

# DEBT DECEPTION

Financial Reporting from  
The Center for Public Integrity



THE CENTER FOR  
PUBLIC INTEGRITY

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# About the Center and iWatch News

The Center for Public Integrity is a nonprofit, nonpartisan, and independent digital news organization specializing in original investigative journalism and research on significant public policy issues.

Since 1990, the Washington, D.C.-based Center has released more than 475 investigative reports and 17 books to provide greater transparency and accountability of government and other institutions. It has received the prestigious George Polk Award and more than 32 other national journalism awards and 18 finalist nominations from national organizations, including PEN USA, Investigative Reporters and Editors, Society of Environmental Journalists, Overseas Press Club, and National Press Foundation.

In 2011 the Center launched iWatch News. Visit [www.iWatchNews.org](http://www.iWatchNews.org) for ongoing coverage of numerous topics, including the stories featured in this newsbook.

## Project Credits

**Executive Director:** Bill Buzenberg

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**iWatch Newsbook Design:** Roger Fidler, Donald W. Reynolds Journalism Institute in Columbia, Missouri. [www.rjionline.org](http://www.rjionline.org)

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This iWatch Newsbook collects a number of stories published by the Center between February and October of 2011. Taken together, they provide a look at how massive corporations and shady lending practices have contributed to the decay of the financial system. To see the original stories, along with video and new pieces about the financial collapse and its impact on the country, please visit [www.iWatchNews.org](http://www.iWatchNews.org)

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## About the Authors

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**David Heath** comes from *The Seattle Times*, where he was three times a finalist for the Pulitzer Prize. He co-authored an investigation of conflicts of interest surrounding clinical cancer research at a Seattle hospital. The series won the Harvard University's Goldsmith prize for investigative reporting, the George Polk award for medical reporting, the Gerald Loeb award, the Scripps Howard Foundation's public service award, the Associated Press Managing Editors' public service award and the Newspaper Guild's Heywood Brown award. Heath's recent expose on congressional earmarks was recognized by the National Press

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# Whistleblowers silenced to protect fraudsters, say former Countrywide employees

iWatch News investigative series reveals legacy of corruption that still plagues Bank of America

By Michael Hudson

Published Online | September 22, 2011

**I**N THE SUMMER OF 2007, a team of corporate investigators sifted through mounds of paper pulled from shred bins at Countrywide Financial Corp. mortgage shops in and around Boston.

By intercepting the documents before they were sliced by the shredder, the investigators were able to uncover what they believed was evidence that branch employees had used scissors, tape and Wite-Out to create fake bank statements, inflated property appraisals and other phony paperwork. Inside the heaps of paper, for example, they found mock-ups that indicated to investigators that workers had, as a matter of routine, literally cut and pasted the address for one home onto an appraisal for a com-



## THE GREAT MORTGAGE COVER-UP

pletely different piece of property.

Eileen Foster, the company's new fraud investigations chief, had seen a lot of slippery behavior in her two-plus decades in the banking business. But she'd never seen anything like this.

"You're looking at it and you're going, Oh my God, how did it get to this point?" Foster recalls. "How do



Todd Wawrychuk/Image Group LA

**Eileen Foster was mortgage fraud investigations chief for Countrywide Financial Corp., which eventually became Bank of America.**

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you get people to go to work every day and do these things and think it's okay?"

More surprises followed. She began to get pushback, she claims, from company officials who were unhappy with the investigation.

One executive, Foster says, sent an email to dozens of workers in the Boston region, warning them the fraud unit was on the case and not to put anything in their emails or instant messages that might be

used against them. Another, she says, called her and growled into the phone: "I'm g--d---ed sick and tired of these witch hunts."

Her team was not allowed to interview a senior manager who oversaw the branches. Instead, she says, Countrywide's Employee Relations Department did the interview and then let the manager's boss vet the transcript before it was provided to Foster and the fraud unit.

In the end, dozens of employ-

ees were let go and six branches were shut down. But Foster worried some of the worst actors had escaped unscathed. She suspected, she says, that something wasn't right with Countrywide's culture — and that it was going to be rough going for her as she and her team dug into the methods used by Countrywide's sales machine.

By early 2008, she claims, she'd concluded that many in Countrywide's chain of command were working to cover up massive fraud within the company — outing and then firing whistleblowers who tried to report forgery and other misconduct. People who spoke up, she says, were “taken out.”

By the fall of 2008, she was out of a job too. Countrywide's new owner, Bank of America Corp., told her it was firing her for “unprofessional conduct.”

Foster began a three-year battle to clear her name and establish that she and other employees had been punished for doing the right thing. Last week, the U.S. Department of Labor ruled that Bank of America had illegally fired her as payback for exposing fraud and retaliation against whistleblowers. It ordered the bank to reinstate her and pay her some \$930,000.

Bank of America denies Foster's allegations and stands behind its decision to fire her. Foster sees the ruling as a vindication of her decision to keep fighting.

“I don't let people bully me, intimidate me and coerce me,” Foster told iWatch News during a series of interviews. “And it's just not right that people don't know what happened here and how it happened.”

### ‘Greedy people’

This is the story of Eileen Foster's fight against the nation's largest bank and what was once the nation's largest mortgage lender. It is also the story of other former Countrywide workers who claim they, too, fought against a culture of corruption that protected fraudsters, abused borrowers and helped land Bank of America in a quagmire of legal and financial woes.

In government records and in interviews with iWatch News, 30 former employees charge that Countrywide executives encouraged or condoned fraud. The misconduct, they say, included falsified income documentation and other tactics that helped steer borrowers into bad mortgages.

Eighteen of these ex-employ-

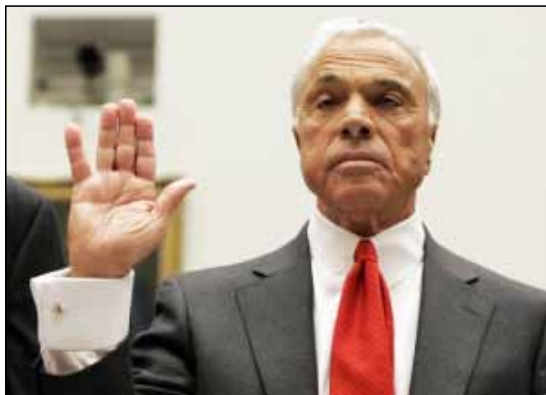


ees, including Foster, claim they were demoted or fired for questioning fraud. They say sales managers, personnel executives and other company officials used intimidation and firings to silence whistleblowers.

A former loan-underwriting manager in northern California, for example, claimed Countrywide retaliated against her after she sent an email to the company's founder and chief executive, Angelo Mozilo, about questionable lending practices. The ex-manager, Enid Thompson, warned Mozilo in March 2007 that "greedy unethical people" were pressuring workers to approve loans without regard for borrowers' ability to pay, according to a lawsuit in Contra Costa Superior Court.

Within 12 hours, Thompson claimed, Countrywide executives began a campaign of reprisal, reducing her duties and transferring staffers off her team. Corporate minions, she charged, ransacked her desk, broke her computer and removed her printer and personal things.

Soon after, she said, she was



Susan Walsh/AP

**Countrywide Financial Corp. former CEO Angelo Mozilo is sworn in during a House Oversight and Government Reform Committee hearing in 2008.**

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fired. Her lawsuit was resolved last year. The terms were not disclosed.

Bank of America officials deny Countrywide or Bank of America retaliated against Foster, Thompson or others who reported fraud. The bank says Foster's firing was based only on her "management style." It says it takes fraud seriously and never punishes workers who report wrongdoing up the corporate ladder.

When fraud happens, Bank of America spokesman Rick Simon says, "the lender is almost always a victim, even if the fraud is per-

petrated by individual employees. Fraud is costly, so lenders necessarily invest heavily in both preventing and investigating it."

When it uncovers fraud, Simon says, the bank takes "appropriate actions," including firing the employees involved and cooperating with law-enforcement authorities in criminal investigations.

Mozilo's attorney, David Siegel, told iWatch News it was "unlikely that Mr. Mozilo either would have had a direct role with, or would recall, specific employee grievances, and it would be inappropriate for him to comment on individual employment issues in any event." Siegel added that "any implication that he ever would have tolerated much less condoned to any extent misconduct or fraudulent activity in loan production and underwriting ... is utterly baseless."

In closed-door testimony a year ago, the ex-CEO defended his company, telling the federal Financial Crisis Inquiry Commission that Countrywide "probably made more difference in society, in the integrity of our society, than any company in the history of America."

Foster says that, in her experience, Mozilo urged managers to crack down on fraud. If he saw an

email about a fraudster within the ranks, she says, he would hit "reply all" and type, "Track the bastard down and fire him."

She says, though, that others within the company often screened his emails, and it's likely Mozilo never saw Thompson's email or many other messages about fraud.

"My sense is they kept things from Angelo," she says.

### 'An old matter'

When Bank of America announced in January 2008 that it was going to buy Countrywide at a fire-sale price, some analysts thought it was a great move, one that would leave the bank well positioned once the home-loan market recovered.

Almost three years later, defaults on loans originated by Countrywide have soared and Bank of America's stock price has plunged as investors and government agencies have pursued mortgage-related claims totaling tens of billions of dollars.

Federal and state officials are pressing Bank of America and other big players to settle charges they used falsified documents to speed homeowners through foreclosure. Lawsuits filed on behalf of investors claim Countrywide lied about

the quality of the pools of mortgages that the lender sold them during the home-loan boom.

Bank of America says issues related to Countrywide are old news. Last year a spokesman described fraud claims by state officials as “water under the bridge,” noting that the bank settled with dozens of states soon after buying Countrywide.

When federal officials announced Foster’s victory last week, Bank of America dismissed the case as “an old matter dating from 2008.”

Accounts from Foster and other former employees, however, put the bank in an uncomfortable position. These accounts, as well as lawsuits pushed by investors, borrowers and government agencies, raise questions about how diligently the bank has worked to clean up the mess caused by Countrywide — and whether the bank has tried to curtail its legal liability by papering over the history of corruption at its controversial acquisition.

In Foster’s case, the Labor Department notes that two senior Bank of America officials — not former Countrywide executives — made the decision to fire her.

The agency says the investigations led by Foster found “widespread and pervasive fraud” that,

Foster claimed, went beyond misconduct committed at the branch level and reached into Countrywide’s management ranks.

Foster told the agency that instead of defending the rights of honest employees, Countrywide’s employee relations unit sheltered fraudsters inside the company. According to the Labor Department, Foster believed Employee Relations “was engaged in the systematic cover-up of various types of fraud through terminating, harassing, and otherwise trying to silence employees who reported the underlying fraud and misconduct.”

In government records and in interviews with iWatch News, Foster describes other top-down misconduct:

- She claims Countrywide’s management protected big loan producers who used fraud to put up big sales numbers. If they were caught, she says, they frequently avoided termination.
- Foster claims Countrywide’s subprime lending division concealed from her the level of “suspicious activity reports.” This in turn reduced the number of fraud reports

Countrywide gave to the U.S. Treasury's Financial Crimes Enforcement Network.

- Foster claims Countrywide failed to notify investors when it discovered fraud or other problems with loans that it had sold as the underlying assets in "mortgage-backed" securities. When she created a report designed to document these loans on a regular basis going forward, she says, she was "shut down" by company officials and told to stop doing the report.

In Foster's view, Countrywide lost its way as it became a place where everyone was expected to bend to the will of salespeople driven by a whatever-it-takes ethos.

The attitude, she says, was: "The rules don't matter. Regulations don't matter. It's our game and we can play it the way we want."

Bank of America declined to answer detailed questions about Foster's allegations. Simon, the bank spokesman, told iWatch News "we are certain" that Foster's claims "were properly and fully investigated by Countrywide and appropriate actions were taken."

And not all former Countrywide

workers say that fraud was condoned by management.

Frank San Pedro, who worked as a manager within the investigations unit from 2004 to 2008, told the Financial Crisis Inquiry Commission the company worked hard "to root out all the fraud that we could possibly find. We continued to get better and better at it."

**Foster claims Countrywide failed to notify investors when it discovered fraud or other problems with loans that it had sold as the underlying assets in "mortgage-backed" securities.**

He said most of the fraud was "external" — outsiders trying to rip off the lender — and in-house sales staffers who tried to push through fraudulent loans "seldom got away with it."

Gregory Lumsden, former head of Countrywide's subprime division, Full Spectrum Lending, says there are thousands of ex-Countrywidors who can vouch for the company's honesty. When bad actors were caught, he says, Countrywide took swift action.

"I don't care if you're Microsoft or you're the Golf Channel or DuPont or MSNBC: companies are

going to make some mistakes,” Lumsden told iWatch News. “What you hope is that companies will deal with employees that do wrong. That’s what we did.”

## The American Dream

In February 2003, Countrywide’s founder and CEO, Angelo Mozilo, gave a lecture hosted by Harvard’s Joint Center for Housing Studies titled “The American Dream of Homeownership: From Cliché to Mission.”

Mozilo, the Bronx-born son of a butcher, had started Countrywide with a partner in 1969 and built it into a home-loan empire that was now on the verge of becoming the nation’s largest home lender.

But he saw trouble on the horizon. Before his audience of academics and business people, he complained that a “regulatory mania” was hurting Countrywide and other “reputable” mortgage lenders. Overreaching predatory lending laws, he said, were threatening shut the door to homeownership for hard-working low-income and minority families. Industry and citizenry needed to work together to prevent government from strangling the mortgage market, he said.

It wasn’t, Mozilo added, that he was against cracking down on bad apples that took advantage of vulnerable borrowers.

“These lenders,” the CEO said, “deserve unwavering scrutiny and, when found guilty, an unforgiving punishment.”

Around the time Mozilo was giving his speech back east, one of his employees was finding what she later claimed to be evidence of serious fraud at Countrywide’s Rosville, Calif., branch.

Employees were falsifying loan applicants’ salaries in mortgage paperwork and forging their names on loan documents, according to a lawsuit filed by Michele Brunelli, who was a loan processor and later a branch operations manager for Countrywide. In March 2003, Brunelli recalled, she used the company’s “ethics hotline” and lodged what she thought was a confidential complaint.

Immediately after, Brunelli claimed, her regional manager yelled at her for calling the hotline. Then, she said, her immediate supervisor called her in and reprimanded her for making the complaint.

“Not everyone’s hands are clean in this office,” the branch manager

said, according to Brunelli. “Are you ready for that?”

Brunelli didn’t back down. She continued reporting evidence of fraud to the executives above her, her lawsuit said. They dismissed her concerns, she said, saying she was having “emotional outbursts” and accusing her of being “on a witch hunt.”

**“Corporate came in. We told them the story. We told them everything. They said don’t worry, whatever you say, you’re going to be covered. A month or so later, I was let go.”**

In court papers, the company flatly denied her allegations, accusing Brunelli of acting in “bad faith.” Her lawsuit was resolved in 2010.

Two other former Countrywide workers, Sabrina Arroyo and Linda Court, claimed they lost their jobs in 2004 after they complained supervisors were directing them to

forge borrowers’ signatures on loan paperwork. After they informed Employee Relations about the forgeries, the company quickly fired them, they claimed.

“Corporate came in. We told

them the story. We told them everything,” Arroyo told iWatch News. “They said don’t worry, whatever you say, you’re going to be covered. A month or so later, I was let go.”

Arroyo and Court sued Countrywide in state court in Sacramento, but Countrywide won an order forcing the case into arbitration. They decided to drop their claim because the odds are stacked against workers in arbitration, their attorney, William Wright, said.

Some ex-employees say they went high up Countrywide’s chain of command to raise red flags about fraud. Mark Bonjean, a former operations unit manager in Arizona, complained to a divisional vice president, according to a lawsuit in state court in Maricopa County. Within two hours of sending the VP an email about what he believed were violations of the state’s organized crime and fraud statutes, the suit said, he was placed on administrative leave. The next day, according to the lawsuit, he was fired.

Another ex-Countrywider, Shalima Shaheem, claimed she took her complaints to the very top. Like Enid Thompson before her, she said she wrote an email directly to Mozilo, the CEO, about fraud and retaliation. She never heard back

from Mozilo, according to her lawsuit in Contra Costa Superior Court. Instead, the suit said, she was subjected to a campaign of harassment by company executives and human-resources representatives that forced her to leave her job.

Shaheem's case was settled out of court, her attorney said.

A Bank of America spokesman declined to respond to questions about allegations by Shaheem, Bonjean and other former Countrywide employees, noting that their claims "are related to situations and investigations that took place at Countrywide prior to Bank of America acquiring the company."

### 'Fund the loans'

Countrywide had been slower than many other mortgage lenders to fully embrace making subprime loans to borrowers with modest incomes or weak credit. By 2004, though, Countrywide had become a player in the market for subprime deals and many other nontraditional mortgages, including loans that didn't require much documentation of borrowers' income and assets.

These loans were part of the plan for meeting its CEO's audacious goal of growing his company

from a giant to a colossus. Mozilo had vowed that his company would double its share of the home-loan market to 30 percent by 2008.

**Former Countrywide CEO Angelo Mozilo had vowed that his company would double its share of the home-loan market to 30 percent by 2008.**

Some former Countrywide employees say the pressure to push through more and more loans encouraged an anything-goes attitude. Questionable underwriting practices often helped risky loans sail through the lender's loan-approval process, they say.

In one example, Countrywide approved a loan for a borrower whose application listed him as a dairy foreman earning \$126,000 a year, according to a legal claim later filed by Mortgage Guaranty Insurance Co., a mortgage insurer. It turned out that the borrower actually milked cows at the dairy and earned \$13,200 a year, the lawsuit alleged.

The borrower provided the correct information, but the lender booked the loan based on data that inflated his wages by more than 800

percent, the legal claim said.

In another instance, according to a former manager cited as a “confidential witness” in shareholders’ litigation against the company, employees appeared to be involved in a “loan flipping” scheme, persuading borrowers to refinance again and again, giving them little new money, but piling on more fees and ratcheting up their debt. The witness recalled that when the scheme was pointed out to Lumsden, Countrywide’s subprime loan chief, the response from Lumsden was “short and sweet”: “Fund the loans.”

Such episodes weren’t uncommon, the witness said. In early 2004, he claimed, he discovered that Nick Markopoulos, a high-producing loan officer in Massachusetts, had cut and pasted information from the Internet to create a fake verification of employment for a loan applicant. Markopoulos left the company of his own accord, the witness said, but he was soon rehired as a branch manager.

The witness said he contacted a regional vice president to object to rehiring an employee with a history of fraud. But he said the regional VP — citing Markopoulos’s high productivity — overruled his objections.

Markopoulos couldn’t be reached for a response. Lumsden says he doesn’t recall any incident involving “loan flipping” allegations.

### Brushed off

Eileen Foster knew little about Countrywide’s fraud problems when she took a job with the company in September 2005.

For Foster, the move seemed like a natural progression. She’d accumulated 21 years’ experience in the banking business, starting out as a teller at Great Western Bank and working her way up to vice president for fraud prevention and investigation at First Bank Inc.

