

Fraud Enforcement and
Recovery Act of 2009

By Robin Beardsley Mark

Criminal mortgage fraud cases present unique challenges for defense counsel.

Banking Institutions Are Victims Too

If you have picked up a paper, surfed the web or listened to a morning news program in the past year, you've no doubt encountered the headlines "Mortgage Banking Fraud."

While there has clearly been a significant amount of talk

about mortgage banking institutions, including blame for the economic downturn, we know as lawyers that there is always another side to the story. While most attention seems to be focused on the alleged fraudulent acts of mortgage banking institutions, there is a trend of recent federal indictments pursuant to the Fraud Enforcement and Recovery Act where the mortgage banking institution is the not the defendant, but the *victim*.

Recently, criminal mortgage fraud investigations and indictments have included the likes of borrowers, lenders, investors, real estate professionals, appraisers, real estate brokers, home builders and attorneys. The rise in mortgage fraud investigations and prosecutions increases the chance that lawyers practicing in the fields of mortgage banking, commercial or financial litigation who are less familiar with white collar criminal defense may be called upon to represent clients who find them-

selves as the subject of a criminal mortgage fraud investigation.

Initially, you may believe that your client is a not a target of the investigation, but rather may be a mere witness or possibly the victim of a mortgage fraud scheme. However, a defense lawyer should not be so quick to assume that his or her client is not involved in the mortgage fraud scheme. Criminal mortgage fraud cases typically involve multiple parties engaged in a conspiracy to commit mortgage fraud that has numerous moving parts. If you suspect or have any reason to believe that your client may be involved in or the subject of criminal mortgage fraud, it is important to evaluate the case and move quickly to protect your client's interests. The rules of civil procedure are not in play when facing a criminal investigation and possible indictment. Therefore, an understanding of the criminal defense basics is increasingly important to the civil defense litigation counsel.



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Recent Legislation Explains the Increase in Prosecution of Mortgage Fraud Cases

On May 20, 2009, President Obama signed into law the Fraud Enforcement and Recovery Act of 2009 (FERA). FERA provides the federal government with new and improved tools to investigate and prosecute mortgage, corporate and other finan-

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cial frauds. The purpose of FERA is to increase enforcement oversight over the types of financial frauds that contributed to the current economic crisis. Among other things, FERA:

- provides substantial funding and resources to the Justice Department, the FBI, the U.S. Postal Inspection Services, the U.S. Secret Service, and the Inspector General for the Department of Housing and Urban Development for enforcement activities, including \$50 million per year to the U.S. Attorney's offices to staff the FBI's fraud strike forces, and \$40 million to Department of Justice criminal, civil and tax divisions to provide litigation and investigative support in fraud cases;
- modifies the definition of "financial institutions" in the criminal code to include mortgage lending businesses that are not directly regulated or insured by the federal government. FERA §2(a) (modifying 18 U.S.C. §20);
- amends the false statements in mortgage applications statute to criminalize making a material false statement or willfully overvaluing a property in order to influence any action by a mortgage lending business. FERA §2(c) (modifying 18 U.S.C. §1014);

- strengthens the Civil False Claims Act (31 U.S.C. §3729 *et seq.*) to ensure that the government can recover taxpayer dollars purportedly lost to fraud and abuse; and
- establishes a Financial Crisis Inquiry Commission (the "Commission") to investigate the causes of the current financial and economic crisis. The Commission has the power to hold hearings and to compel production of documents and testimony. The Commission will submit a report on December 15, 2010, that will contain findings and conclusions regarding the causes of the current financial and economic crisis.

Prior to FERA, private mortgage lenders were not subject to the same kind of oversight and regulations as traditional financial institutions. FERA extended criminal laws to cover private mortgage companies—to "level the playing field"—in the same way that existing regulations apply to federally insured and regulated financial institutions.

On November 17, 2009, President Obama signed an executive order establishing a new interagency Financial Fraud Enforcement Task Force ("Task Force") to combat financial crime. The Task Force was established "to lead an aggressive, coordinated, and proactive effort to investigate and prosecute financial crimes." The Task Force is designed to strengthen collective efforts of federal, state and local agencies to investigate and prosecute significant financial crimes relating to the current financial crisis; to recover illegally obtained funds; and to ensure just and effective punishment for those who perpetrate financial crimes.

The Department of Justice and FBI field offices worked to establish more than 75 regional task forces and working groups around the country. These efforts have successfully targeted real estate professionals including bankers, brokers, appraisers and lawyers who allegedly engaged in fraudulent activities. On December 9, 2009, Lanny Breuer, Assistant U.S. Attorney General, reported the following task force results to the United States Senate Committee on the Judiciary:

- On October 8, 2009, in the Southern District of Texas, a jury convicted a Houston loan officer at a financial institution for submission of fraudulent loan appli-

cations and packages to residential lenders across the country resulting in over \$24 million dollars in fraudulent loans. The defendant and her co-conspirators misrepresented the credit-worthiness of individual borrowers who were recruited to purchase multiple properties.

