Mortgage Fraud and Mortgage Rescue Schemes:
How Panel Trustees Can Help Uncover These Schemes

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Identifying, investigating and pursuing mortgage fraud and mortgage rescue fraud are top priorities of the United States Trustee Program ("Program"), and referrals from panel trustees are instrumental to our efforts. At the NABT's annual meeting in Boston in August 2009, the three prongs of the Program's mortgage fraud initiative were outlined by Cliff White, Director of the Executive Office for U.S. Trustees. Those three prongs are: combating debtor fraud, combating foreclosure rescue schemes and combating mortgage servicer violations. Following the Director's comments, several trustees remarked that they would welcome Program guidance to trustees concerning mortgage fraud schemes, to help them determine whether the debtor had been victimized or was participating in such a scheme.

Through our civil and criminal enforcement efforts, the Program has identified three major types of bankruptcy-related mortgage fraud and mortgage rescue schemes: financial consultant schemes, sale-leaseback schemes and reverse mortgage schemes. This article presents an overview of the various types of mortgage rescue schemes, as well as examples of several mortgage fraud cases the Program has successfully pursued.[1]

Financial Consultant Schemes

In a financial consultant scheme, a so-called "consultant" offers to save a desperate homeowner's residence from foreclosure – for a fee. Usually, the consultant will offer to work with the lender to refinance or modify the homeowner's mortgage. The consultant may tell the homeowner to make monthly mortgage payments to the consultant rather than to the lender. The consultant also may require the homeowner to pay a monthly consulting fee.

Unfortunately for the homeowner, the consultant does not contact the mortgage lender or remit the homeowner's mortgage payments to the lender. Instead, the consultant files serial fraudulent bankruptcy cases in the homeowner's name to invoke the automatic stay and stop the foreclosure. In some situations, these bankruptcy cases are filed without the owner's knowledge or consent. In a variation of this scheme, the consultant directs the homeowner to quitclaim

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[1]The author is grateful to Sandra Taliani Rasnak, an Assistant U.S. Trustee in Chicago and co-chair of the Program's Foreclosure Rescue Working Group, and Sandra R. Klein, Acting Chief of the Criminal Enforcement Unit of the U.S. Trustee Program, for information pertaining to various types of mortgage-related schemes. See Ms. Rasnak's article entitled "USTP's Civil Enforcement Activity Targets Mortgage Fraud and Mortgage Rescue Schemes," *ABI Journal*, March 2010, Vol. XXIX, No. 2, p. 28, for more information on the Program's civil enforcement activities targeting these schemes. See also Ms. Klein's article entitled "USTP Initiative Combats Bankruptcy-Related Mortgage and Real Estate Fraud, " *ABI Journal*, July/August 2009, Vol.XXVIII, No. 6, p.18, for more information on the Program's criminal enforcement activities targeting these schemes.

fractional interests in his home to fictitious individuals or businesses. The consultant then files, or causes to be filed, serial bankruptcy cases in the names of the fictitious individuals or businesses to take advantage of the automatic stay.

The following two examples illustrate recent schemes the Program uncovered through investigation. The Program discovered the first scheme in the course of moving to dismiss *pro se* corporate cases and enjoining the corporate debtors from subsequent bankruptcy filings. The second example involved two individuals from Los Angeles who operated a nationwide "foreclosure rescue" scheme that featured the transfer of fractional interests in property.

In the first scheme, two consultants represented to multiple homeowners that, in exchange for transferring their homes and making monthly rental payments, the consultants would negotiate or refinance the mortgages to allow the homeowners to remain in their homes. The consultants also obtained loans on the transferred properties by fraudulent means and retained the loan proceeds. In some cases, the consultants then filed *pro se* corporate bankruptcy cases listing the homeowner's property as a corporate asset.

In at least one of the *pro se* filings, the corporate debtor filed schedules and a statement of financial affairs (SOFA) listing the homeowner's residence as the only corporate asset and the mortgage on the property as its only debt. In all other regards, the schedules and SOFA were deficient. The debtor's response to every question on the SOFA, as well as every question on schedule B, was "none." In addition, within days after the petition date, a creditor filed a motion for relief from stay alleging that the property listed in the schedules had been transferred to the debtor the day before the bankruptcy filing.