Countrywide brought her on as a first vice president and put her in charge of a high-priority project: An overhaul of how the company handled customer complaints.

The company’s systems for handling complaints, Foster recalls, were disjointed and ineffective. Various divisions had differing policies and there wasn’t much effort to ensure that complaints got addressed. Things had gotten so bad, she says, federal banking regulators ordered the company to do something about the problem. Foster’s task was to standardize the company’s proce-



dures and ensure that people with complaints didn't get brushed off.

As she set about fixing the problems, she says, she encountered things that gave her pause.

The company's mortgage fraud investigation unit, Foster says, refused to share data about the complaints it received. Each time she requested the stats, she says, she hit a brick wall.

Foster says she also ran into a hitch when she began distributing a monthly report that broke down complaint data for each of the companies' operating divisions.

Countrywide Home Loans Servicing, which collected borrowers' payments each month, was the subject of complaints about its foreclosure practices and other issues. The volume of serious complaints involving the servicing unit topped 1,000 per month, dwarfing the number for other divisions.

This upset officials with the servicing unit, Foster recalls. The complaints weren't "real complaints," the servicing execs argued, and Foster was making the unit look bad by including them in her reports.

The upshot: Foster was ordered, she says, not to include many of the complaints about the servicing unit

in her reports. She thought it was odd, she says, but she didn't think it was evidence of a larger pattern. She figured it was mostly an exercise in backside-covering.

"When we lost at the meeting, I was like, 'OK, they want to just cover this up,'" Foster says. "But it wasn't anything to the scale that I thought it would cause great harm."

Only later — after she took over the mortgage fraud investigation unit — did she realize, she says, that cover ups were part of the culture of Countrywide, and that efforts to paper over problems had less to do with bureaucratic infighting and more to do with hiding something darker within the company's culture.

"What I came to find out," she says, "was that it was all by design."

## Bouquets and handbags

State law enforcers would later charge that Countrywide executives designed fraud into the lender's systems as a way of boosting loan production. During the mortgage boom, critics say, Countrywide and other lenders didn't worry about the quality of the loans they were making because they often sold the loans to Wall Street banks and investors. So long as borrow-

ers made their first few payments, the investors were usually the ones who took the hit if homeowners couldn't keep up with payments.

Countrywide treated borrowers, California's attorney general later claimed, "as nothing more than the means for producing more loans," manipulating them into signing up for loans with little regard for whether they could afford them.

Countrywide's drive to boost loan production encouraged fraud, for example, on loans that required little or no documentation of borrowers' finances, according to a lawsuit by the Illinois attorney general. One former employee, the suit said, estimated that borrowers' incomes were exaggerated on 90 percent of the reduced-documentation loans sold out of his branch in Chicago.

One way that Countrywide booked loans was by paying generous fees to independent mortgage brokers who steered customers its way. Countrywide gave so little scrutiny to these deals that borrowers often ended up in loans that they couldn't pay, the state of Illinois' suit said.

In Chicago, the suit said, Countrywide's business partners included a mortgage broker controlled by a five-time convicted felon.

One Source Mortgage Inc.'s owner, Charles Mangold, had served time for weapons charges and other crimes, the suit said.

One Source received as much as \$100,000 per month in fees from Countrywide, banking as much as \$11,000 for each loan it steered to the lender. Mangold, in turn, showered a Countrywide branch manager and other employees with expensive gifts, including flowers and Coach handbags, the suit said.

**One former employee estimated that borrowers' incomes were exaggerated on 90 percent of the reduced-documentation loans sold out of his branch in Chicago.**

Countrywide in turn funded a stream of loans arranged by One Source, the suit said, even as the broker misled borrowers about how much they'd be paying on their loans and falsified information on their loan applications. One borrower provided pay stubs and tax returns showing he earned no more than \$48,000 per year, but One Source listed his income as twice that much, according to the suit.

Mangold couldn't be reached for comment. His attorney said in

2007 that Mangold denied all of the state's allegations against him.

Countrywide, the state's suit said, kept up its partnership with One Source for more than three years. It didn't end the relationship until the state sued One Source for fraud and slapped Countrywide with a subpoena seeking documents relating to the broker.

As questionable practices continued, Countrywide's fraud investigation unit had trouble keeping up, according to Larry Forwood, who worked as a California-based fraud investigator for Countrywide in 2005 and 2006, before Foster took over the fraud unit. His personal caseload totaled as many as 100 cases at a time, many of them involving dozens or hundreds of loans each.

Some cases involved mortgage brokers or in-house staffers who pressured real-estate appraisers to inflate property values. The company maintained a "do not use" list of crooked appraisers who'd been caught falsifying home values, but the sales force often ignored the list and used these appraisers anyway, Forwood says.

Countrywide's fraud investigation unit did have some successes during Forwood's tenure. It shut

down a branch in the Chicago area, he said, after a rash of quick-defaulting loans sparked a review that uncovered evidence of bogus appraisals and forged signatures on loan paperwork. One manager, Forwood says, tried to rationalize the fraud, telling investigators:

**The company maintained a "do not use" list of crooked appraisers who'd been caught falsifying home values, but the sales force often ignored the list and used these appraisers anyway.**

What was the big deal if, say, five out of every 30 loans was fraudulent?

When the unit shut down a branch in southern California after uncovering similar evidence of fraud, Forwood recalls, it got some push-back. It came all the way from the top,

he says, via a phone call to the fraud unit from Mozilo.

"He got very upset," Forwood says. "He basically got on the phone and said: 'Next time you need to do that, clear it with me.'"

Mozilo's attorney didn't respond to questions from iWatch News about Forwood's account. ■

# Mortgage industry tanks, fraud continues at Countrywide

By Michael Hudson

Published Online | September 23, 2011

**T**HE MORTGAGE MARKET was struggling in March 2007 when Countrywide promoted Eileen Foster to executive vice president and tapped her to take over the company's mortgage fraud unit.

Home prices were sputtering, borrower defaults were climbing, and the industry leader, Countrywide, would soon be forced to ask Bank of America for an infusion of capital to help it keep afloat.

The fraud investigation unit was also struggling. The company had laid off several experienced investigators, according to Foster. Those who remained were faced with an ever-growing number of fraud complaints.

Foster had roughly two dozen investigators working for her, but only four or five had real investigative chops, Foster says. Many of the rest had been brought over to the unit from clerical jobs, she says.

The other problem was that the



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company's fraud investigation resources were balkanized. In addition to the company-wide fraud unit that Foster had taken over, many of the operating divisions, such as Countrywide's subprime unit, had their own smaller investigative teams.

This didn't make sense to Foster. It meant the smaller investigative teams reported to divisional sales executives who might be tempted to discourage aggressive fraud investigations in order to protect the flow of loans into the company's production pipeline.



Chuck Burton/AP File

**Bank of America, their N.C. headquarters are shown above, acquired Countrywide Financial in Jan. 2008.**

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One of her first tasks was to oversee a fraud mitigation “reengineering” that would consolidate all fraud investigation within her unit. In June 2007, she presented the plan in a series of meetings with divisional presidents.

A few weeks later, she learned that the plan had been shelved. There was no explanation why, she

says, only that it wasn’t the right time for a reorganization.

She didn’t have time to dwell on the setback. In July, her unit had fielded a call from an ex-employee who claimed he’d been fired because he’d objected to fraud at one of Countrywide’s subprime loan offices in the Boston area.

Foster arranged to have the con-

tractor that handled the Boston branches' shredding set aside the paperwork they hauled off site and hold it in a secure location. Then a team made up of her investigators and other company representatives headed to Boston to go through the piles of paper.

After finding evidence of "cut and paste" document forgery, the team did a full sweep of the offices in question. On top of workers' desks, Foster says, they found an unusual number of Wite-Out dispensers. And inside their desk drawers, she says, they found folders holding blank templates for account statements from various banks and brokerage firms, such as Bank of America and Washington Mutual.

In some of the offices, investigators found more than one fax machine. During interviews with investigators, workers admitted that the extra fax machine was used to simulate faked documents being sent in by borrowers, Foster says. To eliminate a paper trail, she says, branch staffers had programmed the sending fax machine so there was no banner identifying the fax number from which the transmission originated.

The fraud seemed routine and the investigation showed "that the

phony activities of these employees were known ... and tolerated by management," Foster later said in a witness statement in a Country-wide shareholders lawsuit in federal court in Los Angeles.

After the company had closed one branch and was preparing to shut five more, Lumsden, the company's subprime lending chief, called Foster and angrily accused her of running a witch hunt, Foster claims.

Foster told iWatch News that, during a later conference call, Lumsden argued that the tactics that workers were using in the branches weren't designed to take advantage of customers, but rather were a way

of cutting red tape and speeding deals through the company's loan-approval system.

"This is jaywalking," Foster recalls him saying. "Not murder."

Lumsden told iWatch News he didn't recall the phone calls Foster

**In some of the offices, investigators found more than one fax machine. Workers admitted that the extra fax machine was used to simulate faked documents being sent in by borrowers.**

describes. “I’m not able to really comment on anything she has to say,” he says. “I don’t remember Foster, and I don’t remember the conversation.”

As for the Boston investigation, Lumsden says the company handled things the way it should have. “I don’t know what else to say,” he says. “People who did things wrong were terminated.”

Roughly 44 employees in the Boston area lost their jobs.

Foster says, though, that she was blocked from establishing what responsibility upper level executives might have had for the problems in those branches.

She says her unit wasn’t allowed to interview Markopoulos, the former loan officer who had risen to executive vice president of the subprime division with supervisory authority over the Boston region. Instead, she says, Employee Relations conducted the interview, asking Markopolous a series of “tepid” questions and then allowing his boss, Lumsden, to review the transcript before it was turned over to Foster’s unit.

### ‘Shadow approvals’

While Foster was fighting battles within Countrywide’s corporate of-

fices, some employees in the field were getting first-hand lessons, they say, in how far the company’s go-go sales culture was willing to go.

Lupe Manegdeg, a loan specialist at a Countrywide office in Glendale, Calif., claimed that, in early 2007, she discovered that loan officers in her branch were defrauding borrowers in a variety of ways — including forging their signatures on documents and lying to them about the type of loans they were getting.

She reported this, she said, to her supervisors, to Countrywide human-resources officials and to the company’s fraud hotline. The company responded, her lawsuit in state court in Los Angeles said, by firing her.

The case was settled last year before Countrywide had a chance to respond to Manegdeg’s allegations.

One of the highest-level employees to complain about fraud inside Countrywide was Mark Zachary.

Zachary took a job in August 2006 as a vice president in the Houston, Texas, division of Countrywide KB Home Loans. The lender was owned by Countrywide as part of a joint venture between Countrywide and KB Home, one of the nation’s

largest home builders. Countrywide KB Home Loans provided the credit that allowed home buyers to purchase houses being constructed at a furious pace by KB Home.

Soon after he started, Zachary began questioning Countrywide executives about inflated property appraisals and “other grave illegal issues,” according to a lawsuit [5] he later filed in federal court in Texas. The bogus appraisals duped both the consumers, who ended up borrowing more than the homes were actually worth, as well as the investors who bought the loans on Wall Street, Zachary said.

In April 2007, his suit said, he sent an email to Countrywide’s employee relations unit, warning that selling people overpriced homes and putting them into loans they couldn’t afford was a “formula for disaster.”

His suit claimed that he also clashed with management over a requirement that the lending unit approve 10 percent of backlogged loan applications each day so the green light could be given to KB Home to start building the homes under contract. After he said he couldn’t meet that goal, he was “taken out of the loop” and “treated like a pariah by his supervisor.”

Instead, Zachary charged, Countrywide KB Home Loans began OK’ing applications through a back-door process in which loans were in essence “being approved without a review by an underwriter.”

These authorizations, he said, had a special name: “Shadow Approvals.”

And Zachary? A supervisor wrote him up for “performance issues,” he said, a stark turnaround from a glowing performance evaluation he’d received three months before. He was terminated two weeks after the written warning, his lawsuit said.

After Zachary sued, Countrywide said it had “investigated each of his claims and found no merit to his accusations.” It said Zachary had “received verbal counseling on his performance, as well as written feedback in the form of his evaluation, before he first made allegations of impropriety.”

Countrywide said its lending operations were “prudently and effectively managed” and that its ethical standards were “rigorously enforced.”

Zachary and Bank of America reached an out of court settlement in the case in 2009. As part of the settlement, Zachary agreed not to



talk further about his experiences at Countrywide.

### **‘Everybody’s flipping out’**

After the Boston investigation, Foster says, she continued to run into problems with Countrywide’s management

She says she urged the company’s internal audit unit to investigate the lack of accurate reporting of suspicious activity reports. An audit report about fraud across the company’s divisions was “edited down” and in the end “said almost nothing” about problems with reporting the suspicion activity reports, Foster says.

She also hit a roadblock, she says, when she started putting together a report listing all the questionable loans that had been sold to investors. A superior, she says, told her: “You need to pull it. Everybody’s flipping out.”

Management didn’t want the information put down on paper, she believed, because then it would have to buy back the bad loans. The company left it up to investors, she says, to find fraud-tainted loans themselves — a difficult task given the volume of loans pooled into mortgage-backed securities deals.

Foster also began clashing with Countrywide’s employee relations unit, which had a key role in disciplinary actions against employees. Employee Relations, she says, worked with sales managers to shield high-producing salespeople from scrutiny.

In one case, a branch manager hung on to his job despite fraud allegations that went back five years. Workers complained he was doing drugs and ranting and screaming in the office. After the manager swore he only took prescription drugs, Foster says, Employee Relations labeled the drug allegations unsubstantiated.

One witness claimed the manager had threatened to kill an employee’s family. Another supposed witness was too scared to speak, trembling uncontrollably, Foster says. But because it was the manager’s word against the word of a single witness, Foster says, Employee Relations also listed the murder-threat allegation as unsubstantiated.

These and other investigations convinced Foster that Employee Relations was doing more than excusing fraud, according to Labor Department records. It was, in her view, actively working to cover up

fraud by discouraging employees from reporting wrongdoing to her team, violating the confidentiality of tipsters and using its influence over personnel decisions to retaliate against whistleblowers.

“Without ER, the sales people couldn’t have done what they did,” Foster told iWatch News. Employee Relations had “the ultimate power to silence the whistleblower. They were the controlling factor. Without them, it wouldn’t work.”

### ‘A rare opportunity’

In January 2008, Bank of America announced that it had reached a deal to purchase Countrywide, which had lost \$1.6 billion over the previous six months.

Countrywide’s CEO, Mozilo, said it was “the right decision for our shareholders, customers and employees.” Bank of America called it a “rare opportunity” for the company to add what it believed to be the best “mortgage platform” in the nation.

Foster continued her duties as fraud investigation chief, while applying for a chance to work for Bank of America once the merger was completed July 1.

In February 2008, Labor Department records indicate [6], she

learned that over a period of two to three years, several workers had been transferred or fired after telling Employee Relations that Michael Eckhart, a high-producing loan officer at a Countrywide branch in Nashville, was committing fraud. Her team also uncovered evidence that a regional vice president had kept Eckhart apprised of the progress of investigations targeting him, according to Foster’s witness statement in Countrywide shareholders litigation.

Eckhart’s attorney says that Eckhart died last year. The attorney declined to comment about the fraud allegations raised against him.

In late February, Foster began voicing open criticism of Employee Relations’ actions, pressing the issue with senior executives in emails and meetings, according to the Labor Department. In May, she informed Employee Relations that she intended to refer her allegations about its treatment of whistleblowers to Countrywide’s internal audit unit.

As Foster was reporting her concerns about Employee Relations’ conduct, Labor Department records say, Employee Relations launched an investigation — not of Foster’s allegations, but of Foster herself.

A senior vice president from Employee Relations began questioning members of Foster's team about her management style, according to the Labor Department. One of Foster's fraud investigators later complained, agency records show, that Employee Relations reps grilled him for almost three hours, asking leading questions and trying to get him to say damaging things about her. He said he worried that many employees might simply cave to the pressure.

Foster remained unaware of the investigation against her for several weeks. In early July, with the merger complete, she got some good news: Bank of America named her senior vice president in charge of its new combined mortgage fraud unit.

Foster says she learned about Employee Relations' investigation later in July. She was questioned by Employee Relations in August.

By early September she thought the investigation was dead, she says. Bank of America had stripped Countrywide's employee relations unit of power to conduct investigations, she says, and she believed the new owners weren't going to put stock in anything Employee Relations had to say about her.

On Sept. 8, 2008, a Monday, Foster reported to work with a busy week ahead of her. She was supposed to meet the following week, she says, with officials from the bank's federal regulator, the Office of the Comptroller of the Currency. The subject: questions about Countrywide's reporting of suspicious activity reports. She had a spreadsheet showing the Countrywide's subprime division was grossly underreporting these reports, she says.

The phone rang at 8 a.m. It was a call she'd been expecting from a Bank of America human-resources official. She thought they would be discussing salary structure for her team members.

Instead, with the Bank of America official on the phone, two Countrywide officials walked into her office, turning it into a conference call. They presented her with a 16-page severance agreement.

Bank of America offered her a buyout totaling almost one year's salary, nearly \$230,000. The catch was that, to get the money, she had to agree to a gag order that would prevent her from talking about what she knew about the company's practices. "I was just furious," she says. When she refused to sign,

she says, the buyout offer turned into a straight-up firing.

They asked for her ID badge and keys. Then Bank of America security operatives escorted her out of the building.

It was her 51st birthday.

Later, in an email exchange, the employee relations official who'd led the investigation told Foster that her firing was due to her "inappropriate and unprofessional behavior" and "poor judgement as a leader." Within her unit, the official said, there was a perception that Foster would retaliate against underlings who crossed her. As a result, the official said, Bank of America's senior managers had "lost confidence" in her ability to lead the team.

The Labor Department later noted that the bank never consulted or interviewed Foster's direct supervisor during the investigation, and that it violated its own progressive disciplinary policy: She'd never been written up, suspended or disciplined previously, and in fact was "a high-performing employee with no history of poor performance or conduct issues."

Four former coworkers told iWatch News that the picture of Foster's management style painted

by Bank of America doesn't square with their recollections of Foster as a colleague and boss. Among them is Larry Goebel, a former captain in the Los Angeles Police Department's internal affairs unit who worked with Foster at Countrywide and Bank of America. "She had a lot of integrity," he says. Any suggestion she was unprofessional is "total b---s---, to be honest with you."

### **'Sleaze factor'**

After it fired Foster, Bank of America named Goebel to replace her as head of its mortgage fraud investigation unit.

The former police detective was surprised, he says, to find that many sales-department holdovers from the Countrywide era continued using fraudulent tactics to try to maintain their production and commissions as the mortgage market fell in on itself. "It was a culture that wouldn't die," he says.

Management didn't block him from investigating fraud cases, Goebel says, but it never gave him enough trained investigators to keep up with the huge volume of fraud. Bank of America didn't show much interest, he says, in rooting out the culture of corruption or

getting a reading on just how much misconduct had gone on inside Countrywide. “It wasn’t really like: ‘We need to take a look back, we need to clean house.’”