- On August 10, 2009, in the Central Division of California, two real estate professionals were convicted for their roles in a massive mortgage fraud scheme that caused more than \$40 million in losses to federally insured banks. The jury convicted a prominent Beverly Hills real estate agent and licensed appraiser on charges of conspiracy, bank fraud and numerous loan fraud charges for their roles in the mortgage fraud scheme. Eight other real estate professionals pled guilty to federal felony charges for their roles in this scheme.
- In November 2009, the Middle District of Florida announced the results of a nine-month long "Mortgage Fraud Surge" that resulted in charges against more than 100 defendants involving more than \$400 million in loans on more than 700 properties.

On June 17, 2010, members of the Task Force released the results of a nationwide initiative called "Operation Stolen Dreams," that targeted mortgage fraudsters throughout the country. Operation Stolen Dreams is the largest collective enforcement effort to confront mortgage fraud. See Department of Justice Press Release dated June 17, 2010. From March 1, 2010, through June 17, 2010, "Operation Stolen Dreams has involved 1,215 criminal defendants nationwide, including 485 arrests, who are allegedly responsible for more than \$2.3 billion in losses. Additionally, ... the operation has resulted in 191 civil enforcement actions which have resulted in the recovery of more than \$147 million." *Id.* In a press conference announcing the results of Operation Stolen Dreams, FBI Director Robert S. Mueller III stated that "[f]rom home buyers to lenders, mortgage fraud has had a resounding impact on the nation's economy." Mueller issued a warning: "[t]hose who prey on the housing market should know that hundreds of FBI agents on task forces and their law enforcement partners are tracking down your schemes and you will be brought to justice."

The Task Force helped to identify mortgage frauds such as loan origination schemes, short sales, property flipping, and equity skimming. As part of Operation Stolen Dreams, on June 17, 2010, the FBI reported the following examples of the types of mortgage fraud cases that were targeted in this operation:

- Two people were arrested in Miami for preying upon the Haitian-American community by offering to assist them with immigration and housing issues. Instead the fraudsters used the Haitian-American's personal information to produce false documents to obtain mortgage loans.
- In California, a prominent home builder used straw buyers to sell his houses at inflated prices. The scheme inflated prices on other homes in the area, creating artificially high comparable sales and affecting the overall new-home market.
- In Detroit, FBI agents arrested several individuals in a \$130 million scheme organized by a local motorcycle gang. The gang members fraudulently represented themselves as mortgage brokers, appraisers, real estate agents, and title agents and used straw buyers to obtain around 500 mortgages on only 180 properties.

See FBI Press Release on Operation Stolen Dreams dated June 17, 2010.

White Collar Defense

While you may be an attorney skilled in handling commercial, financial, and mortgage banking litigation matters, you may soon need to learn about white collar criminal defense to fully represent your current clients. Criminal mortgage fraud cases present unique challenges for defense counsel. On one hand, a criminal mortgage fraud case may involve numerous documents and transactions that are familiar to a civil defense attorney who is experienced with commercial, financial, and mortgage banking litigation cases. On the other hand, the opposing side is not a local plaintiff's attorney, but an assistant U.S. attorney with the support of nationally trained and experienced task force agents with proactive investigative techniques including undercover operations, wiretaps, and surveillance. Defense counsel will need to balance the sophisticated financial aspects of

the case with the street crime nature of the investigation and prosecution of the case.

Who Is a Target?

Mortgage fraud has been defined as a "material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase or insure a loan." See Financial Crimes Section, FBI, FBI Financial Crimes Report to the Public (September 2006) (hereinafter "2006 FBI Financial Crimes Report"). The targets of these serious federal investigations include borrowers, lenders, investors, real estate professionals, appraisers, and real estate brokers. Many cases involve multiple co-conspirators involved in the underlying mortgage fraud scheme. In some cases it is not obvious which participants are involved in the conspiracy as participants and which persons may be innocent bystanders or additional victims. It is crucial that you know and understand the roles of the participants in assessing your client's role in a criminal investigation or indictment.

The Investigators

The Justice Department is not sympathetic to anyone perpetuating mortgage fraud crimes. In white collar crime, it's one strike and you're out. FBI agents are utilizing intelligence, enhanced surveillance, and undercover operations to identify key players behind large scale fraud and identify trends. Rest assured that the Task Force and numerous local and regional task forces targeting mortgage fraud are equipped with experienced personnel and advanced investigative tools.