Facts such as those set forth in this case – the *pro se* bankruptcy filing by a corporation,[2] the gross inadequacy of the schedules and SOFA, and the allegations in the motion for relief from stay – should alert trustees to the possible existence of fraud. Indeed, the Program moved to dismiss the corporate cases pursuant to 11 U.S.C. §§ 707(a)(3), 105 and 349, and to enjoin the corporate debtors from refiling. The Program also referred the matter to federal law enforcement for possible criminal investigation and prosecution. Both defendants pleaded guilty and were sentenced in 2009.

In the second scheme, two individuals sent out more than 1,000 solicitations per day to homeowners facing foreclosure, promising them that they would not have to make mortgage payments for two years. At the fraudsters' direction, homeowners transferred fractional interests in their properties to fictitious companies and paid the defendants fees ranging from $500 to $2,000 per month. Thereafter, the fraudsters placed the fictitious companies in bankruptcy, thereby invoking the automatic stay to halt collection activities

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[2] A corporation may not file a petition *pro se*, nor may a corporation represent itself. *In re America West Airlines, Inc.*, 40 F.3d 1058 (9th Cir. 1994); *Southwest Express Co. v. Interstate Commerce Comm'n*, 670 F. 2d 53 (5th Cir. 1982); *In re Dick Tracy Ins. Agency, Inc.*, 204 B.R. 38 (Bankr. W.D. Mo. 1997).

against the homeowners. When the homeowners stopped paying, the fraudsters stopped filing serial bankruptcy cases, the lenders foreclosed, and the homeowners lost their properties.

This scheme, which was also uncovered by Program personnel, would have been difficult for a trustee to detect. Because no schedules were filed and the fictitious debtors never appeared for the section 341 meeting of creditors, the only indication of a financial irregularity was the mortgage lender's motion for relief from stay, which alleged that the debtor had an interest in property in another state. As is often the case, third party filings that disclose new or inconsistent information should prompt the astute trustee to ask additional questions, in order to unearth undisclosed assets or other evidence of fraud. Ultimately, the two defendants were convicted in the District of Kansas on multiple counts of conspiracy and mail fraud.

Sale-Leaseback Schemes

In a sale-leaseback scheme, the fraudster convinces the homeowner to transfer title on the home to a third party straw buyer of the fraudster's choice. The homeowner remains in the home, and the victim is promised that the rent payment will be less than the current mortgage payment. Frequently, the fraudster falsely tells the homeowner that he or she can buy back the home within a certain period of time at the same price at which it was sold, thus protecting the homeowner's "equity." After the transaction is complete, the homeowner often learns that the rent payment will be higher than the mortgage payment.

The perpetrators of sale-leaseback schemes profit by gaining control over the homeowner's property and by obtaining loans in the straw buyer's name based on inflated appraisals. Fraudsters also may arrange to have the homeowner assign any remaining sale proceeds directly to them, rather than to the homeowners. Finally, the straw purchasers usually receive some money at closing – that is, a kickback – 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 to liquidation.

Recently, the Program discovered a sale-leaseback scheme through the straw buyer's bankruptcy case. In the complaint against the straw buyer, the U.S. Trustee alleged that the perpetrators of the scheme identified financially desperate homeowners through published foreclosure notices, and contacted them claiming they could help save the homes. The perpetrators persuaded homeowners to transfer their properties to the debtor or her associates with the promise that the homeowners could rent their homes from the buyers for two years and then repurchase them. The debtor, along with others, however, 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.