Nine months after taking over the fraud unit, Goebel says, he quit, fed up with the “sleaze factor” that had overtaken the mortgage industry. He now works as head of security for the Performing Arts Center of Los Angeles County.

Bank of America declined to answer questions about Goebel’s account of his time in charge of the fraud unit.

Since the merger, Countrywide has produced little but headaches for Bank of America.

The bank agreed to an \$8.5 billion settlement with a group of 22 big mortgage investors. It also helped Countrywide’s founder, Angelo Mozilo, settle charges that he’d added \$141.7 million to his personal fortune through fraud and insider trading. (Mozilo’s attorney called the charges “baseless.”) The final settlement was for \$67.5 million, with Bank of America and Countrywide’s insurers chipping in \$45 million and Mozilo paying \$22.5 million — or about 16 cents out of his own pocket for every dollar authorities claimed he’d taken in ill-

gotten personal gains.

The bank also agreed to pay \$108 million to settle fraud charges against Countrywide Home Loans Servicing, the same unit Foster says forced her to stop highlighting its complaint data in her reports. The Federal Trade Commission alleged that the servicing unit gouged

**The Federal Trade Commission alleged that the servicing unit gouged homeowners with illegal fees and misled them about how much they owed on their mortgages.**

homeowners with illegal fees and misled them about how much they owed on their mortgages.

Countrywide Home Loans Servicing now operates as BAC Home Loans Servicing, but it continues to draw the ire of regulators for its conduct under the Bank of America banner. A coalition of state attorneys general and federal authorities are pressing Bank of America and other big banks to pay \$20 billion or more to settle claims that they used so-called “robo-signers” to falsify foreclosure documents and push homeowners out of their homes.

The Federal Housing Finance Agency, which oversees mortgage investing giants Fannie Mae and Freddie Mac, has filed massive lawsuits charging that Countrywide, Bank of America and other lenders misled Fannie and Freddie about the quality of the loans they pooled into mortgage-backed securities.

A lawsuit by Nevada's attorney general, meanwhile, charges that Bank of America's servicing unit has engaged in a pattern of misconduct in the way it handles homeowners' requests for loan modifications. The practices, the suit says, include falsely promising that their homes wouldn't be foreclosed on while their applications were pending, promising them one set of terms but then delivering agreements with different terms, and providing "inaccurate and deceptive reasons" for denying their requests.

One former employee told the attorney general's office the company gave instructions to mislead borrowers about their modifications. "One time I complained to my supervisor that I felt I was lying to borrowers," the ex-employee said. "Her instructions ... were just to give the borrowers their status and tell them that they are 'in the process,' in spite of the fact that the

computer showed that nothing was happening."

In response to the Nevada action, Bank of America said it was disappointed that the state had sued, because it had been "a cooperative partner" with attorneys general around the country in working out solutions for distressed homeowners. "We are already underway with further improvements to our processes and programs for Bank of America customers," the bank said.

### **Holding the line**

Eileen Foster says she didn't set out to be yet another of Bank of America's legal adversaries.

"In the beginning, I just wanted my job back," Foster says. "I thought as soon as Bank of America looked into it, they would bring me back."

It didn't happen. Instead, she and the bank's lawyers spent almost three years locked in a punishing fight inside the Labor Department's whistleblower protection division.

Since last week, when the labor agency ordered that Bank of America rehire her, Foster has declined to comment on the bank's role in her case, noting that she may end up

going back to work there.

In interviews with iWatch News before the ruling, she expressed mixed feelings about the bank. She said she thought that the bank may have been misled by Countrywide holdovers, and wondered whether the bank's lawyers had prevented it from realizing she'd been done wrong.

At other times, she expressed stronger feelings about the bank. "They had multiple opportunities to fix things," Foster said in an interview earlier this year. "They chose not to do the right thing."

Foster was unemployed for more than two years after Bank of America fired her.

"I applied for 145 jobs before I got one," she says.

She's now vice president of security at Lockheed Federal Credit Union in Burbank, a job that pays about half what she would have been making at Bank of America. But she says it's a good place to work and the credit union's CEO is a model of openness and straight-shooting.

What her next step will be is unclear. Although the Labor Department ordered Bank of America to rehire her, the bank has vowed to appeal the order to an administra-

tive law judge. That could set up a lengthy round of litigation.

Foster says she remains a reluctant whistleblower. She's turned down interview requests from many media outlets, and agreed to go on the record with iWatch News only for publication after the Labor Department issued its final ruling.

It was important, she says, to tell her story — and the story of other employees who tried to blow the whistle on fraud.

"I don't want this to be about me," Foster says. "The only reason I have a voice is because of my position. It's not the same for somebody who's an underwriter or production staff assistant. Management can call them disgruntled or whatever."

Fraud flourishes, she says, when companies are allowed to intimidate and abuse employees. Without protections for whistleblowers, it's easy for big companies to "beat people down" and silence them.

"It's very difficult to hold the line and do what you believe," she says. ■

# Loan underwriter found herself in ‘dangerous territory’ at Countrywide

By Michael Hudson

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**A**FTER she lost her job in the fall of 2007, Cassandra Daniels had a word with a trio of her managers. As she recalls it, she told them she was praying that, someday, they’d learn to use their positions of power “to uplift your staff instead of destroying people.”

She cleaned out her desk and taped a handwritten sign to her computer screen, quoting one of her favorite gospel songs: “GIANTS DO FALL.”

That marked the end of Daniels’ tumultuous relationship with Countrywide Financial Corp., the nation’s largest home lender during the mortgage boom.

For Daniels, her four years as a loan underwriter inside Countrywide’s mortgage-production machine were a blur of 12- and 14-hour workdays and frequent clashes with managers and salespeople regarding loans she believed were tainted by fraud.



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When she rejected loans that were based on inflated income statements or other questionable information, she says, management overruled her and pushed the deals through.

“The sad part is I lost hope in the integrity of any system,” Daniels recalled in an interview with iWatch News. “Because there were supposed to be checks and balances. But there weren’t. All these people were driven by pure greed. And they didn’t care that it was at the expense of other human beings.”





Damian Dovarganes/AP file

### **A California branch office of Countrywide Financial in 2007.**

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Bank of America Corp., which bought Countrywide in 2008, declined to comment on Daniels' account of her time at the lender. However, a spokesman has dismissed the idea that Countrywide management encouraged fraud inside the company. When fraud happens, the spokesman said, "the lender is almost always a victim,

even if the fraud is perpetrated by individual employees."

### **'Fast and sleazy'**

Before she began working at a Countrywide branch in Chicago's western suburbs in the summer of 2003, Daniels, a single mom, was working two jobs, as a manager at a

local bank in Naperville, Ill., and as a night auditor at a Marriott hotel.

She thought going from two jobs to one was a good idea, especially with the prospect of earning \$50,000 to \$60,000 a year in salary and bonuses at a brand-name company that seemed to be growing bigger every day.

As an underwriter, Daniels was an important line of defense against fraud, vetting loan packages submitted by the sales department to see if they met Countrywide's guidelines and whether the information on applications was truthful.

**According to Daniels, there was no checkout procedure or safety measures to make sure no one walked out the door with a file full of sensitive financial data about loan applicants.**

She says she got little training; before throwing her into the mix, her manager spent 2½ hours showing her how to underwrite Countrywide's "Fast and

Easy" loans, which required little or no documentation of borrowers' income and assets, prompting some mortgage industry hands to dub them "Fast and Sleazy" loans.

Her branch was selling "Fast and Easy" loans and other mortgages so fast that Daniels and other underwriters had trouble keeping up. Daniels recalls tables stacked with pending loan files. Managers told her: "Just grab one and get it done." There was no checkout procedure or safety measures to make sure no one walked out the door with a file full of sensitive financial data about loan applicants, she says.

"I wondered, 'Where is all the security in this?'" she recalls.

The company expected her and other underwriters to get through eight to 12 loan packages a day. She'd get in early, work all morning and afternoon, then rush out to pick up her 3-year-old son at day care. She'd hit a drive-through restaurant window to pick up some food, and then head back to the office. Her son would fall asleep as she continued to work on files, sometimes as late as 11 p.m. or midnight.

The next day she'd do it all over again.

### **'Making widgets'**

She began tangling with managers and salespeople, she says, when she started rejecting loans that looked fishy. This earned her a deri-

sive nickname from the sales staff: “The Decline Queen.”

Many of the disputed deals, Daniels claims, involved paperwork that listed questionable Social Security numbers or claimed applicants were making huge sums of money working in nail salons or running housecleaning or landscaping businesses.

She didn’t believe that the proprietor of a housecleaning business could be pulling in \$100,000 or \$120,000 a year. But when she asked for more documentation — such as copies of loan applicants’ tax returns — her managers scolded her, she says, telling her that, with “Fast and Easy” loans, such paperwork wasn’t necessary.

One borrower owned eight investment homes in the northern Chicago suburbs and had defaulted on local real-estate taxes owed against the properties, Daniels says. But Countrywide still approved a series of refinance deals that allowed the investor to suck hundreds of thousands of dollars in cash out of the properties.

“I realized I was in dangerous territory,” Daniels recalls. “I told my family: ‘You know what? The mortgage industry is nothing but legalized fraud.’”

In court records and in interviews, former employees say Countrywide executives cared little about fraud or whether borrowers could afford their loans. Most loans declined by underwriters would “come back to life” when new information supporting approval would “miraculously appear,” according to

**In court records and in interviews, former employees say Countrywide executives cared little about fraud or whether borrowers could afford their loans.**

a former underwriter in Countrywide’s Jacksonville, Fla., loan-processing center who was cited as a “confidential witness” in shareholders’ litigation against the lender.

Brian Koss, who oversaw 54 loan branches in New England and upstate New York as a senior

regional vice president, told Bloomberg Businessweek that company officials “approached making loans like making widgets, focusing on cost to produce and not risk or compliance. ... The fiduciary responsibility of making sure whether the loan should truly be done was not as important as getting the deal done.”

To make matters worse, Daniels claims, management worked to quash investigations by her division's internal fraud investigations unit.

At one meeting, she says, supervisors told workers they were making too many referrals to the investigations unit. The managers said that if anyone had suspicions about fraud, the matter should be referred to them, and they would decide whether it should be reported.

"They pretty much put a lid on it," Daniels says.

Another former employee at Daniels' branch agreed with Daniels' assertion that management worked to paper over questionable loans and get them funded.

"There was a lot of fraud, I believe," the former employee, who spoke on the condition her name not be used, told iWatch News. "It was all about getting the files out, making numbers for the month."

iWatch News attempted to contact former managers at the branch but was not successful.

### **'This is your last day'**

Daniels acknowledges that no one ever directly threatened to fire her for reporting fraud, but says she "always felt like my job was in jeop-

ardy. I never knew. It was uncomfortable."

The end came in September 2007. The mortgage market was in a free fall, and Countrywide announced that it was sacking 10,000 to 12,000 workers across the country, slashing its 60,000-strong workforce by as much as 20 percent.

Managers called her into an office and told her: "This is your last day of employment at Countrywide." She's still not sure whether she was terminated or was included as part of the layoff, she says.

Within a few months, America's home-loan giant had indeed fallen, gobbled up at a going-out-of-business-sale price by Bank of America.

Since she left Countrywide, Daniels has worked temporary jobs and done some consulting as a leadership development trainer. Even though she could use the money, she won't go back into the mortgage business.

"I have no trust in the banking industry, period," Daniels says. "All these major banks — they were major contributors to all this. They were all doing the same thing. I have no desire to be part of that." ■



Paul Sakuma/AP

# A ‘counseling meeting’ then termination at Countrywide

By Michael Hudson

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**DAYS BEFORE** Mari Eisenman was to undergo cancer surgery, a senior vice president with her employer, Countrywide Financial Corp., called her in for a “counseling meeting.”

The impetus for the meeting, according to Eisenman: her complaints that workers at her branch in Colorado were falsifying docu-

ments and manipulating the home appraisal process.

The executive, Eisenman later claimed in a lawsuit, chastised her for causing trouble, complaining that one of the executive’s protégés had been suspended because of her whistleblowing.

While she was at home recovering from her surgery, her suit said,

it became clear she was going to be fired.

Eisenman claimed she contacted Countrywide's home office in California and sought intervention "from the highest officials" to provide her safe harbor as a whistleblower. The officials, her lawsuit said, "indicated that all actions taken against Mrs. Eisenman were proper and the corporation would not provide protection for her."

Eisenman's description of her rocky tenure at Countrywide is similar to accounts from other former employees who claimed the lender punished them for pushing back against corrupt practices. The retaliation, many of them charged, came not just from low-level managers or coworkers, but was also carried out or condoned by upper-level executives.

A spokesman for Bank of America, which purchased Countrywide in 2008, declined to answer questions about Eisenman's allegations. The bank has refused iWatch News' requests to discuss specific allegations by former Countrywide employees, saying they involve allegations of problems that occurred before the bank acquired Countrywide. It has also declined to answer questions about how much inves-



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tigation, prior to and after the acquisition, it conducted concerning fraud at Countrywide.

Before the merger, Countrywide chief executive Angelo Mozilo and other company officials blamed market conditions for the wave of dicey loans and defaults that weighed down the lender's balance sheet.

"No one, including Mr. Mozilo, could have foreseen the unprecedented combination of events that led to the problems borrowers, lenders and investors face with many of these loans today," a Countrywide spokesman told The New York Times in 2007.

### 'Stay quiet'

iWatch News identified 18 former Countrywide employees who said

they'd been retaliated against for trying to prevent fraud. The allegations date back as far as 2003 and as recently as 2008. They involve various Countrywide divisions operating in multiple regions, including Alabama, Arizona, California, Colorado and Texas.

**Hobart Curtis Sanders, who supervised more than 20 employees as the manager of a loan-sales branch in California, claimed Countrywide fired him in April 2004 for complaining about predatory lending tactics.**

Some of the former workers were non-supervisory employees who said they were fired for refusing orders to commit fraud. Antonio Noyola claimed Countrywide fired him after he refused to falsify mortgage documents and complained that paperwork was being “routinely” doctored or backdated. Noyola, a licensed notary, said he was ordered in late 2006 and early 2007 to notarize documents “for dates that were incorrect, for persons that he did not in fact know, and to falsify his ledger accordingly,” his lawsuit in Ven-

tura County (Calif.) Superior Court charged.

When he refused, Noyola said, managers told him to “stay quiet” and transferred him so he would no longer have access to the falsified documentation, then terminated him.

Noyola and Countrywide settled the case before Countrywide formally responded to his allegations.

Others who claimed they were punished for whistleblowing were managers with broader access to information about the company's operations. Many of these managers claimed they were fired for trying to report fraud to higher-ups.

Hobart Curtis Sanders, who supervised more than 20 employees as the manager of a loan-sales branch in California, claimed Countrywide fired him in April 2004 for complaining about predatory lending tactics. These practices, he charged in a lawsuit in Los Angeles Superior Court, included “price gouging” and “contract knavery” — sneaking added costs and other provisions into loan contracts with the idea that, amid the small print and many pages of mortgage paperwork, borrowers would miss the add-ons.

Countrywide denied Sander's



allegations. In a court filing, it asserted that Sanders had mishandled a sexual harassment complaint against one of his employees by failing to report the issue up the chain of command until his superiors had heard about it independently. He wasn't fired but instead left the company after he refused to accept a demotion or transfer, Countrywide said.

Sanders and Countrywide reached a confidential settlement in the case.

### **'Action plan'**

Eisenman, the former Countrywide employee in Colorado, said she uncovered indications of fraud soon after the company hired her as a branch operations manager at its Bergen Park, Colo., location.

She started the \$200,000-a-year job in June 2004. By October 2004, her lawsuit said, she suspected that managers in the branch and beyond were either taking part in or condoning illegal practices.

The practices, she said, included inflating applicants' incomes, misrepresenting whether customers were buying homes as residences or as investments and "securing multiple property appraisals when the

original property appraisals failed to qualify the individual for a loan."

She claimed she also observed other bad business practices, including improper disposal of borrowers' confidential information and alcohol consumption inside the branch.

Eisenman said she forced an investigation by the company's fraud unit by reporting the illicit activities to a regional executive. After her allegations were substantiated, her suit said, a branch manager and several loan officers were fired or forced to resign.

Instead of rewarding her for exposing the fraud, Eisenman claimed, higher-level managers began laying a trap for her. She claimed one manager hired the wife of a personal friend and encouraged her to file "false reports" against Eisenman. The woman claimed that Eisenman had made disparaging remarks about the woman's husband, who also worked at Countrywide.

Soon after, in February 2005, a senior VP called her in for her counseling meeting and presented her with an "Action Plan" that included a 30-day "final" written warning.

Eisenman's suit said the plan was full of fabricated information, including a made-up state-



ment that Eisenman had previously been reprimanded for engaging in intimidating behavior and making inappropriate comments to other employees.

While she was on leave for cancer surgery, her suit said, the company moved someone else into her position. She learned that she was being fired, the suit said, through a “COBRA” notice informing her that she was entitled to continue her health insurance until she found a new job.

The lawsuit was resolved in 2008, according to the clerk’s office for Arapahoe County (Colo.) District Court. Bank of America didn’t respond to a request for a response about Eisenman’s allegations.

### ‘Go home’

Diana Wingard, who worked as a manager across the country in Alabama, said her career arc at the lender, like Eisenman’s, was brief and turbulent.

Wingard began working in November 2006 as a team manager at Countrywide’s regional operations center in Montgomery, Ala. Her job was to oversee the processing and underwriting of loans streaming in from various branch offices that

fed the regional center.

She discovered, she later said in a lawsuit, evidence that the lender was violating federal consumer laws and putting itself at risk of big fines and big hits to its balance sheet.

Wingard claimed Countrywide was inflating borrowers’ incomes on loan applications, approving loans based on “unverifiable” borrower employment histories, and failing to provide borrowers with paperwork informing them of their right, under federal law, to change their minds within three days and cancel their loans.

Three incidents made it apparent, she claimed, that the fraud was being tolerated or encouraged by upper management:

- A worker at a branch in Auburn, Ala., complained to Wingard that her supervisor was forcing her to approve loans she believed were fraudulent, declaring that if she refused to go along she “could just get in her car and go home.”
- When Wingard investigated a mortgage that appeared to be backed by an inflated appraisal and murky income documentation, her immedi-

ate boss, a regional vice president, forbade her from talking to the loan underwriter who had signed off on the deal.

- Later, in a meeting, her boss and a vice president of operations ordered her to discontinue her fraud audit and to stop advising employees to call the company's "fraud hotline" when they suspected wrongdoing.

On Jan. 2, 2007, soon after Wingard's meeting with the two executives, the company fired her, claiming she had falsified employee time cards, according to Wingard's lawsuit. Later, when Wingard tried to collect unemployment benefits, the

company changed its story, telling the unemployment office that she had been terminated for "mishandling a group of loans," her suit said.