Federal prosecutors are developing and maintaining relationships with community groups that come in contact with mortgage fraud victims, which helps prosecutors identify potential schemes. "Legal services attorneys, housing counselors, and housing activists ... have direct, personal contact with the people that mortgage fraud affects. By contacting [the U.S. Attorneys' office] right away when someone comes to them, they can save ... the time of searching out victims." See Michael S. Blume and Richard J. Zack, Using Community Outreach to Find and Prosecute Mortgage Fraud, United States Attorneys' Bulletin, May 2010.

"Mortgage fraud is no different from any other scheme to defraud; it is about lying

or hiding the truth for money. The fact that mortgage fraud occurs in the business environment is actually a huge plus for the investigation and... prosecution. The business environment requires documentation, and documentation means the fraud has left tracks." See Barbara E. Nelan, Finding the Smoking Gun, United States Attorneys' Bulletin, May 2010. Prosecutors have

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the subpoena power and the investigative tools necessary to gather all relevant documents and piece together the document puzzle before the defendants and their counsel even know that they are under a federal investigation. Well before indictment, the prosecutors have already identified and catalogued all the smoking gun documents necessary for prosecution.

The Crime

Historically, mortgage fraud cases are generally divided by law enforcement investigations into two basic categories: fraud for housing and fraud for profit. See 2006 FBI Financial Crimes Report; see also FFIEC Fraud Investigations Symposium, The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper 2 (Oct. 27–Nov. 7, 2003) (hereinafter "FFIEC Mortgage Loan White Paper"). Fraud for housing is typically perpetrated by an individual borrower who wants to purchase property that the borrower would not otherwise qualify to purchase. On the other hand, fraud for profit is a scheme where the purpose is to profit from either creating fictitious properties or falsely creating high property values and then looting the values of the properties. Mortgage fraud schemes can come in all shapes and sizes depending upon the ingenuity of the participants. However, there are



certain schemes that may be identifiable, including but not limited to, the following:

- **Property flipping** occurs when property is purchased and then its value is artificially inflated through false or fraudulent appraisals before being quickly resold. The purpose is to acquire as much money from the property as possible. The process may be repeated with

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co-conspirators or straw buyers until eventually the property is foreclosed. Unfortunately, the end buyer of the property may be an innocent bona fide purchaser of the property. Sophisticated defendants may use identity theft, straw buyers or shell companies to assist in the flipping schemes. *See* 2006 FBI Financial Crimes Report.

- **Equity skimming** occurs when the fraudster/investor recruits a straw buyer (or nominee) to obtain a mortgage in the straw buyer's name. After closing the straw buyer signs the property over to the investor by quit claim deed. The investor rents the property and pockets the rental income, and makes no payments on the mortgage. Eventually the property is foreclosed by the lender for non-payment. Even worse, the unknowing tenants may continue to pay rent to the fraudster for a period of time during the foreclosure process. *See* 2006 FBI Financial Crimes Report.
- **Chunking** occurs when a fraudster recruits homebuyers or investors to buy investment rental property for a commission. The investor is promised some incentive such as no down payment; the fraudster will find tenants, manage the property and re-sell the property after a designated period of time. In reality, the fraudster fails to find tenants, fails

to make mortgage payments, and fails to sell the property. *See* FFIEC Mortgage Loan White Paper at 14.

- **Foreclosure fraud**, also known as "mortgage rescue" fraud, occurs when fraudsters identify homeowners who are at risk of default, or who are in need of help with a property that is close to foreclosure. The fraudster offers help by having the borrower surrender title of the property to the fraudster with promises of refinance or securing a better interest rate. The homeowner agrees to pay rent to the fraudster and buy back the property over a long period of time. The borrower is then unable to meet the terms of the buy back and the homeowner is stripped of both ownership and equity in the home. *See* 2006 FBI Financial Crimes Report; see also Steve Tripoli and Elizabeth Renault, Nat'l Consumer Law Ctr. Report, *Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure "Rescue Scams"* 8 (June 2005).

Strategy for Preparing a Defense

Typically, by the time you learn of the investigation or indictment, the government has already gathered all relevant information and evidence for prosecution of the case. Many civil defense attorneys find themselves surprised by the speed of criminal investigations and indictments, but that's due in part to the fact that the government has already been working the case for a period of time before the civil defense attorney finds out. Additionally, civil defense counsel are comfortable with the rules of civil procedure that allow for discovery and exchange of information. Such is not the case in a criminal case where discovery is severely limited in comparison to the rules of civil procedure.

Unfortunately, many clients will cling to denials saying that they "are innocent," "didn't start out intending to do anything wrong," "it wasn't my idea," or believing that they will ultimately prevail at trial. If the client has not been indicted, then you may still have some time to evaluate and conduct your own investigation into the case. However, defense counsel should not wait on indictment to evaluate and begin defending the case.