This case illustrates some of the hallmarks of fraud for the vigilant trustee. Although the debtor filed schedules and a SOFA and appeared at the 341 meeting, the information in her schedules and SOFA was confusing and raised questions that the debtor could not explain satisfactorily. For example, on Schedule A the debtor listed an ownership interest in property where she did not reside. At the 341 meeting, she stated that the property was an investment property she intended to surrender. The debtor did not list rental income from the property on her SOFA. Upon the trustee's questioning, the debtor disclosed that the tenant/former owner had not been paying rent and was suing the debtor on "various counts." On Schedule B, the debtor listed a claim against an individual whose address was "unknown." At the 341 meeting, the debtor described the individual as a business partner in "real estate speculation," but she did not list any interests in partnerships, failed to maintain adequate books and records and provided vague testimony concerning the nature of the partnership.

Other inconsistencies also raised suspicions of fraud. On Schedule D, the debtor listed three mortgages, but only two were tied to the property listed on Schedule A. On Schedule F the debtor listed over $1 million in deficiency claims on five other properties that either were foreclosed or sold at a loss. According to her schedules, the debtor obtained all but one of the mortgages during the same year. The number of mortgage-related transactions in a limited time frame was unusual for an individual debtor, was inconsistent with and unsupportable by the debtor's income and prompted further investigation.

Based on these red flags – confusing and inconsistent schedules, and disproportionate amount of debt incurred in a short period of time – the trustee asked numerous questions about the real estate transactions, the suits against the debtor and the debtor's claim against her former business partner, and requested additional information. Many of the trustee's questions followed the Sample General Questions in the *Handbook for Chapter 7 Trustees*. Ultimately, the Program sought to bar the debtor's discharge pursuant to 11 U.S.C. §§ 727(a)(2)(A), (B), 727(a)(3), 727(a)(4)(A) and 727(a)(5), and the bankruptcy court entered a default judgment against the debtor, preventing her from discharging nearly $1.3 million in unsecured debt.

<u>Reverse Mortgage Schemes</u>

Finally, an increasingly widespread scheme involves federally insured home equity conversion mortgages ("HECMs"), otherwise known as reverse mortgages. A person 62 years or older who owns or seeks to acquire a primary residence may borrow the equity in the home without incurring any mortgage payments, provided that the borrower occupies the home. Unlike traditional mortgages, HECMs do not have any income, credit or employment requirements. The borrower may elect to receive the proceeds from the mortgage either monthly or in a lump sum. Upon the homeowner's death, the lender sells the property to repay the loan.

Perpetrators of HECM schemes may be organized rescue fraud rings, neighbors or even members of the homeowner's family. Individuals who are eligible for HECMs may be more vulnerable than borrowers in the population at large; some suffer poor health or memory loss. Perpetrators take advantage of these vulnerabilities by causing borrowers to sign paperwork, such as a power of attorney, that confers to the perpetrator control over the borrowing process. By exercising these powers and opting for a lump sum payment, the perpetrator quickly depletes the funds available to the borrower. The perpetrator keeps the loan proceeds, and the homeowner loses the equity and may be unable to retain the home. If the homeowner lacks equity in the home, the perpetrator typically generates a false appraisal to manufacture equity to inflate the size of the lump sum payment. In some situations, the perpetrator may also file bankruptcy on behalf of the homeowner to stop other related collection activities or to extinguish unsecured debt incurred in the homeowner's name.

As with other mortgage fraud and mortgage rescue schemes, attention to the schedules and SOFA as well as other filed documents may provide insight. The use of *pro se* bankruptcy filings by a straw corporation, or filings by a power of attorney, incomplete schedules and SOFA, and suspicious details – or suspicious absence of detail – in the motion for relief from stay should alert trustees to the possible existence of fraud.

Conclusion

Detecting mortgage fraud and rescue fraud schemes is not an easy task, as numerous variations exist on the basic schemes and fraudsters are constantly changing tactics. Accordingly, a trustee's best tools are curiosity and awareness. Each case is different, and the trustee should evaluate the facts and circumstances of each one. Bankruptcy documents presenting 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 may warrant further inquiry. Taking the time to ask questions and exercise extra scrutiny when investigating complaints and reviewing claims and motions from relief from stay can yield significant results. If a trustee suspects the existence of a mortgage fraud or other scheme, he or she should immediately contact the local U.S. Trustee office.