Wingard said both rationales were made up.

She filed a whistleblower claim with the U.S. Department of Labor under the 2002 Sarbanes-Oxley corporate reform law, then tried to move her case to U.S. District Court in Alabama. A judge dismissed the lawsuit, ruling Wingard had no right to go to court and bypass the administrative process within the Labor Department.

A spokesman for Bank of America didn't respond to questions about Wingard's claims. ■

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# Payday lending bankrolls auto racer's fortune

A joint investigation of iWatch News and CBS News

By David Heath

Published Online | September 26, 2011

**SCOTT TUCKER** used stealth to become a millionaire. Now the mysterious businessman from Kansas is spending his fortune to become a famous auto racer.

Though Tucker has not won any premier races outright, his publicity machine already compares him to NASCAR superstar Jimmie Johnson. It produced a slick documentary of his team's third-place finish at a Daytona race which played at film festivals and aired on the Discovery Channel. A glowing Wall Street Journal profile last year dubbed Tucker as "Racing's One-in-a-Million Story."

Tucker competes mostly in a special class for wealthy owners, taking turns behind the wheel with hired professional drivers. But he burst through obscurity last year to become — at age 48 — rookie of the year in endurance racing's American Le Mans Series.

Tucker's quest for fame in sports



## LOOSE LENDING

contrasts sharply with his secrecy in business. He describes himself simply as the CEO of Westfund, which is a fledgling private-equity firm with no visible marketing and a mail drop as a corporate office.

What Tucker doesn't publicize: he is an ex-convict who runs a controversial business that regulators in at least five states have tried to shut down for violating their laws. Hiding behind a labyrinth of shell companies and operating from the ether of the Internet, Tucker's businesses make payday loans over the Web even in



Level 5 Motorsports/Flicker

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**Payday lender turned racecar rookie, Scott Tucker.**

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states where they are outlawed. He offers quick cash to people desperate enough to borrow money from a faceless Web site, even signing over access to their bank account to total strangers. And he charges nearly 800 percent interest on loans that take months to pay off.

iWatch News found that some

of Tucker's tactics are common among businesses operating on the fringes of the law. By setting up a confusing array of shell companies and selling over the Internet, businesses are often able to frustrate state investigators trying to figure out simply who's who.

But Tucker's most innovative tac-

tic has given businesses a new, powerful tool for eluding state authorities. The tactic has survived major court challenges, but the practice is so questionable that even storefront payday lenders —hardly known as paragons of business probity — denounce it as unethical.

Tucker has partnered with a number of small Indian tribes to provide his payday lending business with the cloak of tribal sovereign immunity. Under federal law, tribes are equal to states as sovereign powers. So they are immune from being sued in state court.

Tucker says his payday lending businesses are now owned by the Miami and Modoc tribes of Oklahoma as well as the Santee Sioux of Nebraska. However, iWatch News found evidence in court and public records showing that Tucker secretly runs the payday lending business from his offices in Overland Park, Kan.

Lawyers in the Colorado attorney general's office described Tucker's tactics as a "web of deceit." Others refer to it as "rent-a-tribe."

In a written statement Friday, the chief of the Miami tribe, Tom Gamble, said the payday lending business was "100 percent tribally owned and operated." For the first time, he acknowledged Tucker is an

employee of the tribe's payday lending business but did not elaborate on his role. The Modoc and Santee Sioux declined to comment.

Tucker himself said, "Due to a confidentiality agreement, I am not permitted to discuss the business of my employer."

**Tucker has partnered with a number of small Indian tribes to provide his payday lending business with the cloak of tribal sovereign immunity.**

Tucker has eluded the grasp of several state authorities. Colorado Attorney General John Suthers has been trying to stop Tucker for seven years. He convinced a Denver judge to order Tucker and his company to stop making payday

loans in Colorado. He even has a warrant for Tucker's arrest for violating a court order. Yet Tucker is so contemptuous of the warrant that, after it was issued, he bought an \$8 million vacation home in Aspen, Colo., through a limited partnership in his wife's name, and he now flies to Colorado undetected on his private Learjet that retails for \$13 million.

The contrast between Tucker's

lifestyle and those of the tribes that claim to own the lucrative business is stark.

Tucker flashes his wealth on the race track. He is reported to have a fleet of 15 race cars, including custom-built prototypes that can cost more than \$500,000. He employs a team that includes accomplished drivers, among them the 1993 Le Mans winner Christophe Bouchut of France. He travels constantly, even shipping his cars overseas for races. In France last June, his team finished tenth in the grueling and legendary 24 Hours of Le Mans.

Meanwhile, the Miami tribe, whose business offices adjoin farm land and rundown properties, cautioned its members last year that it was struggling through tough financial times after losing partial ownership of a casino in a small Oklahoma town. The tribe won't talk about the presumably lucrative payday lending business it claims to have owned since at least 2005. But the chief said in the tribal newsletter last year that hard times were forcing the tribe to consider layoffs



David Heath/iWatch News

**The exterior of Miami Nation Enterprises, which has an online payday lending business that has sovereign status beyond the reach of state regulators.**

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and other budget cutting measures.

The Miami and Santee Sioux tribes have tried to obscure their connection to Tucker in court despite an irrefutable paper trail. Despite this effort, the Colorado Supreme Court last November handed the tribes and Tucker's businesses a major victory. The court ruled that businesses claiming to be part of a tribe have sovereign immunity, too. That protection even covers business done off the reservation.

The justices also ruled that the state has to prove a business is not an arm of an Indian tribe before it can take court action or issue

subpoenas. That puts authorities in a Catch 22 — having to prove a company is lying without the power to compel the company to answer questions.

### Tangled web frustrates states

Some states have given up trying to stop illegal online payday lenders claiming tribal affiliations. Regulators in Washington state and North Carolina concluded that the effort would be too costly and difficult. Yet industry analysts say Indian tribes are now clamoring to get involved

in payday lending. Frank Cotton, an industry analyst in Atlanta, estimates at least 30 payday lenders and possibly double that number are affiliated with Indian tribes.

Still, states are banding together against Tucker in one court battle. In 2009, Tucker's lawyers convinced a local Kansas judge to block Colorado court orders, arguing that Colorado courts have no power in Kansas. But last July, attorneys general from 22 states joined forces to argue in a Kansas appeals court that unless it reverses this judge's decision, any culprit could violate a state's consumer laws simply by operating out of another state.

Meanwhile, the business of online payday lending is sizzling. In 2010, revenue was up 32 percent, with online payday lenders making \$10.8 billion in loans in the United States, according to Stephens Inc., an investment firm that tracks the industry. That equates to more than 30 million loans, with Stephens estimating that the loans racked up interest and fees of \$2.7 billion. In contrast, revenues for storefront payday lenders are fizzling.

**The business of online payday lending is sizzling. In 2010, revenue was up 32 percent, with online payday lenders making \$10.8 billion in loans in the United States.**

Tucker's operations are likely only a sliver of that business. While exact figures on how much his operations make are unavailable, one court document revealed that Tucker's business paid \$80 million in 2008

just for sales leads. That suggests he could be making millions of online payday loans a year.

Many of Tucker's borrowers complain about being harassed. Melissa Rush of Vancouver, Wash., tears up about the never-ending phone calls



from online payday lenders to her cell phone, her friends and her co-workers.

In January 2009, the former mortgage loan officer borrowed \$300 from US FastCash, one of Tucker's brands. She couldn't keep up with the payments, which totaled \$1,200, and ended up borrowing more to try to pay off existing loans. That only buried her deeper.

Now the calls are constant. In fact, US FastCash called while an iWatch News reporter interviewed her. As a reporter listened in, Rush asked 31 times for the company's address. She wanted to write a letter telling them to stop calling her. After repeatedly ignoring her request, the debt collector finally said he didn't have to give her an address.

Rush, who ironically is a debt collector herself, has researched the company but says she can't figure out who's really behind it. She had never heard of Scott Tucker.

The Miami tribe's chief acknowledged that there are complaints from borrowers who don't pay off their loans. But he defended the business, saying that it "provides a vital service to many Americans who would otherwise be without access to short-term financial assistance. For many of our customers,

the alternative to an online loan would be, at best, simply to write a bad check, or, at worst, the prospect of bankruptcy and the loss of their home, or worse yet, pressure toward more desperate and unproductive behaviors."

In the past five years, the Better Business Bureau of eastern Oklahoma has received more than 2,000 complaints about payday lenders tied to Tucker and the tribes. The bureau's chief officer, Rick Brinkley, has gone to the tribes' offices to investigate without any success.

"Most people think that loan sharking is illegal," said Brinkley, who is also a Republican state senator in Oklahoma. "The reality is that in this particular case if you can become affiliated with a tribe and be able to avert local and state laws then, in my opinion, apparently loan sharking is legal."

### **The beginning of the legal fight**

An epic legal saga in Colorado began on Nov. 3, 2004, when a woman sent two brief letters complaining to the attorney general.

Desperate for cash, the woman had found a pair of payday lenders online willing to deposit a total of \$550 directly into her bank



account. What she hadn't given much thought to, or didn't understand, was that the two loans came with an interest rate of nearly 800 percent. In interest alone, the five-month loans would cost the cash-starved woman \$1,575.

The woman, whose name the state won't reveal, said she had discovered that the loans were illegal. They violated Colorado's payday loan laws. On top of that, neither lender — Cash Advance and Preferred Cash Loans — was licensed to make loans in the state.

**Out of nowhere, two Indian tribes — the Santee Sioux of Nebraska and the Miami of Oklahoma — swooped into court and proclaimed that they were the true owners of Preferred Cash Loans and Cash Advance.**

The two lenders seemed connected, each operating exactly the same way. Even more telling, they shared a common address at a strip mall in Carson City, Nev. But investigators couldn't tell who was behind these lenders.

The Colorado attorney general dashed off letters, ordering Cash

Advance and Preferred Cash Loans to stop making illegal payday loans in the state. Cash Advance ignored the order. Curiously, Preferred Cash Loans sent back a brief, unsigned note, saying it had forgiven its loan to the woman. But there was no promise to stop lending in Colorado.

The legal wrangling quickly escalated. Still, both Cash Advance and Preferred Cash Loans kept ignoring court orders. By June 2005, the attorney general asked a Colorado judge to cite the lenders for contempt.

At that point, the case took an unexpected twist that left the state of Colorado's top law enforcement official stumped to this day.

On July 20, 2005, out of nowhere, two Indian tribes — the Santee Sioux of Nebraska and the Miami of Oklahoma — swooped into court and proclaimed that they were the true owners of Preferred Cash Loans and Cash Advance. The next day, the company based at the mysterious Carson City address said in court documents that it had nothing to do with Preferred Cash Loans or Cash Advance.

It seemed almost comical. After all, the woman's contracts had the address in big, bold letters: 2533 N. Carson St., Carson City, Nev. Yet

the tribes swore that they had no offices there.

How could that be? One of the lenders had already forgiven the loan. Besides, the attorney general asked, how did the tribes even know about this petty legal tussle? Why were they getting involved when they faced no legal sanctions themselves? Why would they defend total strangers?

As absurd as it seemed, the tribes' involvement erected a powerful legal shield: Tribes cannot be sued in state court.

As a result, the case has been bogged down in court for seven years now. The complicated legal issues have also stymied efforts by other states to halt the lending abuses. Amid the confusion, a controversial industry keeps thriving.

At the same time in the neighboring state of Kansas, the bank commissioner had been trying to stop the online payday lender Cash Advance from making illegal loans for more than two years. By 2005, the Colorado and Kansas cases against Cash Advance were on parallel tracks. But paradoxically, Cash Advance was making claims in a Kansas court that contradicted statements it was making in a Colorado court.

In Kansas, Cash Advance decided

to settle. But the company officer who signed the settlement papers for Cash Advance was from a Carson City company called C.B. Services. Only two months earlier in Colorado, C.B. Services claimed it had no connection to Cash Advance. The discrepancy is irreconcilable.

And while the Miami tribe had already claimed in Colorado that it was the true owner of Cash Advance, the tribe made no such claim in Kansas.

Something wasn't right.

## Enter the shell player

James Fontano of Carson City was the answer to the riddle. In Kansas, Fontano swore in an affidavit that he was the president of Cash Advance. But in Colorado, Fontano swore in an affidavit that he had no connection to Cash Advance.

It would take perplexed attorneys in Colorado another two years to finally confront Fontano face-to-face for a day of closed-doors interrogation.

Fontano revealed that his true trade was being an imposter. For a small fee, Fontano would create a shell company and pose as its chief executive officer. It was a way, Fontano acknowledged, that

“clients could conceal themselves from public view.” He did this for hundreds of companies.

Setting up shell companies and posing as officers is a legal and thriving business in Nevada, although in 2006 Fontano landed in federal prison after pleading guilty to charges that he and others provided clients with a tax evasion scheme. Today, the IRS claims that Fontano, who now works at a Utah gift shop, still owes it \$3.5 million.

Fontano was not the mastermind behind the payday lenders. In fact, he was only one layer of a multilayered façade.

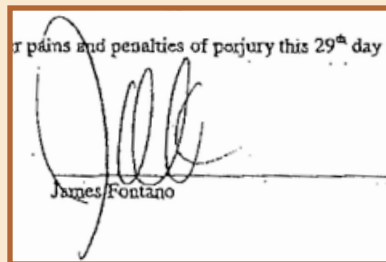
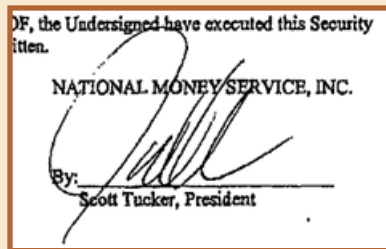
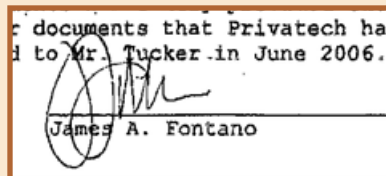
While Fontano listed himself as the officer of a shell company called C.B. Services, the payday loans were offered on the Internet with trade names such as Cash Advance. In addition, the address in Carson City on the loan documents was only a mail drop.

When asked who really ran the payday lenders, both Fontano and the company managing the mail drop pointed to the same man: Scott Tucker. All mail was being forwarded to Tucker's business in Overland Park, Kan.

The layers of deception were so thick that Fontano knew nothing about the Indian tribes and very

## Compare the signatures

Two court affidavits in different states make contradictory claims about a payday lending business. One (top) is signed by James Fontano. Fontano says the other (bottom) is forged. A handwriting expert agrees and says the signature probably came from Scott Tucker, who started the business and whose signature is in the middle.



little about Tucker, whom he never recalls meeting. “I did not have a lot of knowledge of what he was doing,” Fontano said.

The two affidavits were different for a simple reason. Fontano said attorneys paid by Tucker—though listed in court as representing Fontano—wrote the affidavit in Colorado, where Fontano claimed ignorance of Cash Advance. Fontano said he signed it, assuming it was true.

As for the affidavit in Kansas where Fontano claimed he was president of Cash Advance? Fontano said he never signed it. He called it a forgery.

iWatch News asked a handwriting expert at Applied Forensics to compare the signature to samples of Fontano’s signature. Dennis Ryan, a former forensic supervisor for the Nassau County Police in New York, concluded “with a reasonable degree of certainty” that Fontano’s signature on the Kansas affidavit was forged.

Ryan also compared the affidavit signature with documents signed by Tucker. Although he couldn’t be certain, Ryan said that Tucker “probably” signed the affidavit. Ryan said he had only 11 samples of Tucker’s signature, too few comparisons under forensic standards to be certain.

The Kansas affidavit was submitted by the same Kansas City law firm that submitted the one in Colorado. Fontano said those attorneys also never told him that he had been subpoenaed and cited for contempt by a Colorado court, which made him upset when he learned the truth.

In June 2006, Tucker’s company sent an email to Fontano: “Please forward any and all records for corporations organized by Mr. Scott Tucker.”

Fontano said that he complied, not knowing that the Colorado Attorney General had issued subpoenas to obtain those same records and that he might be breaking the law. But a search of Fontano’s computer turned up the records, which Fontano gave to the attorney general’s office.

For his cooperation, Fontano was off the hook. The state of Colorado turned its attention to Scott Tucker. ■

**CORRECTION:** *The payday/tribal connection attributed to Frank Cotton was incorrect in the original story. The correct sentence reads, “Frank Cotton, an industry analyst in Atlanta, estimates at least 30 payday lenders and possibly double that number are affiliated with Indian tribes.”*

# Race car driver Scott Tucker drew elaborate facade around his payday loan businesses

By David Heath

Published Online | September 28, 2011

**A** DEPUTY SHERIFF in Olathe, Kan., ticketed race car driver Scott Tucker late one night in October 2008 after clocking Tucker's Mercedes-Benz CLS63 going 86 mph in a stretch of Interstate 35 posted at 60 mph.

Two days later, Tucker's wife, brother and sister-in-law as well as several businesses with ties to the payday loan mogul suddenly donated a total of \$4,000 to the campaign of a candidate for local district attorney — the office that prosecutes traffic tickets.

Among the businesses that donated \$1,000 to the campaign were two payday loan companies that the Miami Tribe of Oklahoma claims to own.

Weeks later, the ticket was reduced to improper parking, to the surprise of the deputy who ticketed Tucker. The change kept Tucker's driving record clean.



## LOOSE LENDING

Whether or not the contributions played a role in ticket being reduced, the episode shows a strange commingling of the interests of Tucker and the Indian tribe. Regulators in Colorado and California are investigating whether Tucker is merely using the tribes to circumvent state laws.

Tucker started a controversial online payday lending business that several states have tried to shut down. Tucker now says Indian tribes own the business and he is just an employee. That arrange-



Level 5 Motorsports/Flickr

**Scott Tucker's Level 5 Motorsports racing team. From left, the three drivers are: Christophe Bouchut, Scott Tucker and Joao Barbosa.**

ment gives the payday lending business the cloak of sovereign immunity and has stymied the efforts of state regulators to stop the company from making illegal loans in their states.

Yet an iWatch News investigation found that Tucker is living the life of luxury and spending a fortune on his racing hobby, while the tribes may only be getting a small

piece of the revenue from the business.

The tactic of affiliating with Indian tribes has been widely copied among online payday lenders, frustrating state regulators and drawing the condemnation of payday lending's storefront brethren.

Storefront lenders generally don't do business in 18 states that restrict payday lending. And those

that have ventured into the online market usually get licensed and obey state laws, said Jean Ann Fox of the nonprofit Consumer Federation of America.

The head of the payday lending trade group Community Financial Services Association of America, D. Lynn DeVault, said that using tribes to avoid state laws violates the association's standards "and would lead to the automatic expulsion of a company in violation."

Critics call the tactic "rent-a-tribe."

Tucker acknowledged Friday for the first time that he works for AMG Services, the paydaylending business that the Miami Tribe of Oklahoma says it owns and operates. He says a confidentiality agreement prevents him from talking about it.

