a contractor preyed upon individuals with hurricane damaged homes, obtaining home equity lines of credit for repairs, obtaining the funds through a co-conspirator at Argent Mortgage, taking the funds and not performing the repairs. The individuals were prosecuted under the Florida RICO act but many homes were still foreclosed upon as a result of the scheme.

These cases and others demonstrate that Florida's statutes in this area suffer from several shortcomings. First, in its civil prosecutions of mortgage fraud matters, this Office was unable to pursue, in most cases, realtors and appraisers under FUDTPA because they were statutorily excluded on the theory that regulatory agencies would take corrective action. Second, even though the Attorney General has the power to investigate and file civil RICO actions, the proceedings are basically *in rem* proceedings under the state RICO statute. Under current law, the effect is that if the property in question has been dissipated prior to filing suit, a personal money judgment cannot be obtained against the perpetrator who dissipated the assets and neither can any substituted assets be seized, as is allowed under federal law.

In 2008, the Attorney General obtained statutory reform in the mortgage foreclosure rescue scam area with the passage of Florida Statute § 501.1377, which made the acceptance of any fees for mortgage modification presumptively an unfair and deceptive trade practice. Additionally, the new law regulated lease buyback schemes by requiring written agreements before an instrument transferring title can be given to homeowner to sign. A prominent notice is now required on the cover page of a written agreement of the consumer's right to cancel and the law requires that the purchaser verify the homeowner's ability to make the payments required to repurchase the home. The law also establishes a rebuttable presumption that there is ability to pay if expenses and debt do not exceed 60% of gross monthly income. It further requires that the repurchase price cannot be unconscionable and creates a rebuttable presumption that the price is unconscionable if it exceeds 25% to 30 % of actual costs incurred by equity purchaser.

Further, with the passage of the Safe Act, any person now modifying mortgages must be a licensed mortgage broker and regulated by the Office of Financial Regulation (OFR). This law has effectively put those companies without licenses out of business. The net effect of these laws has been to virtually eliminate complaints, and hopefully scams, involving mortgage foreclosure rescue.

In April, 2008, in response to some of the shortcomings of the statutory structure in Florida, the Attorney General expanded the internal mortgage fraud task force into an Interagency Mortgage Fraud Task Force, consisting of representatives from the Attorney General's Office (including the Office of Statewide Prosecution), the Office of Financial Regulation, the Florida Department of Law Enforcement, local law enforcement agencies, the Department of Business and Professional Regulation, the Department of Financial Services' Division of Insurance Fraud, and the Florida Bar. Among other things, task force members

triage incoming complaints and refer any promising leads to appropriate agencies for action. Local offices around the state have developed their own interagency lines of communication. Attorney General McCollum and the Mortgage Fraud Interagency Task Force have also sponsored several Mortgage Crisis Forums around the state providing a one-stop shop for distressed homeowners. Officials from each of the state agencies involved in the task force as well as officials from HUD, local law enforcement and local judges give formal presentations providing information on how state and local agencies can assist in addressing concerns. Pro bono legal assistance is also provided by local bar associations and representatives from the five largest lenders in the state are brought together to provide direct face-to-face assistance to homeowners seeking loan modifications. Hundreds of distressed homeowners have attended each of these forums and most have walked away armed with the information they need to better tackle the problems they face and many have been able to obtain the loan modifications they needed to stay out of foreclosure.

Resources available for civil and criminal prosecution of mortgage fraud on the state level are, unfortunately, very limited. There were weeks during the height of the mortgage crises that as many as 5000 complaints concerning mortgage fraud were logged by our consumer hotline. Even now, we continue to receive leads on mortgage-related fraud cases. For example, in the Panhandle of Florida, one investigator has commented that you can throw a stone down any beach road and if the real property transactions are analyzed, fraudulent activity can be found. This, of course, is long after lessons about freewheeling lending practices and false appraisals should have been learned. IN 2009, we attempted to supplement the Attorney General's resources by applying for a \$6,000,000 BJA Edward Byrne Memorial Competitive Grant to fund mortgage fraud activities but were unsuccessful in obtaining it. As a result, we

must continue to carefully select and pursue those cases where we can make the most impact or the conduct is most egregious, and we must do our utmost to expand our resources to the utmost by joining with the other agencies on the task force to reduce duplication of effort and ensure efficient and effective investigation and prosecution wherever possible.

It is not the role of the Attorney General's Office to quantify the dollar loss from mortgage fraud in Florida or to estimate its impact on the financial crisis. However, anecdotally, it is clear from the frequency and gravity of complaints of which we are aware that fraudulent activity in the mortgage fraud area continues to far exceed the state and federal resources dedicated to addressing it. Based on my experience over the last three years, I can say, without hesitation, that mortgage fraud was rampant at the height of the financial crisis and clearly played a major role in precipitating the financial crisis. In the American Heritage Mortgage Group case I mentioned earlier, it took just three not particularly sophisticated criminals to organize a scheme that wreaked havoc on the lending system. These individuals obtained almost \$50,000,000 in fraudulent loans, made off with \$6,000,000 in skimmed proceeds, and caused at 50 homes in a limited geographic area into foreclosure. All of these properties were financed at amounts far exceeding their value, most went into foreclosure and are either still on the market or sold for substantially less than the loan amount.

One example is a home in Windermere, Florida, that was purchased in 2005 at the fair market value of \$400,600 but then was sold to a straw buyer associated with the American Heritage scheme in May 2006 for \$820,000 and was fully financed. The home went into foreclosure and finally sold in November of 2008 for \$300,000. Another home in Longwood, Florida, was sold to a straw buyer in May of 2006 for \$773,000, was fully financed and later sold

after foreclosure for \$319,000. The financial impact of transactions such as these was and continues to be devastating.

Mortgage fraud, as a crime, is unique. In most instances, the “victims” of the crime are often also perpetrators involved in the fraud. Those who are the victims of mortgage foreclosure rescue schemes, for example, may well have committed serious felonies in misrepresenting to lending institutions their available assets, income or occupation to obtain the mortgage that is in distress. Lending institutions that suffered unfathomable losses were often guilty of predatory lending practices and sometimes even encouraged the commission of felonies, beseeching mortgage brokers to write mortgages through any means necessary so that they would have an inventory of subprime loans to market to Wall Street. Mortgage brokers often encouraged borrowers to misrepresent material information to induce lenders to lend to them, or, in some instances, falsified the application themselves without the knowledge of the applicant. Some brokers, knowing their compensation would be greater, improperly placed borrowers into inappropriate subprime loans when the borrower qualified for a conventional loan. Lending institutions often misrepresented the quality of mortgage portfolios marketed to Wall Street and Wall Street and the rating agencies misrepresented the mortgage-backed securities to institutional purchasers like the Florida Retirement System. The fraud was perpetrated over and over again at every level of our financial system.

The recent dramatic increase in the criminal prosecution of mortgage fraud perpetrators at all levels is commendable and necessary, and no category of perpetrator should be ignored. Unfortunately, most of the economic damage is done and is irreversible. To characterize mortgage fraud as simply a major contributor to our present economic crisis will probably be proven to be a vast understatement. The best intentioned mortgage modification plan will not fix

the problems caused by schemes like American Heritage, where straw buyers with little or no income purchased millions of dollars of distressed real estate and defaulted on the mortgages. The time to eliminate mortgage fraud is before or while it is occurring through appropriate regulation and well-funded investigative and prosecutorial resources.

Thank you for this opportunity to testify.