A good defense strategy should focus on

quickly evaluating and determining your client's involvement. Interviewing the client is the first step, but the client's version of the story will undoubtedly need to be verified by performing independent investigation of the allegations and the co-conspirators. Defense counsel should work to obtain all relevant documents from all possible participants including the client, the lender, the broker, the appraiser, the real-estate agent, the closing agent and/or attorney, the borrower, and the seller. To the extent possible, defense counsel should consider interviewing as many other players as possible. It is the inconsistencies in the documents and information from each of the relevant players that will be crucial to evaluating the case.

The next step is to follow the money. This may include hiring a forensic accountant, a consultant, or other appropriate investigator to trace the funds connected to the baseline property transaction. The amount of money flowing to various players will be critical to evaluating the case and will undoubtedly be central to the government's investigation and later prosecution. Furthermore, it is necessary for defense counsel to understand the flow of money to determine your client's culpability, knowledge, credibility, and the potential for criminal charges.

After you have reviewed and considered the facts and all relevant documents it is time to engage in an honest assessment of your client's potential risks and culpability. Unfortunately, defense counsel may not be able to fully investigate the case and there may be documents and information that are unavailable for evaluation. Defense counsel should remember that the government has information and documents that the client and defense counsel will not be able to review. However, an accurate assessment of the client and the client's involvement and culpability is crucial to representation of your client.

If not already engaged, at this point, defense counsel will likely need to engage experienced white collar counsel and consider whether the client should cooperate with the government. Determining whether cooperation is the right strategic move for your client can only be determined on an individual case basis. In federal cases,

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defense counsel should consider taking appropriate and timely action based upon the defense counsel's own investigation, culpability assessment, and serious discussions with the client. Depending upon the timing and stage of the investigation, a meeting with the prosecuting or investigating authority may be useful. If the meeting occurs pre-indictment when defense counsel may not yet be entitled to full disclosure of all the facts and discovery, the meeting can provide potentially valuable information.

Timing is crucial to obtaining the full benefit of cooperation for the client. If your client has information that is useful to the investigators and chooses to cooperate against other participants in a mortgage fraud scheme, then defense counsel should start that process as soon as possible. On the other hand, the longer a client waits to cooperate, the more likely it is that other participants will meet with prosecutors and the value of the client's information may diminish. Additionally, it is necessary to maintain a realistic approach with the client and know that cooperation does not necessarily mean that the client will be exempt from punishment.

Punishment

The Department of Justice has sought significant jail sentences in mortgage fraud

cases. On May 4, 2010, Assistant Attorney General Lanny Breuer, before the United States Senate Committee on the Judiciary Subcommittee on Crime and Drugs, stated "Our prosecutors and agents are determined to ensure that wrongdoers are punished. This means seeking jail time whenever appropriate. We believe that these efforts are critical to restoring investor confidence in the markets and ensuring that our corporate citizens play fair. Recognizing the deterrent value of jail time, the department has sought significant prison sentences against white collar criminals." Breuer went on to state that punishment for fraud can mean "significant statutory penalties, for example, up to 20 years for each count of wire fraud and up to 25 years for each count of securities fraud." Additionally, the Federal Sentencing Guidelines allows for consideration of other factors, including the amount of loss, which can result in significant guideline sentencing ranges. Following the U.S. Supreme Court's decision in the *Booker* case, the Federal Sentencing Guidelines are advisory. *United States v. Booker*, 543 U.S. 220 (2005). Therefore, sentencing judges are not required to impose a sentence that falls within the Federal Sentencing Guideline range, and may result in harsher sentences than those set forth in the Federal Sentencing Guidelines.

In addition to seeking jail time in mortgage fraud cases, the Department of Justice

is also seeking substantial fines and forfeitures against individuals and corporations involved in mortgage fraud schemes.

Conclusion

It is troubling that many individuals believe that banks and lending institutions cannot be victims because the banks are considered to be alleged perpetrators. However, the unrelated wrongs of banks or lending institutions do not excuse the fraudulent acts of individual defendants who engage in mortgage fraud schemes that target the banks and lending institutions. The government is calling for aggressive and well coordinated law enforcement response to the financial crisis, including thorough investigation and prosecution of all instances of mortgage fraud by any individual or corporation engaged in activity to defraud customers. These mortgage fraud schemes not only prey upon unsuspecting and innocent homeowners, these schemes prey upon lenders and jeopardize property values and billions of dollars of private and public money. If you find that one of your clients is the subject of a criminal mortgage fraud investigation, the best advice is to quickly investigate the case and be prepared to provide your client with advice that will help your client maneuver through difficult decisions and develop the best defense strategy for facing a criminal mortgage fraud case. 