The chief of the Miami tribe, Thomas E. Gamble, defended the business, saying the tribe owns and operates it. Gamble says the business obeys tribal and federal laws but he didn't say whether it obeys state laws. At least five states have tried through legal proceedings to shut down the business for violating state laws. Several other states have either instructed the business to stop making loans or warned consumers about it.

Tucker, who lives in the upscale Kansas City suburb of Leawood, told a judge that he no longer controls the payday lending business. But iWatch News found evidence in court and public records that Tucker still pulls the strings on the business he founded. The evidence includes:

- Among the companies that gave \$500 campaign donations to the prosecutor on the same day as several of Tucker's relatives were two tribal businesses, AMG Services and MNE Services.
- AMG Services operates out of an office complex in Overland Park, the same office that Tucker lists as his own in Securities and Exchange Commission filings.
- AMG Services pays the property tax on Tucker's \$8 million vacation retreat in Aspen, Colo., according to county records.
- One of AMG Services biggest vendors said in a lawsuit that Scott Tucker in 2009 was the owner and chief officer of AMG Services.

Most revealing of all, bank records show Tucker and his brother

Blaine were the only the two people able to sign for four payday lending businesses of one tribe. The tribes may only receive a sliver of the revenue from the payday lending business.

### **Rags to riches story**

Scott Tucker's life is both a rags-to-riches and get-rich-quick story. He grew up in the Kansas City area, graduating from a Jesuit high school and attending Kansas State University for two years, where he studied business administration. Tucker has a criminal past. In April 1988, at the age of 26, he borrowed \$50,000 from American Bank of Kansas City, offering a new Porsche as collateral. Court records show that Tucker lied on the application; he had sold the sports car months earlier.

A year later, Tucker wrote a bad check for \$1,200 to a moving company hired to transfer two loads of used furniture for a business, according to court records.

In the meantime, Tucker participated in a bogus loan scheme to bilk money out of businesses, court records reveal. While a partner in Oregon ran newspaper and magazine ads throughout the country offering

commercial loans, Tucker posed as the president of a seemingly high-powered investment bank in Overland Park called Chase, Morgan, Stearns & Lloyd. The operation was a fraud, collecting more than \$100,000 in "advance fees" from at least 15 borrowers without providing any loans.

Tucker ultimately pleaded guilty in federal court to two felony charges of mail fraud and making a false statement to a bank. A Missouri state judge found him guilty of a felony charge of passing a bad check. He was sentenced for all three crimes to serve a year in Leavenworth federal penitentiary, followed by three years of probation. He got out of prison on June 8, 1992.

Then Tucker went into the short-term lending business. In 1997, he met Philadelphia businessman Charles Hallinan, who offered the following account in a lawsuit he would eventually bring against Tucker.

Hallinan was already in the payday lending business. The two hit it off. Hallinan viewed Tucker as a protégé and decided to bankroll another payday lending company with him, making Tucker president of the company and letting him run it



from Overland Park. Tucker agreed in writing not to open any competing businesses.

On Sept. 19, 1997, Hallinan agreed to loan Tucker \$500,000. Tucker signed the revolving loan note.

A month later, Tucker filed for Chapter 7 bankruptcy. In the bankruptcy records, Tucker did not disclose his new business as president of a payday lending company. Tucker listed a total debt of \$583,000, including more than \$220,000 owed to the IRS.

The court cleared Tucker of his debts. Though Tucker had promised Hallinan he would not open any competing businesses, Tucker started a new company in 2001 called CLK Management, listing himself as the owner. Soon, Tucker was setting up dummy companies in Carson City, Nev., using them as mail drops for payday lenders he called Cash Advance, Preferred Cash Loans and UnitedCashLoans.

Starting in 2004, Tucker registered new trade names for payday lenders, including AmeriLoan, UnitedCashLoans, US FastCash, 500Fastcash and OneClickCash. Court documents show that by 2005, Tucker had teamed up with Indian tribes, continuing to run

the payday lenders out of Overland Park.

CLK Management was becoming a major business. By 2006, it took up two floors of an office complex in Overland Park, and eventually employed as many as 400 workers, according to former employees and court records. One of its web sites claimed that it was making thousands of loans each day.

One former employee who worked there at the time swore in a court statement that the business was using addresses on tribal land for “protection.” William James said no one was allowed to reveal where the company was actually located and that his boss once said, “They don’t touch us on Indian reservations.”

Borrowers complained to state regulators about the loans’ high interest rates and the lenders’ aggressive collection tactics. Regulators in California suffered a major setback when an appeals court ruled that because of the tribal affiliation, the lenders had sovereign immunity. With the corporate shell games and the tribes’ involvement, states were finding it difficult to even prove who was doing the lending.

Some companies locate off shore to try to hide from authorities. With

scant effort, Tucker was able to hide CLK Management at an office park in suburban Kansas City.

### Colorado AG's seven-year chase

The Colorado attorney general, John Suthers, had been trying to stop Tucker's lending businesses since 2004. At first, consumers complained about a lender called Cash Advance based in Carson City. But in a surprise move, two Indian tribes—the Miami and Santee Sioux—appeared in court to claim that they were the true owners of the payday lenders. The tribes said the lending business had no connection to Carson City, though there is irrefutable evidence that Tucker set up those shell companies.

By the end of 2007, the investigation in Colorado was continuing to unfold, where complaints about new online payday lenders poured in. Investigators suspected Tucker was behind these new lenders. The Colorado attorney general subpoenaed CLK Management and Tucker.

CLK's lawyer responded with defiance. He argued derisively that Colorado's subpoenas had no power in the state of Kansas.

"I can only conclude in your zeal to pursue CLK you believe there are

no limitations on your power," CLK lawyer Thomas Bath wrote back. "We will continue to ignore subpoenas and orders improperly and unlawfully obtained."

The attorney general wasn't giving up. In March 2008, his office asked a Denver judge to cite Tucker for contempt of court. Tucker himself didn't respond in court, but oddly attorneys for the tribes did. This puzzled Denver District Judge Morris Hoffman because the tribes had never mentioned any connection to Tucker or anyone else.

"Are you representing Mr. Tucker?" Hoffman asked tribal attorney Conly Schulte.

"No, your honor," Schulte replied.

"Is Mr. Tucker part of the tribal entities, or connected to them in any way?" the judge asked.

Schulte stumbled a bit for words, arguing that because any questions challenged the tribes' sovereign immunity, "I feel obligated to my client to respectfully decline to answer that."

Hoffman cited Tucker for contempt and two months later ordered a warrant for Tucker's arrest. In the meantime, the tribes finally acknowledged in a court filing, without ever elaborating on the de-

tails, that they had a relationship with CLK.

Because Tucker was cited on a civil — not criminal — contempt charge, he can only be arrested if he sets foot in Colorado. Three weeks later, he did just that. Tucker, who by now was starting his racing career, set a track record in a Ferrari 360 at the La Junta Raceway in Colorado.

The state, not paying attention to Tucker's racing schedule, missed its chance to arrest him.

With CLK Management now in Colorado's crosshairs, Tucker would make the situation even more confusing. He filed corporate papers in Kansas claiming that CLK no longer existed, that it had merged with a new company owned by the Indian tribes. The new company was called AMG Services. Tucker said he had no control over the company's books.

Based on Tucker's word alone, a Kansas judge ruled that CLK merged with AMG on June 24, 2008. The target of Colorado's investigation — first Cash Advance, then CLK Management—kept moving.

## Partner turns on Tucker

By then, state authorities were not the only ones accusing Tucker of

breaking the law. His own business partner, the man who had bankrolled him, accused Tucker of being a thief.

Charles Hallinan had put up the cash for Tucker to run the payday lending business. For years, Tucker had called Hallinan each Saturday at his home in Boca Raton, Fla., to give an update on their company called National Money Service.

According to a lawsuit Hallinan later filed in Las Vegas, Tucker acknowledged to Hallinan that he had created a new company in Overland Park called CLK Management and that Indian tribes were involved. But Hallinan said Tucker led him to believe that CLK Management was just part of their company and that, in truth, they still owned the payday lending business.

By 2006, the weekly calls were replaced by sporadic emails. Hallinan had become suspicious and sent an accountant in May 2008 to look at the books of their company. According to Hallinan's lawsuit, the accountant discovered the company "had essentially been ransacked and substantially all of its assets, cash and profits diverted."

Hallinan accused Tucker of stealing the business by moving everything over to CLK Management.

Now, it looked as though Tucker might be moving the business again to a new company, Hallinan alleged.

The lawsuit revealed interesting details about Tucker's relationship with the tribes. Hallinan alleged that Tucker held "significant influence" over the Indian tribes. He released a letter from Tucker that showed that on July 31, 2008, Tucker had completed new "management" and "power of attorney" agreements with the tribes.

What's more, Tucker's letter revealed a proposal, as part of a settlement, to share with Hallinan all money from the tribal accounts after an undisclosed amount was paid to the tribes. The lawsuit was settled.

Two companies working for the Modoc tribe recently revealed what the tribe gets paid from the payday lending business. Answering questions in a class-action lawsuit from borrowers in California, the companies said the tribe received between 1 percent and 2 percent of revenues from the loans, even though borrowers pay nearly 800 percent in interest.

But no one from the tribe is even able to sign for several of the tribe's bank accounts used for payday lending. In the same suit, US

Bank disclosed the only two people able to sign checks on four tribal accounts were Scott Tucker and his brother Blaine Tucker. Scott Tucker identifies himself on the accounts as the "treasurer" of the Modoc tribe's corporation. An attorney for the tribe said recently that Tucker is no longer the company's treasurer.

The Miami and Santee Sioux tribes are still fighting in a separate class-action lawsuit to keep their financial details secret.

Tucker's biggest break came from the Colorado Supreme Court last November. The court made it easy for anyone to conspire with an Indian tribe to break state law.

The justices may have had no idea who Scott Tucker was. His name never came up during the hearing. One of the justices asked what the tribes' connection was to Cash Advance of Carson City, Nev., the name and address given on the original loan documents. But the tribes' attorney, Conly Schulte, said the confusion was a case of mistaken identity.

"We submit that there is no connection other than the fact that the Nevada corporations used the same unregistered trade names," Schulte told the justices. "Quite frankly, the

name ‘Cash Advance’ is quite common in this industry.”

The attorney for Colorado knew that there was a connection. It was Scott Tucker, who had at first made the loans through a shell company in Carson City to hide his ownership. When that didn’t work, he cut a deal with the tribes. The lawyer from the attorney general’s office didn’t mention Tucker in court because his role wasn’t yet identified in the court record.

At the hearing, the justices described their feelings of being hemmed in by federal law. On Nov. 30, the court announced its decision. The court put the burden on the state to prove whether a business claiming to be an arm of a tribe was lying. State attorneys general read the ruling as a major defeat.

In a partial lone dissent, Justice Nathan Coats argued that the decision opens the door for “criminally unscrupulous predators, especially in the current technological environment,” and makes it “virtually impossible for the state to protect its own citizens against even the most blatant acts of fraud.”

Despite the Colorado Supreme Court ruling, the attorney general there is still trying to shut down Tucker’s operation in his state. And

it found new evidence from a lawsuit filed in Las Vegas.

Though Tucker says he has no control over AMG Services, Tucker went to a company that sells leads to online payday lenders in the summer of 2009 and complained that someone was stealing AMG Services’ leads. The owner of the lead company identified Tucker in a lawsuit as the owner and chief officer of AMG Services. In 2008, AMG Services paid the vender \$80 million for its leads.

Colorado is continuing to investigate Tucker. While the tribes can claim sovereign immunity, Tucker himself cannot. Since 2008, the state of Colorado has been trying to enforce a subpoena ordering Tucker to appear in a Denver court.

The biggest obstacle has been a local judge in Kansas. Tucker went to Johnson County District Judge Charles Droegge to block Colorado’s subpoena. The judge agreed to do it without even asking the Colorado attorney general for a response.

But when the attorney general showed up in Droegge’s court, the judge changed his mind. He would enforce the subpoena, but only after giving Tucker six months to go to Denver and resolve the matter in court there. Tucker chose not to

go to the Denver court, which had already cited him for contempt and issued an arrest warrant.

After the six months were up, Tucker's attorneys continued to plead with Droege that Colorado's subpoena had no power in Kansas. In a stunning reversal of his earlier reversal, Droege agreed and ruled that the attorney general of Colorado had no jurisdiction to issue a subpoena in Kansas. He ordered Colorado to stop trying to enforce the subpoena or to take any action that would cause any "further annoyance, embarrassment, oppression or undue burden" on Tucker.

The judge also blocked an order by the Denver judge that instructs Tucker to stop making loans in Colorado.

## States band together

Colorado appealed the decision. Last month the attorneys general of 22 states, led by Kansas, filed a brief in the Kansas appeals court blasting Droege's decision. They pointed out that the U.S. Constitution requires states to honor the laws and court decisions of every other state.

The states argued that unless Droege's decision is overturned, "Businesses will be able to commit

unlawful acts in [other states] with impunity, as long as all condemning evidence is kept elsewhere." That, the brief said, "renders states incapable of enforcing laws meant to protect their citizens."

Tucker's story exposes a myriad of challenges for state regulators and the courts in trying to enforce laws against companies operating over the Internet and hiding behind shell companies.

The simple act of setting up shell companies can delay enforcement actions for months. And merely changing a company's name can make settlement agreements or court orders moot.

Kansas was the first state to go after Scott Tucker. But Danny Vopat, the lead attorney in the case for the Kansas Bank Commissioner, says he never knew that Tucker, living and working in the same state, was actually behind the payday lenders he battled for more than two years. Vopat settled with one of Tucker's shell companies in Nevada, a shell that no longer exists. Tucker quickly abandoned the trade name Cash Advance. For those reasons, Vopat says it's unclear that Tucker would violate the settlement agreement if he started lending in Kansas again.

Now with the tribal immunity

shield, some states say they don't have the resources or legal expertise to fight people like Tucker. Deborah Bortner of the Washington Department of Financial Institutions said she consulted with attorneys about tribal payday lenders, who told her "we really don't have a leg to stand on."

There is hope of federal action. Tribal immunity cannot stop federal regulators, who have the right to investigate and take action against tribes. And in the financial reform act passed last year, Congress gave the new Consumer Financial Protection Bureau the explicit power to regulate payday loans.

Without a confirmed director, the new consumer agency is limited in its powers. Still, the agency is expected to make oversight of payday loans a top priority. Consumer lawyers who've talked to the bureau officials say that the agency is especially concerned about lenders who flout the law, including payday lenders who claim to be affiliated with tribes.

The bureau can't enforce state laws. But it can subpoena tribal records and then share those documents with state regulators.

Yet industry analysts say that Indian tribes are now clamoring to get involved in payday lending. Frank Cotton, an industry analyst in Atlan-

ta, estimates at least 30 payday lenders are affiliated with Indian tribes. He said the number may even be as high as 60.

Meanwhile, Tucker has a heavy schedule of racing ahead. He recently made the unusual and costly decision to switch in mid-season to a new custom-built vehicle for the Le Mans series.

His publicity machine continues to promote Tucker as the next superstar of the racing world, recently describing him as "a real-life action figure [who] can be found working his magic at racetracks all over the world."

"With all of his recent success, fans of the three-time champion may have a hard time picturing Tucker in anything other than a driver's suit, but he was a successful businessman long before he was a race car driver," Tucker's publicist said in a press release in July. "Give that man a cape." ■

**CORRECTION:** *The original story incorrectly quoted Frank Cotton about estimates of tribal/payday connections. The sentence now reads, "Frank Cotton, an industry analyst in Atlanta, estimates at least 30 payday lenders are affiliated with Indian tribes. He said the number may even be as high as 60."*

# Credit unions remake themselves in image of payday lenders

Some short-term loans carry equivalent of 876% interest rate

By Ben Hallman

Published Online | May 27, 2011

**T**O MILLIONS of member-customers, credit unions are the financial equivalent of a trusted uncle, dispensing prudent loans for cars, homes, and education without the profit motive of traditional banks.

The National Credit Union Administration (NCUA), which supervises and insures about 4,600 federally-chartered credit unions, says they operate with a “not for profit but for service” philosophy, providing “an alternative to the oppressive loan rates charged by predatory lenders.”

But encouraged by federal regulators, an increasing number of credit unions are competing directly with traditional payday lenders, selling small loans at prices far higher than they are permitted to charge for any other product.



## LOOSE LENDING

Last September, the National Credit Union Administration raised the annual interest rate cap to 28 percent from 18 percent for credit unions that offer payday loans that follow certain guidelines.

Under this voluntary program, credit unions must allow at least one month to repay, and cannot make more than three of these loans to a single borrower in a six-month period. Credit unions are not allowed to roll over the loans, a





Ross D. Franklin/The Associated Press

**A growing number of credit unions around the country are offering payday loans and competing with traditional payday loan businesses, like those shown here in Phoenix in this file photo.**

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practice that typical payday lenders use to make big profits.

But because these firms can charge a \$20 application fee for each new loan, the cost to borrow \$200 for two months often translates into an annual interest rate of more than 100 percent.

What's more, many credit unions prefer to sell loans outside the federal program, allowing them to

charge significantly more in fees.

At Mountain America Federal Credit Union in Utah, a five-day \$100 “MyInstaCash” loan costs \$12, which works out to an 876 percent annual interest rate. That rate rivals traditional storefront payday lenders.

An iWatch News investigation found 15 credit unions like Mountain America that continue to offer

high-cost loans that closely resemble the payday loans they are meant to replace.

“They are promoting these loans as payday alternatives, but they are not really alternatives, they are egregious payday products,” said Linda Hilton, a community activist in Salt Lake City. “We look at it as a moral lapse of credit unions.”

All told, more than 500 credit unions are making payday loans with widely varying interest rates — from a modest 12 percent with no fees at State Employees’ Credit Union in North Carolina to the high triple-digits loans sold by Mountain America. It has become a fast-growing trend in an industry struggling to remake itself after the financial crisis.

Consumer groups typically warn against borrowing at interest rates higher than 36 percent per year. That’s the maximum allowed by many states and by the U.S. Defense Department for loans to active-duty members of the military.

The top U.S. regulator of credit unions told iWatch News she hopes more will adopt payday-style lending with new rules that came out of her own experience working at a credit union.

Many credit unions, NCUA

Chairman Debbie Matz said, were afraid to make small-dollar loans for fear of losing money. Short-term loans are risky because there isn’t a credit check, and that higher interest costs are necessary for credit unions to recoup the costs from the larger proportion of customers who will default, she said.

“We spent a long time trying to do this in a way that would work for members and for the credit unions and not be predatory,” Matz said.

### **New revenue stream**

Credit unions date to the mid-1800s when mill and bakery workers in Germany created democratic co-operatives to loan money to each other at reasonable rates. The co-operative approach to lending money to members for home and auto purchases flourished in the United States throughout much of the mid-20th century, but some critics say the business model has outlived its usefulness.

Most U.S. credit unions have struggled in the wake of the 2008-09 financial crisis with many of the same problems as banks — a surge in loan defaults and a drop in customers looking for loans on big ticket items like homes and cars. Unlike

banks, credit unions operate as not-for-profits. Their assets are primarily member deposits. They need to make loans in order to pay interest and insurance on those deposits. And, unlike banks, they can't raise investor capital when times are lean.

At the end of 2010, the NCUA had designated 368 credit unions as either a serious supervisory concern or at high risk of failure. Forty-one credit unions have closed since 2009.

Thomas Glatt, an industry consultant in North Carolina, said that his analysis of financial reports suggests that 700 mostly small credit unions are in financial distress. While most credit unions offering payday loans do so to give members a better alternative to storefront payday lenders, Glatt said some appear to see the loans as a new revenue stream to shore up crumbling finances.

"Not every credit union is as pure as they could be," he said. "If they are offering something similar to what is sold on the street corner, you have to wonder if that is in keeping with the credit union philosophy."

It isn't clear how profitable payday lending is for credit unions. But there is potential for big profits. Payday lenders extended an esti-

mated \$40 billion in credit in 2009, according to Consumers Union. Profits were about \$7 billion.

Many of the credit unions that offer high-cost loans declined to discuss their profitability, but NCUA filings show that Mountain America Financial Services — which administers the Mountain America credit union payday program — reported profits of \$2.4 million in 2010. That includes profits from its insurance business, which the subsidiary operates.

Still, several that offer low or moderate-priced loans said they either broke even or lost a little money on their programs.

### **Fast cash for car loans**

On a recent Saturday morning, Sam Heredia, a 29-year-old producer for a Spanish language morning radio show, stopped in at a Nix Check Cashing branch in Highland Park, a middle-class Mexican-American neighborhood just north of downtown Los Angeles.

Heredia had come for the Nix standard payday loan offer: a \$400, 14-day loan, for \$42.25. He wrote a postdated check for the full amount and pocketed the cash.

Heredia, who was wearing sun-

glasses and a bright red and blue soccer jersey, said in an interview in the parking lot that he needed fast cash to help stay current on bills.

The biggest drain on his finances is his car, a 2007 Toyota Tundra. He said that the car was his pride and joy — “I love it,” he said — but that he took out a loan to pay for it under his father-in-law’s name because he has bad credit. He is having trouble keeping up with the payments and other accrued debt.

Every two weeks or so for the past year, Heredia has made the trip to Nix, borrowing \$400 each time. That means he has paid about \$1,000 in interest on his borrowing, which works out to a 362 percent annual interest rate.

“I think it’s a high percent,” he said.

With 48 branches in mostly low-income neighborhoods, Nix Check Cashing is one of the largest payday lenders in the Los Angeles area.

The Nix chain was acquired four years ago by Kinecta Federal Credit Union, a major player in the credit union industry founded in 1940 by employees of Hughes Aircraft Co. Workers at the California company were tired of driving into town to do their banking and asked owner

Howard Hughes, the aviator, engineer and Hollywood producer, for permission to start a credit union at the plant.

“Just keep my name clean. I don’t want anything funny going on,” Hughes replied, according to credit union founder Lou Merandi. In the early days, membership in the Hughes credit union cost just 25 cents and members could borrow up to \$200.

Today, Kinecta has grown to \$3.5 billion in assets, 227,000 members and ranks as the 27 th largest U.S. credit union. It maintains the tradition of sponsoring little league baseball teams, neighborhood street fairs, college scholarships for high school students and budgeting classes for the community.

Kinecta also directly finances the payday loans offered by Nix to customers like Heredia through a service company called Kinecta Alternative Financial Solutions. The interest rate cap for loans that don’t follow the new federal payday guidelines is still 18 percent. So how is Kinecta allowed to charge a rate that tops 350 percent?

In calculating Heredia’s \$42 charge, Kinecta says that just \$3, or 15 percent, is interest. The rest of the charge comes from a \$39.95 ap-

plication fee. The application fee is charged each time, even for repeat borrowers.

Kinecta Alternative Financial Solutions president Randy Dotemoto told iWatch News that the federal truth-in-lending law known as Regulation Z permits financial institutions to calculate the interest on a loan without including the application fee.

Consumer advocates say that credit unions are using inflated application fees to get around the interest rate cap.

Regulation Z says that application fees are to “recover the costs associated with processing applications for credit,” such as credit reports, credit investigations and appraisals, notes Lauren Saunders, the managing attorney of the National Consumer Law Center’s Washington, D.C. office. She has been pressing the NCUA to use its regulatory authority to crack down on credit unions like Kinecta since 2009.

The whole idea of payday lending, promoted for being fast and needing no credit check, is to offer a speedy loan without any underwriting, Saunders said.

“The NCUA is not being aggressive enough in defending its own statute,” she said.

An NCUA spokesman said that Kinecta must comply with the truth-in-lending law, but declined to comment on whether Kinecta was doing so.

## Payday history

Payday loans are a product of the deregulation trend of the 1990s, when many states rolled back laws that limited how much a lender could charge for a loan.

In a typical loan, a customer borrows a small sum, usually less than \$500, for a week or so, until their next paycheck. Lenders assess flat “fees” for these loans, rather than typical interest charges. At Advance America, the nation’s biggest payday lender, a borrower in Texas pays \$40.91 to borrow \$200 for two weeks — a 533 percent annual interest rate.

Lenders say they provide short-term cash to people in need. They say they have to charge high fees because they loan to borrowers with bad or no credit.

Dotemoto said that payday lenders like Nix perform a vital community service. Before payday lending was legalized in California in 1997, payday customers bounced checks, paid high bank overdraft fees, or pawned their possessions when in

a financial crunch, he said.

Critics say the loans can trap customers in a cycle of debt. Many payday borrowers juggle multiple loans at any given time. "Borrowing more money at triple-digit interest rates is never the right solution for people in debt," the Consumers Union says in its payday lending factsheet.

Credit unions are still new to the payday business. Most started making small dollar loans in the past five years. Some go out of their way to offer small loans, even if it means losing money.

Campus Federal Credit Union, which serves mostly students and employees of Louisiana State University, offers a "Money-Wise" loan. Loans from \$100 to \$345 are available, at an 18 percent interest rate, with six months to repay. There are no additional fees.

John Milazzo, the president of Campus Federal Credit Union, said it loses about \$30 on each payday-style loan. But with just a handful of borrowers — 63 as of mid-April — the credit union can afford a small loss. "We understand that this is part of the business of helping," he said. "And hopefully we can establish a good customer."

More typically, credit unions aim to at least break even on their loans.

In Ohio and Michigan, about 50 credit unions have banded together and collect annual fees from subprime borrowers of \$35 or \$70, depending on whether they want a \$250 or \$500 credit line. Those fees go to a central fund, with current assets of \$633,000, used to backstop losses at participating credit unions. Once a customer has paid the annual fee, loans are made at 18 percent interest.

A customer who took two loans in a year under these terms would pay an effective annual interest rate of more than 100 percent. But the architect of the loan program, Douglas Fecher, the president of Wright-Patt Credit Union in Dayton, Ohio said that annualized interest rates are not the best way to gauge short-term, small-dollar loans.

Without the annual fee, he said, credit unions couldn't afford to make the loans.

A lender earns just \$3 on a \$250, 30-day loan offered at 18 percent interest, he said. "If one person doesn't pay that back we would need to make 80 more loans to make up for it," he said.

Fecher said he opposes any type of lending that preys on vulnerable customers.

His loan, "doesn't save the world,"

he said. “But it’s cheaper than what they can get somewhere else.”

### ‘Wild West of financial services’

Consumer advocate Linda Hilton has been battling payday lenders in her home state of Utah for nearly 20 years.

“It’s the Wild West of financial services out here,” Hilton, the director of the Coalition of Religious Communities, said in a recent interview in her Salt Lake City office. A two-mile stretch of State Street, which descends from the state capitol building into a working-class neighborhood, boasts three payday lending outlets, a pawn shop that also offers payday loans, and a branch of Mountain America Credit Union. Public officials in the state have mostly sided with the payday lenders.

Utah Attorney General Mark Shurtleff, for example, has said that banning payday loans could hurt the poor more than it would help them.

In 2007, Shurtleff accepted free round-trip airfare to the Bahamas from the Community Financial Services Association of America, a payday-lending trade group, which had invited him to speak at its annual convention. Shurtleff told the Deseret News he did nothing

wrong, saying “I accept airfare from various groups when I fly out to speak to them.”

The fight got personal last summer, when Hilton learned that her credit union, America First, was selling high-cost loans online and at a kiosk in one of its branches. A \$4.7 billion credit union, America First grew from modest beginnings in 1939 when a group of civilian employees at an Army base in Salt Lake City used a tobacco can to store the nascent credit union’s funds.

“They are supposed to be stores of the people owned and operated by shareholders,” Hilton said. “I expected more of them than to sell their members on a product that can lead to a payday loan trap.”

She and religious leaders staged a protest outside an America First branch, which drew local press attention. Under public and private pressure — the NCUA was also investigating America First, iWatch News has learned — the credit union dropped payday loans altogether.

America First, like most credit unions offering high cost loans, was partnering with an existing payday lender.

That company, called Capital Finance LLC, still funds loans at a handful of credit unions, including

those made by Mountain America, the second-biggest credit union in Utah after America First, under the “MyInstaCash” brand.

Hilton was surprised when she learned from a reporter that Mountain America, which has \$2.8 billion in assets, was still in the payday business. “That’s just terrible,” she said.

Sometimes, it is a state-chartered credit union that doesn’t have to follow federal lending rules that is financing the payday loans.

For example, Orlando Federal Credit Union offers an XtraCash loan that tops out at 266 percent interest per year. Those payday loans are financed by Mazuma Credit Union, a state-chartered credit union in Kansas City.

Saunders, the consumer lawyer, said that regulators should stop these relationships.

“They should prohibit any federal credit union from partnering with payday lenders or marketing anything that they would be prevented from offering themselves,” she said.

An NCUA spokesman said credit unions are permitted to direct customers to payday lenders from their web sites in exchange for a commission fee.

Mountain America declined to

comment, referring questions to Scott Simpson, the head of the Utah Credit Union Association, a trade group. Simpson said that he didn’t know how much Mountain America or other credit unions make from their payday lending partnerships. He said he was surprised that there was opposition to the loans.

“They are creating an alternative in the marketplace,” he said of credit unions like Mountain America, which was founded in 1934 for Salt Lake City telephone workers. “The demand doesn’t stop if these loans go away.”

Mountain America Financial Services, which administers the Mountain America credit union payday program, reported profits of \$1.8 million in 2009 and \$2.4 million in 2010. But that number also includes profits from the credit union insurance business, which the subsidiary operates.

America First also declined to discuss its payday programs, or to say how much it makes from referral fees paid back to the credit unions from the third-party payday vendor.

Orlando credit union president John Neusaenger said that his credit union makes “very little” in referral fees that come back to the credit union for each XtraCash loan. Gate-



way declined to disclose how much it earns in referral fees.

Nix Check Cashing, likely the biggest credit union payday lending operation in the country, has actually been operating at a loss. Nix lost \$4 million in 2010 and \$2 million in 2009.

Dotemoto attributed the losses to a down economy. Much of Nix's business comes from people who pay a fee to cash work checks, he said, and that business is off 30 percent from a few years ago.

### How much is too much?

The NCUA says that 244 credit unions as of December 31, 2010 had \$14 million in outstanding loans under the new federal short-term loan guidelines.

Borrowers who take those loans typically pay less than the high-cost credit union lenders. Those borrowers, in turn, typically pay less than at a storefront payday lender. So how much is too much?

Pentagon rules prohibit loans to active-duty service members for more than 36 percent annual interest, all inclusive. That is also how much a recent Federal Deposit Insurance Corp. pilot program for banks allows.

Some credit union executives have decided they shouldn't be in the payday business at all.

American Southwest Credit Union in Arizona for years offered a short-term loan with an 18 percent annual percentage rate and a \$25 quarterly fee. As a goodwill gesture to struggling customers, America Southwest offered to waive the fee if payday borrowers came in for a financial counseling session, even though the credit union was losing money on the overall program.

"Not a single person took us up on it," said Brian Barkdull, the chief executive.

Meanwhile, customers with short-term loans from the credit union were also usually juggling several payday loans from more traditional lenders. They wouldn't take the counseling, and they didn't stop borrowing.

Barkdull eventually pulled the plug on American Southwest Credit Union's short-term loan program.

"The payday loan is a highly addictive product conditioning borrowers to live beyond their means," he said. "This is a product that should never have been created." ■

*Bethany Firnhaber contributed information used in this story.*

# Fights over tribal payday lenders show challenges of financial reform

By Michael Hudson and David Heath

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**I**N THE BATTLE to shield themselves from lawsuits and government oversight, some high-interest payday lenders have found unlikely allies: Native American tribes.

In legal fights in California, New Mexico, West Virginia and Colorado, a group of Internet-based payday lenders have argued they are immune from lawsuits and regulation because they are “tribal enterprises.” They claim they enjoy tribal-nation sovereignty, which allows them to operate outside state oversight — even when they’re making loans to non-Native Americans living far from Indian lands.

State regulators and consumer lawyers say that the lender-tribe marriages are ruses designed to allow non-Native American companies to skirt consumer-lending laws. The tribes, they claim, are being used as fronts for the lenders.



## LOOSE LENDING

An ex-employee of one tribal-affiliated lender testified the company secured post office boxes on tribal land to protect itself from attacks by consumer lawyers and government regulators. He claimed a manager told him: “They don’t touch us on Indian reservations.”

Affiliating with tribes is just one method some payday lenders have used to skirt existing laws and oversight. Others have operated online payday lending sites from offshore headquarters. And still others have claimed that borrowers are actu-

ally paying for Internet access with a rebate. In Texas, payday lenders get around state interest-rate limits by calling themselves credit service organizations set up to help consumers repair their credit records.

"This industry is so good at finding loopholes or gaps it can exploit," Jean Ann Fox of the Consumer Federation of America says.

So good that the new federal Consumer Financial Protection Bureau will be challenged to bring some order to the chaos. Experts say the new bureau will likely have rulemaking authority over tribal payday lenders. But it's also likely that any effort by the agency to take enforcement action against them would spark drawn-out court battles that would delve into the legal intricacies of tribal immunity.

The broad financial reform law passed by Congress last summer gives the consumer bureau the power to regulate payday lenders, which extended an estimated \$42 billion in credit and took in more than \$7 billion in revenues in 2008, according to investment bankers at Stephens, Inc.

In a typical payday loan transaction, a borrower might pay a \$50 finance charge to borrow \$300

that's scheduled to be paid back in two weeks, when his next payday comes around.

Payday lenders say they provide reasonably priced, short-term cash to people in need. The industry's trade association says its customers are "the heart of America's middle class. They are typical hard working adults who may not have savings or disposable income to use as a safety net when unexpected expenses occur."

Critics say many customers can't cover the quick repayment, so they're forced to roll over their loans many times and pay still more fees.

### **Interest Rate Over 1,200 Percent**

A payday loan customer in California, Amy Baillie, claims that after she borrowed \$300 from a tribal-affiliated lender, the company debited a total of \$977 from her bank account over the next five months, then told her she still owed \$430. The lender disclosed an annual interest rate on the loan of over 1,200 percent, according to her lawsuit in federal court in Oakland.

Andrea Felts, an assistant high school principal in Albuquerque, N.M., says she had a similar expe-

rience with three tribal-affiliated lenders.

While going through a divorce, Felts says, she went online to get some quick cash to help “reestablish” herself and her daughter. But the price ended up being steeper than she expected. On the final transaction, for example, her lawsuit says she paid an annual interest rate of 521 percent on a cash advance from Ameriloan, which claims a relationship with the Miami Nation of Oklahoma.

When she found she couldn’t keep up with the payments on the loans, Felts claims, collectors began calling her at home and at work, with one even threatening to have her arrested on a bad-check charge.

“It ends up being one big trap,” Felts says. “You take out one loan and before long you need to get another one to pay the first one and it will just continue. It’s a vicious cycle.”

Felts’ and Baillie’s cases are among three private lawsuits filed in New Mexico and California against tribal-affiliated lenders. All seek class action status.

The lenders and tribes involved in these cases could not be reached by the Center for Public Integrity for comment. An attorney for one

group of tribal-affiliated lenders said in an e-mail: “We decline to comment on matters in litigation.”

## **‘Revolving Door of Debt’**

The federal government has mostly left oversight of payday lenders up to the states, producing a regulatory patchwork.

Seventeen states ban or discourage payday lending. In the rest, the rules often allow them to charge annual interest rates of 400 percent or more.

The new Consumer Financial Protection Bureau won’t be able to regulate interest rates, but Fox and other activists say they want the agency to write rules that will make it harder for payday lenders to trap borrowers in cycles of debt by defining frequent, costly loan rollovers as an unfair practice.

Elizabeth Warren, the presidential aide who is overseeing the bureau’s launch on July 21, says payday lending will be a “high priority” for the agency. During a recent fact-finding trip to Ohio, Warren said families need access to small-dollar loans for emergencies, but “a model that is designed to keep those families in a revolving door of debt is not good for families — and ulti-

mately not good for the economy.”

If the agency does seek tighter rules on payday loans, it will tangle with an industry that isn't shy about spending money to influence voters and lawmakers. In 2008 in Arizona and Ohio, the industry invested \$30 million pushing unsuccessful ballot measures that would have wiped out laws banning payday lending, outspending opponents by more than 60 to 1.

Payday lenders say they're not against sensible regulation, but they're against laws that cut off access to consumers who need credit. These laws, the lenders say, are the work of critics who've spread misinformation about the industry.

They say their customers seldom get caught in cycles of debt and that quoting annual interest rates is misleading, since most loans are for two weeks.

Steven Schlein, a spokesman for the Consumer Financial Services Association, an industry group for payday lenders, says it's ridiculous to suggest that payday lenders go to great lengths to avoid regulation. “We're highly regulated by the states. We adhere to all the state laws.” Consumer activists, he added, have “just got into this blind spot where they're just going to op-

pose anything the payday lending companies do, whatever product they offer.”

As for the possibility that the new federal agency will get tough with payday lenders, Schlein says he's confident that, if they look at the facts, the agency's architects will see that consumers need ready access to the kinds of loans that the industry provides.

“They're not there to deny consumers credit,” he says. “They're there to make sure that credit is done in a very simple, straight-forward way.”

### **‘Rent-a-Bank, Rent-a-Tribe’**

Not much is simple about the battles that have been waged over the past decade and a half over how payday lenders do business.

In the 1990s, as some states began enforcing limits on what they could charge, many payday lenders teamed with out-of-state banks to evade interest-rate caps in states with strict limits on finance charges.

Under federal law, a state-chartered bank could “export” interest rates allowed in its home state to another state — using one state's loose interest-rate rules to make loans in a state where interest rates

were capped. The payday lenders structured the deals so that they acted, on paper, as loan brokers, and the out-of-state banks were the lenders of record.

Consumer advocates dubbed the arrangement “rent-a-bank.”

That approach worked well for payday lenders until federal banking regulators enacted rules discouraging banks from working with payday lenders.

By 2005, with the “rent-a-bank” model essentially shut down, payday lenders began searching for new ways of doing business. It was around that time that a group of online payday lenders began using what consumer attorneys now call the “rent-a-tribe” model.

It was a model built on more than two centuries of legal precedent. Court decisions have decreed that state governments have little authority over tribes.

State authorities first became aware of the tribal lending model after they began investigating unlicensed operations that were offering loans over the Internet.

In 2005, Colorado’s attorney general obtained a court order for production of documents from two payday lenders, Cash Advance and Preferred Cash Loans, which ran

various websites under names such as Ameriloan and One Click Cash.

After months of silence from the Nevada-based companies, state officials were surprised when two Indian tribes, the Santee Sioux Nation of Nebraska and the Miami Nation

**The “rent-a-tribe” model built on more than two centuries of legal precedent. Court decisions have decreed that state governments have little authority over tribes.**

of Oklahoma, intervened in the case, claiming that they actually owned the businesses. The same scenario played out in California in 2007, when the state Department of Corporations went to court to try to stop Ameriloan, US Fast Cash, One Click Cash,

and other online lenders from doing business in the state.

A company called Miami Nation Enterprises explained to a California judge that it was an “economic subdivision” of the Miami Tribe of Oklahoma and that it used Ameriloan and US Fast Cash as trade names in its payday lending business. Another company, SFS Inc., explained that it was owned by the

Santee Sioux Nation of Nebraska and that it made loans under the trade names One Click Cash and Preferred Cash.

Both said that, as arms of federally recognized tribes, they were immune from state enforcement actions. Both added, too, that the profits from payday lending were vital to the welfare of the tribes.

More than a century ago, their lawyers say, the tribes were “stripped of their economic vitality and forced to relocate to remote wastelands” incapable of supporting their populations. The Miami tribe says profits from payday lending are used to pay for such items as “tribal law enforcement, poverty assistance, housing, nutrition, pre-school, elder care programs, school supplies and scholarships.”

### Address Unknown for Tribe's Lending Arm

Surrounded by flat farmland in northeastern Oklahoma sits a modern brick and stone building where the Miami Nation conducts its business. When a reporter from the Center for Public Integrity visited in December, the front door was locked. A receptionist said no one was available to answer questions,

but promised to have an official from the tribe call the Center.

No one from the tribe responded to repeated requests for information from the Center over the following weeks.

Across the street is an empty warehouse that the tribe lists as the address for several businesses, including a rural Internet provider and an attorney's office.

But nowhere does the tribe list an address for its most controversial business, a collection of websites offering quick, small loans to cash-strapped borrowers.

The tribe, which has about 800 members in Oklahoma, is best known in the area for its casino, The Stables, one of 13 Indian casinos around the Bible-belt town of Miami, Okla.

Locals appear unaware of the Miami Nation's online payday lending business, or its legal battles with states such as Colorado, California and West Virginia. The head of the local Chamber of Commerce knew nothing about it. And the websites themselves reveal nothing about who owns them.

Authorities in Colorado and California have tried to build the case that the relationships between the lenders and the tribes are marriag-

es of convenience. California authorities have called the affiliations a “sham.”

Colorado authorities contend that Miami Nation Enterprises and SFS weren’t created until the spring of 2005 — as many as two years after they say the lenders had begun doing business. Colorado’s attorney general says that it was only after the state took enforcement actions against the lenders in late 2004 and early 2005 that the tribes

incorporated the tribal enterprises and enacted payday loan ordinances.

The California Department of Corporations supported its case with a statement from a whistleblower who had worked for One Click Cash. William James said his former employer was part of a web of companies — as many as 500 in all — that were headquartered in an office complex in Overland Park, Kan., a suburb of Kansas City. Other than mailboxes on Indian land, James said, there was nothing to suggest the companies were owned or run by Native American tribes.

The companies kept their location top secret, barring employees from telling anyone where it was, James said. The third floor where he worked “was very private and

extremely secure, and the environment was very luxurious and posh, including multiple 37-inch LCD televisions for the employees.”

Though James was making lots of money, he fretted that One Click Cash and its sister companies were taking advantage of people, “banking on the fact that a person will be unable to repay their loan on time, thus accruing exorbitant interest, extension and late fees.” He saw customer loans of \$300 quickly turn into \$900 debts, he said.

The lenders’ websites don’t give details about fees or interest rates charged. Money is deposited in a checking account, and payment is later automatically withdrawn from the same account. If there are insufficient funds, the loan is automatically renewed, with additional fees.

The Better Business Bureau, which lists addresses in Nevada, Kansas, Colorado and Oklahoma for Ameriloan, reports that the lender has received hundreds of complaints and gives it an “F” rating.

### **Bank Overdraft Fees Also Costly**

In the Colorado case, lawyers for the lenders and tribes deny the allegations tossed at them by their critics. They suggest, for example,



that interest rates charged by payday lenders are a bargain compared to the 3,500 percent annual interest rate that bank customers can shell out for a two-week, \$20 overdraft.

The Santee Sioux Nation said in a court filing that all its loans are approved on tribal land. Despite evidence that the tribes are engaging in legitimate lending, the tribes say, the state of Colorado has pursued a “protracted, caustic assault on the Tribal Entities’ status, replete with false allegations and innuendo.”

After years of litigation, the tribal lenders’ battles with California and Colorado show no end in sight. On Nov. 30, the Colorado Supreme Court ruled that tribal enterprises can use tribal immunity to block state investigations, but then sent the case back to the trial court so that the judge could determine whether the lenders were truly owned and operated by the tribes.

One case involving tribal lenders has been resolved. West Virginia’s attorney general reached a \$128,000 settlement in 2008 with companies associated with the Miami and Santee Sioux tribes as well as a third Native American group involved in payday lending, the Modoc Tribe of Oklahoma. The deal cancelled debts and provided refunds for 946

borrowers. The attorney general’s office had claimed that Internet-based lenders associated with the tribes had violated West Virginia’s limits on payday lending. The tribal companies didn’t admit any wrongdoing.

Richard Guest, an attorney with the Native American Rights Fund in Washington, D.C., says that the tribes want to reach a settlement in Colorado, too, but state officials have shown no interest in working things out.

Guest notes that “I personally am not a big fan of payday lending,” Still, he says, the tribes have to raise money somehow to pay for programs that the federal government has failed to cover.

“Tribes are the ones who’ve gotten screwed over,” he says. “They are not looking to screw others over.” ■

*This project was supported in part by the former Huffington Post Investigative Fund, which recently became part of the Center for Public Integrity.*

# Buyer beware

## Car dealers adopt outlawed mortgage tactics, new consumer agency powerless against them

By David Heath

Published Online | April 11, 2011

**A**FTER THE FINANCIAL crisis exposed the devastation caused by predatory lending, state and federal authorities vowed to protect consumers from practices that lured them into debt they couldn't afford.

But Congress kept most auto loans — the second largest source of debt for Americans — out of the reach of the fledgling U.S. Consumer Financial Protection Bureau. And now many of the same tactics that led to the mortgage meltdown — like fudging facts on the loan application or charging consumers hidden fees — continue to plague auto loans, an investigation by the Center for Public Integrity found.

The politically powerful industry has also mastered a few high-pressure tactics of its own. Chief among them is the “yo-yo,” where dealers let buyers drive a new car home in hopes of locking them into a deal



### LOOSE LENDING

and later tell them their financing fell through. The tactic can lure buyers to accept a higher interest rate.

And while the financial crisis rendered subprime mortgages extinct, Wall Street is once again buying up bundled subprime auto loans, fueling a market aimed at the most vulnerable consumers and relieving dealers of the risks of making bad loans.

The end result is that financial incentives to take advantage of auto shoppers remain unchanged while the agency charged with pro-



Paul Sancya/The Associated Press

**The floor of the North American International Auto Show is shown in Detroit on Jan. 11, 2011.**

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tecting borrowers will be powerless against an industry polling shows is the most distrusted in America.

“I think that’s a problem because a lot of fairly unsophisticated people buy cars from auto dealers,” said Rep. Barney Frank, a Massachusetts Democrat who co-authored the 2010 financial reform law. “We felt that consumers need protection in this.”

The National Automobile Dealers Association says that its members face lots of regulation already and didn’t need any further government oversight, which it argued would only end up costing consumers.

But don’t try to convince Tammy Moses of that.

The dental hygienist from Oklahoma City trusted her car salesman, a family acquaintance who

joined hands with her and prayed for her troubled son.

He found creative ways to finance a 12.25 percent loan in 2007 despite Moses' lousy credit rating. But for some reason he limited her choice to only two cars on the lot. She fell in love with a sleek, new Hyundai Elantra, despite her father's warning that the car looked a little askew.

On a trip to Dallas two months later, Moses lost control of the Elantra as she veered to avoid a car swerving into her lane. When a mechanic suspended the car on the rack, he immediately spotted rusted damage from an earlier wreck.

Punching the car's ID into the computer turned up a previous owner from Georgia, according to an interview with Moses and court documents. She learned through court proceedings that the dealer, Automax Hyundai South, routinely got duplicate "certificates of origin" from the automaker to sell used cars as new.

### **Similarities to mortgage crisis**

Lying about the car's true value mirrors the inflated appraisals that contributed to the mortgage crisis.

Moses's case exposed other

problems reminiscent of the days of mortgage mania. The income reported on her loan application was bogus, three times the actual amount. And dubious fees meant that she was charged \$22,000 for a \$15,000 car. A jury recently awarded Moses \$400,000, concluding the dealer committed fraud. The dealership didn't appeal and hasn't responded to requests for comment.

It's the sort of lending horror story that now sounds familiar.

But car dealers will continue to live by the old rules under a last-minute political deal in Congress last year that freed the industry from the Dodd-Frank financial reform law.

Elizabeth Warren, the Harvard professor now advising President Barack Obama on setting up the new consumer agency, said at the time that dealers were sending a cynical message: "We still want to be able to do the old contracts that nobody can read and nobody can understand and still have all the tricks and traps."

Frank told the Center in an interview that most lawmakers don't know the same sort of tactics used during the mortgage crisis are being used in auto loans and that dealers' exemption to the Dodd-

Frank law was a “mistake.”

Dealers mounted a political offensive in lawmakers’ home districts that ultimately prevailed. “Auto dealers are an example of the most effective lobbying force, a built-in grass roots network... There are auto dealers in everybody’s district,” he said.

### **“You don’t belong here”**

It comes as no surprise that Americans distrust car dealers.

A Gallup poll for the Better Business Bureau in 2008 showed that only 13 percent of Americans trust car dealers. No other business garners so much distrust. But industry whistleblowers say that shoppers would still be shocked if they could listen to some of the private conversations they’ve heard.

John Callahan said in his three years selling cars on dealer Web sites he was troubled by the sales techniques he saw taught. “They were teaching you how to steal money from the consumer and hide the fact.”

He remembers a case where a salesman overcharged an elderly woman \$2,500 on a car and cheated her \$5,000 on her trade in. As she drove off the lot, everyone was

high-fiving the salesman. “You just destroyed her. That’s awesome,” Callahan recalls his colleagues saying. “And the management would laugh about it.”

The pressure to squeeze each customer can be intense, said Ray Lopez, a car salesman for 33 years. One major dealership in Southern California, he says, automatically fires the bottom three salespeople each month. It’s not enough just to make a sale, Lopez said. You’re expected to score big each time.

He got fed up one day after his boss chewed him out for selling a used car to his brother with only a \$500 markup. “He calls me into his office and good God, I’ve never heard anybody cuss up such a storm. ‘You gave your brother a house deal? If you can’t f--- your own family and brag about it, you don’t belong here.’”

### **Profit made in finance manager’s office**

Consumers are much more savvy today about how to negotiate the price of a car, but industry insiders say shoppers remain largely ignorant about what to do when they walk into the finance manager’s office.

While the consumer thinks the

negotiations are over at that point, dealers know that a lot more profit can be made off the financing.

For starters, dealers routinely jack up the interest rate on a loan and split the profit with the lender. So if you qualify for a 4 percent loan, the dealer will say the best he can do is 7 percent. Half of the extra profit goes to the dealer as a “markup.”

Buyers never know they’ve been charged more because the markup usually isn’t disclosed. The Center for Responsible Lending calls these “kickbacks” and calculates that they cost car buyers \$20 billion a year.

“Auto lending is the only major lending where this still occurs,” said Chris Kukla, the group’s senior counsel. “It’s time for an end to it.”

A similar practice was also routine in the mortgage business, where brokers would earn higher commissions for inflating the interest rate. This help put borrowers into loans they couldn’t afford, and the Federal Reserve has now outlawed the practice.

Strong incentives remain that may tempt dealers to gouge car buyers.

Most dealers don’t keep loans on their books, so they face few con-

sequences if the borrower can’t afford the payments. And while Wall Street investors won’t touch mortgages, they continue to buy bundled auto loans from finance companies, even risky subprime car loans.

Loans to subprime customers — those who have low credit scores because they may have a history of missed or late payments — have been on the rise. Subprime loans now account for more than one-third of the new and used auto-loan market, according to the credit rating agency Experian.

General Motors last year bought the subprime lender

AmeriCredit Inc. to expand sales to financially troubled borrowers. That lender reports that 9.2 percent of its loans went into default last fiscal year, the same rate as before the crisis in 2006 and during it in 2008.

The explosion of consumer debt has compounded the risks for borrowers. Most car shoppers now

**Subprime loans now account for more than one-third of the new and used auto-loan market, according to the credit rating agency Experian.**

owe more than their trade-ins are worth, limiting their borrowing options and making them especially vulnerable when negotiating a car loan.

Deals today routinely include costly GAP insurance, which in the event of a catastrophe covers the difference between what the car is worth and what is owed. And with lending companies willing to finance up to 125 percent of the car's value, dealers have room to sell costly and often dubious extras, such as duplicative extended warranties or service contracts.

David Stivers, a former auto finance manager who now works as an expert witness for consumer lawyers, said that subprime car loans often bury the consumer in debt.

The amount still owned on the trade-in is added to other extras and hidden fees, so that the buyer will never have any equity in the car and may be unable to afford the loan, he said. There are even worst schemes, such as charging for equipment not on the car, lying on the loan application or not being honest about the car's history.

For desperate customers, Stivers said, these practices are "like taking food off the table... You overcharge

a poor person and you are taking away things they really need."

Losing your car can be more devastating than losing your house, contends consumer advocate Rosemary Shahan, who started the non-profit Consumers for Auto Reliability and Safety.

"People do lose jobs because they've lost a car," she said. "Your life just falls apart."

### **Police involved in financing yo-yo**

One controversial but common technique is called the "yo-yo." That's when a buyer drives a car home with a signed contract, but the dealer calls days or weeks later to say that the financing fell through.

Yo-yos give the dealer tremendous leverage to coerce the buyer into paying a higher price or interest rate even after the deal has been inked. Consumer lawyers say yo-yos violate the terms of the sales contract as well as Truth in Lending laws.

But Bob Balderston, owner of Blue Springs Ford near Kansas City, Mo., told the Center that a yo-yo is necessary as a convenience for the customer, so they can close a

deal on a Saturday night when the banks are closed. Yo-yos are good for dealers, too, Balderston said, because it keeps the buyer from shopping around once an offer has been made.

Research by the Center for Responsible Lending shows that one in eight car buyers making less than \$40,000 have experienced a yo-yo deal. For those making less than \$25,000, the incident rate rises to one in four.

Antuane Barnes knows how it feels. Nearly two months after he bought a used Dodge Ram pickup from Norman Chrysler-Jeep in Norman, Okla., Barnes was told the financing had fallen through.

Barnes was willing to return the truck, because he found one just like it for a better price elsewhere. What's more, the other dealer was willing to give him \$2,000 for his trade in. The Chrysler dealer had paid only \$800 for it. Barnes says the finance manager agreed to have the trade-in waiting for him when he got there.

But when Barnes arrived, the finance manager claimed they no longer had his old vehicle — a claim Barnes says doesn't jibe with car title records. All they'd offer him was a \$800 check. Feeling he



David Heath/Center for Public Integrity

**Antuane Barnes of Norman, Okla. says he ended up in handcuffs when he refused to go along with an auto dealer's "yo-yo" sales scheme.**

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was being conned, Barnes says he angrily decided to keep the pickup and stormed out of the dealership.

Days later, Oklahoma City police officers rang Barnes' doorbell.

Soon, they had him in handcuffs and were leading him down the block to their patrol car as neighbors watched. The dealer had reported the truck stolen. Barnes told the officer what had happened, and in the police incident report the officer concludes that

it was probably not a criminal matter. Even so, Barnes says one



of the officers insisted that he allow his home to be searched, or else they would have to take his wife and 2-year-old daughter down to the station with him for questioning.

Barnes relented, and police allowed a repo man to drive the pickup truck out of his garage, back to the dealership.

Norman police Capt. Tom Easley blamed the mistake on a junior officer who didn't ask enough questions. "What is not in that original report is the fact that he had a trade-in that the dealer still had. Once we found that out we said, 'Wait a minute. This is civil.'"

But the initial police report in fact does mention the trade-in. And officers at the scene said in their report that they didn't arrest Barnes because they concluded it might be a civil matter. Easley said stolen vehicle reports from dealers are a common occurrence and raise red flags, so police departments probably should review them carefully.

Brian Pritchard, the general manager who reported the car stolen, declined to respond to Center requests for comment. In court filings, the dealership denies the deal was ever consummated.

Barnes is now suing Pritchard and the dealership for fraud and

says, "I've lost a little bit of faith in people." Similar lawsuits involving police being summoned by dealers in yo-yos have been brought in Michigan and Maryland.

Although Norman police now say the initial report was incomplete, Easley said charges for filing a false report are unlikely, saying, "We reserve those for very special cases, those that are generally a slam dunk."

### **Litigation costly, penalties small**

Consumer activists contend new federal oversight is necessary because state and local authorities rarely take action against car dealers, even when there's substantial evidence of fraud. The lack of prosecutions of auto dealers for fraud has become a lifelong obsession for Bernard Brown, a consumer lawyer in Kansas City.

Now a leading authority on car fraud, Brown says it's easy for dealers to hide bogus charges in the finance papers so that most consumers don't even realize what they've paid. But even when a fraud is discovered, like a rebuilt wreck, dealers rarely get prosecuted. Brown began representing consumers after a National Highway Traffic Safety

Administration investigator told him how prosecutors refused to file charges against a dealer who had sold 75 rebuilt wrecks.

He himself became the victim of an odometer roll-back years ago and having once worked in a prosecutor's office thought he had an easy criminal case against a car dealer. "I had him dead," Brown recalls. "But the local prosecutor would not prosecute the case."

In his research, Brown subpoenaed records on all rebuilt wreck complaints to the Missouri Attorney General from 1990 to 2003. It showed that despite receiving 351 complaints against franchise dealers, the office had only brought two lawsuits. By keeping the wreck secret, dealers are also defrauding the lenders by inflating the value of the car. Similar tricks were played by mortgage companies leading up to the financial crisis.

Michael and Kimberly von David called Brown in 2002, after discovering problems with a Ford Ranger pickup they'd bought from a major dealership, Blue Springs Ford. Von David had popped the hood and



David Heath/Center for Public Integrity

**Michael and Kimberly von David, on the right, won more than \$1.75 million when a Missouri jury decided an auto dealer fraudulently sold the couple a rebuilt wreck. Also pictured is the von Davids' lawyer.**

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found clues that the bolts attached to the frame were all off center. A mechanic friend slid under the truck and instantly reported that the truck had been in a serious accident and wasn't safe to drive.

The von Davids' complaint became the lawyer's fourth case against Blue Springs Ford for selling a rebuilt wreck. When it finally went to trial last year, Brown emphasized during the penalty phase the dealer's long history of selling

rebuilt wrecks and the lack of regulatory and law enforcement against dealers.

The jury came back with one of the largest judgments ever for car fraud, awarding the von Davids \$170,000 and an additional \$1.75 million for punitive damages.

Bob Balderston, owner of Blue Springs Ford, acknowledged selling the pickup without disclosing the damage was a mistake, but he says the salesman just didn't know.

"We thought the jury went way over the top," Balderston said. He is appealing the verdict.

**UPDATE:** *The Federal Trade Commission, which has not filed an enforcement action against an auto dealer for a decade, held a public meeting today [April 11, 2011] in Detroit examining some of the auto financing problems spotlighted by the Center's investigation. The FTC was ambiguous about its plans, saying it would gather information "to assess the propriety of promulgating a rule or conducting other initiatives."*

With little enforcement against auto dealers by state and federal authorities, consumers are left to taking their cases to court. But that's rarely an option either.

Kathi Rawls, the Oklahoma City attorney who handled cases for both Moses and Barnes, says she gets about 15 to 20 calls a week for auto fraud and has to turn most of the potential lawsuits down. "I can't afford to take them," she laments.

Cases can be extraordinarily complex and damages small. Said Jane Santoni, a consumer lawyer from Maryland, "There are really no penalties for these rip-offs. We've tried to strengthen these statutes but the legislature is not listening."

A U.S. Supreme Court decision underscored how paltry the penalties can be when car dealers cheat customers.

Bradley Nigh was told by a dealer in Virginia that the financing on his SUV had fallen through. According to the court decision, the dealer, Koons Buick Pontiac GMC, also "falsely told" Nigh that his trade-in had been sold, which put pressure on him to sign a new contract. When he did, the dealer charged Nigh \$965 for an alarm system that wasn't on the SUV.

Nigh sued and the case went all the way to the Supreme Court in 2004. But in an 8-1 decision, the court ruled on highly technical grounds that the most Congress

allowed for Truth-in-Lending violations in certain consumer credit cases was \$1,000.

### Arbitration another barrier

In recent years, dealers have made it more difficult for consumers to go to court by burying mandatory arbitration clauses in contracts. That means consumer complaints often have to go before a private arbitrator who's not bound by court rules and whose decision cannot be appealed. Ironically, in 2002 auto dealers managed to persuade Congress to enact a law barring auto manufacturers from forcing disputes with dealers into arbitration.

Duane Overholt, a former car salesman who now runs a nonprofit website called StopAutoFraud.com, is swamped with complaints from consumers. But because of arbitration clauses and other drawbacks, he said lawyers turn down 98 percent of his referrals.

Dealers say there are plenty of regulations already to protect consumers. The National Automobile Dealers Association lists six federal laws or regulations that impose rules on auto dealers, from laws against discrimination, unfair and

deceptive practices and withholding the terms of the loan.

But Jack Fitzgerald, the owner of a group of dealerships in the Washington, D.C. area, said new rules would not make a difference because like the existing rules, regulators won't enforce them. "The reason things are so bad now is that regulations are being ignored," Fitzgerald said.

Fitzgerald, who posts factory invoices on his website, advises buyers to educate themselves. Manufacturers pressure dealers to make as many sales as possible and show no concern for assuring repeat business, Fitzgerald said. To avoid getting ripped off, he advises buyers to shop around and get three competing offers before making a purchase.

Good advice. But Tammy Moses's case shows that some scams may be unavoidable.

Her attorney discovered that Automax Hyundai got 51 duplicate certificates of origin in 2007, including 22 for new cars that the dealer had yo-yoed.

"We contacted all 22 of them, and they were all mad," said Rawls. Still, none of them have filed a lawsuit. Said Rawls, there just doesn't seem to be much point. ■

# Disabled homeowner alleges broker, bank sold her mortgage she could not afford

By Ben Hallman

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**M**ARGARET MOSUNIC is 63 and a devout Christian, but if she ever encounters her building contractor again, she has a specific, violent plan of action.

"I want to choke his little Irish neck," she said in a recent interview in her home of more than 40 years in Queens, New York.

As for the mortgage broker who recommended the contractor? "[He is] a devil in the disguise of a man," she said.

On Jan. 9, 2008, Thomas Delaney, a broker at Home Consultants, Inc., drove Mosunic to a law office to close what she thought was a \$40,000 bank loan, according to a lawsuit filed by Mosunic in Queens County court. She planned to use the money to pay back taxes and make repairs to a downstairs rental apartment, she said.

But that wasn't the loan that the broker had asked the lender, Emi-



## BORROWERS NIGHTMARES

grant Mortgage Co. of New York to approve, Mosunic's lawsuit alleges.

An hour later, Mosunic claims, she stood on a street corner with a \$20 bill that Delaney had pressed into her hand for cab fare, confused and upset. She had just signed her name to a \$300,000 mortgage with terms she alleges she couldn't possibly meet.

Mosunic's loan required a monthly payment of \$2,227. At the time, her only income was a \$738 monthly disability check.



Ben Hallman

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**Margaret Mosunic in front of her Queens home.**

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“I was flabbergasted and I was so upset,” Mosunic said when she got her first bill.

The interest rate on the loan was 8.125 percent. But if she missed a single payment by more than 30 days, the rate would jump up to a “default” rate of 18 percent. If that happened, her monthly bill would double, to about \$4,500 a month.

While Mosunic was obligated to make payments on the full loan amount, the bank held back half — \$150,000 — in escrow, with its

release contingent on repairs to a downstairs apartment.

Emigrant Bank, the parent of Emigrant Mortgage, said in written answers to questions from iWatch News that loan documents prove Mosunic knew in advance of the closing the amount of her mortgage loan.

The bank said withholding two times the amount estimated to complete repairs is “usual practice” and that Mosunic could have afforded the payments if the renovation had

been completed. Then Mosunic would have received the rest of her loan and she could have brought in a tenant, the bank said.

But that didn't happen. The contractor she hired, at the broker Delaney's suggestion, took \$70,000 and left the job half-done, she alleges in her lawsuit. She says back taxes and bills ate up most of the rest of the \$150,000.

She made two mortgage payments. The foreclosure notice came in September 2008.

In the run-up to the housing collapse, millions of borrowers with bad credit bought homes that they couldn't afford and have since lost to foreclosure.

Mosunic, who moved to New York City from Croatia when she was a teenager, does not fit the usual profile of those borrowers. She owned her house in the Astoria neighborhood outright. She has lived there since the 1960s.

But a low income and poor credit history made borrowing money difficult. With a huge tax bill, payment due on heating oil, and other debt, she needed money badly.

Enter Emigrant Bank, which offered a program that allowed homeowners to borrow about half of their home's appraised value without

having to provide proof of income. The home was the collateral.

In a court filing contesting the foreclosure, Mosunic claims [5] the lender, broker and contractor took advantage of her disability — she says she is legally blind and reads very slowly — and her limited education.

She alleges she was “fraudulently induced” to take out the loan and that it was “entirely unaffordable by any industry standards, thus putting her at clear and obvious risk of losing her long-time home.”

At least a dozen other homeowners in the New York City area have fought an Emigrant foreclosure on similar grounds.

These homeowners alleged that they were deceived, or that the terms of the loans were excessively unfair, or both. Some, like Mosunic, claim they were lied to by a mortgage broker.

Some of these cases have since resolved, with the homeowners accepting a mortgage modification, according to the bank. The bank denies all allegations of wrongdoing and asserts that in one case the borrower violated the loan agreement and that in most others it offered modifications at 6 percent interest with default interest waived.

The bank said that its “no documentation” lending program provided struggling homeowners a needed financial lifeline and an opportunity to improve their creditworthiness.

“As a general matter, it is absolutely the case that, in addition to a loan commitment letter, each Emigrant borrower was issued all of the documentation required under federal and state lending laws, including a Truth in Lending disclosure statement and a HUD Good Faith Estimate,” the bank said.

Making mortgage documents easier to understand is a top priority of the new Consumer Financial Protection Bureau, which formally launched in July with a broad mandate to make borrowing money fairer. The CFPB will also have regulatory authority over mortgage brokers and it can draft new rules governing loan products for banks like Emigrant that have more than \$10 billion in assets.

The agency declined to comment for this story, and has not yet set forth any detailed new rules governing the home loan industry. As the foreclosure crisis drags along — RealtyTrac estimates 2 million foreclosure notices will be sent in 2011 — additional rules that seek to help keep borrowers out of loans

they can't afford seem likely.

But no regulator can solve Mosunic's dilemma.

She may lose her only possession of value: the two-family brick home on a quiet street that her immigrant parents bought soon after moving to the United States. She has lived in it since she was a teenager.

She owes Emigrant about \$470,000, including penalties and interest. Unable to work since a brutal attack more than 20 years ago, she has little chance of paying that money back. She claims that the contractor's half-finished renovation, which she showed to a reporter, has left her home uninhabitable. She is now staying with a friend.

But a bad experience is not the same as a fraudulent one, and a loan with terms that a borrower cannot repay is not the same as a loan made in bad faith.

Convincing a judge to invalidate a contract based on allegations that it is unfair to one side is difficult, foreclosure lawyers say. And her claim that she didn't know in advance the terms of the loan faces major challenges. Among them: A loan application filed months before the closing that Emigrant says bears her signature, and conflicting information in filings by her own lawyers



about how much she thought she was getting.

### High-stakes borrowing

In several iWatch News interviews, Mosunic said she is still confused about how she fell into so much debt.

But she remembers her broker very well.

Mosunic first met Delaney after he called an elderly friend in the fall of 2007, offering his services as someone who could extract value out of her home. The friend said that she wasn't interested, but that she knew someone who needed money badly.

Mosunic owed more than \$25,000 in back taxes on her home, which sits on an attractive block in the rapidly gentrifying Astoria neighborhood, and thousands of dollars more in other unpaid bills. The state had put a tax lien on her home and she was worried that she might lose it.

Delaney, who could not be found by Mosunic's lawyer or by iWatch News, claimed that he could quickly secure her a \$40,000 loan using her home as collateral, Mosunic alleges in her lawsuit.

She said that she gave him financial information, including records

that showed that her income was less than \$1,000 a month. Mosunic alleges in her lawsuit that it wasn't until the closing, at the office of law firm Mattone, Mattone, Mattone in College Point, Queens that she learned that she was borrowing \$300,000, not \$40,000.

Mosunic said she asked what was going on. Delaney told her not to worry about it, she said.

"He said 'Sign, sign. You can't stop. You have to keep signing,'" Mosunic told iWatch News in an interview elaborating on her allegations in the lawsuit.

She claims the broker told her that the notary public earns \$250 an hour so she had to hurry. She was told that another closing was scheduled very soon, and that she had to hurry, Mosunic said. Everything would be fine, she said the broker told her.

She signed.

Neither the bank's own files, nor Emigrant's attorney's recollection of the closing, support any claim that Mosunic was confused or unaware of any of the key terms of the loan, Emigrant told iWatch News.

Emigrant further said that attorneys who work for the bank are instructed not to close on a loan if they sense confusion on the part of

a borrower, or if they discover that a borrower feels there has been a misrepresentation.

Joseph Mattone Jr., the head of the law firm that represented Emigrant, said when reached by phone by iWatch News that he was not familiar with the case and could not comment. But he said that his lawyers are at closings to look out for the interests of their client — Emigrant Bank — not borrowers, mortgage brokers, or anyone else. He said that his attorneys typically “don’t interact” with prospective purchasers.

“If that woman thought something was going on, my doors are not locked,” he said. “She could have walked out at any time.”

Emigrant said that the government vets brokers through its licensing process and that the bank ensures that those it deals with have those licenses. The bank also said it confirms that brokers are not on a Freddie Mac “exclusionary list.”

“These brokers are not agents of the bank and we cannot be expected to police the activities of the more than 2,000 brokers Emigrant works with,” the bank said.

Delaney, whose brokerage is one of the hundreds that failed after the collapse of the mortgage market,

later made repeated calls to Emigrant asking that the bank release the \$150,000 that it had held back pending completion of the renovation, Emigrant said. “Of course, as it turns out, if we had not held back these funds, the borrower’s contractor might have stolen the entire \$300,000,” Emigrant said.

Whatever Mosunic’s interactions with the broker, her allegations that she didn’t know in advance how much she was borrowing are “absolutely false,” Emigrant said.

In October, months before she closed on her mortgage, Mosunic applied for a \$257,000 loan from Emigrant, according to an application provided by Emigrant to iWatch News. A letter from a lawyer who was representing Mosunic in 2009 says that she required a loan “closer to \$150,000” to pay taxes and complete repairs and asked for a waiver to reflect her “original desire” to close on a \$150,000 loan.

These two documents prove that Mosunic knew what she was getting into in advance, the bank said.

Mosunic’s current lawyer, Elizabeth Lynch at MFY Legal Services, said that Mosunic’s story hasn’t wavered. Mosunic claims she was told by her broker that she was applying for a \$40,000 loan and didn’t realize

she was applying for a \$300,000 loan until the day of the closing.

“Based on the loan application [ iWatch News ] showed me that does not appear to be her signature and that is something we would raise as an issue in court with a handwriting expert,” Lynch said.

And the language in the previous lawyer’s letter is likely an acknowledgment that Mosunic’s debt and the cost of her construction would not have been fully covered by a \$40,000 loan, Lynch said. She said that it was “poorly phrased.”

Mosunic didn’t realize how much she owed in back taxes or how much work she needed to make the apartment habitable, the lawyer said.

On Jan. 28, 2011, Judge Janice Taylor denied Emigrant’s motion to dismiss the case, ruling that all but one of Mosunic’s claims against the bank—a conspiracy claim—could go forward.

## Emigrant held onto loans

For most of its 160-year history, Emigrant, a privately-held regional bank that currently holds about \$11.7 billion in assets, made meat and potato loans to middle class New Yorkers.

By the early 2000s, Emigrant had

moved into the business of lending to people with bad credit in a big way, according to allegations in a discrimination lawsuit filed in federal district court by a mortgage borrower in Brooklyn.

By 2004, more than half of all Emigrant mortgage loans were “no income” loans according to the discrimination lawsuit.

Emigrant said this statistic is “wildly inaccurate” but did not provide a different figure.

The bank said its mortgage branch has made about 9,000 no income loans since 2006, and it that as of June 30, it was servicing about 14,000 loans in total.

The expansion of Emigrant’s no income loan program came while Howard Milstein, a real estate tycoon, was chief executive officer. Milstein, a big donor to the campaign of New York Gov. Andrew Cuomo, was recently confirmed as chairman of the New York State Thruway Authority.

Milstein did not respond to an iWatch News request for comment.

Emigrant, which still owes the \$267 million it borrowed from taxpayers under the Troubled Asset Relief Program, wasn’t alone in making loans to people with bad credit, nor was it the only bank to

offer no income loans. But its business strategy diverged from most other banks when it came to servicing the loans.

Instead of selling the debt up the food chain, where loans were pooled, sliced, diced and eventually sold to investors as mortgage-backed securities — leading to the collapse of the subprime lending market and very nearly the American economy — Emigrant held on to its higher-risk loans.

This is a point of pride for the bank.

“We never created products to feed the Wall Street securitization machine. To this day, Emigrant’s loans remain in our portfolio. And we service all of our loans in-house, so performance of these loans is of the highest importance,” the bank said.

How, then, to make this lending strategy pay?

The bank was willing to make loans to people with bad credit, so long as the borrower already owned a home for collateral.

The bank said that 85 percent of the 9,000 no income loans it has made since 2006 are still performing.

“For the vast majority of borrowers, these products work, provid-

ing a bridge back into the banking system for borrowers who otherwise would have lost their homes or been forced to go to hard money lenders,” the bank said.

Under the Community Reinvestment Act, banks are required to make loans in their entire geographic area, including low and moderate income borrowers. In 2006, the Federal Deposit Insurance Corp., said that the bank “makes extensive use of innovative and flexible lending products and practices” for poor borrowers and specifically cited the no income loans that the bank had made in the evaluation period.

Four years later, in 2010, the FDIC again said that the bank was innovative and flexible, but did not mention no income loans in the report.

Like most of its peers, the bank does a “satisfactory” job of meeting its Community Reinvestment Act obligations, according to the FDIC.

Mosunic claims in her lawsuit that her experience was anything but satisfactory. She said the loan she got was “unconscionable” — essentially, so unfair to her as to make it invalid.

Her foreclosure challenge alleges that the bank “knew or should

have known” that she couldn’t afford the loan payments. Since the likelihood of default was quite high, the bank should have included the 18 percent rate when calculating the “true” cost of the loan, the suit alleges.

### Default rate controversial

The 18 percent default rate included in some loan contracts prior to 2009 is perhaps the most controversial aspect of the bank’s lending program.

Emigrant said that in the past a default rate was included in certain loan programs “to offset costs for that portion of its portfolio that was delinquent, and also as an appropriate incentive to ensure the borrower would make payment.”

“Since Emigrant does not sell its loans, performance is paramount, and the default rate encouraged borrowers to make their mortgage payments first. A good mortgage payment history is often the first step on the path to restoring credit,” the bank said in a statement to iWatch News.

Others see it differently.

Nina Simon, the director of litigation at the Center for Responsible Lending, said that making loans

to people with bad credit without checking their income, and then including a trigger that could more than double the interest rate if they miss a payment, was a recipe for disaster.

“Who comes up with this stuff?” she asked. “It’s outrageous.”

Eric Feinberg is a lawyer in Rockland County, N.Y. who is representing an Emigrant borrower in another case. “If things go bust, then the bank takes the house,” he said. “It is a win-win for them completely.”

Even in a bad economy, a home in a gentrifying New York City neighborhood can be worth quite a lot. Mosunic’s home was appraised in 2007 by the city for \$729,000. It is now worth \$685,000, according to a recent New York City appraisal.

Emigrant said that it is “indisputable” that no income loans are of higher risk than traditional loans. But failure is costly, not just for the homeowner, the bank said. Nearly every foreclosure of a mortgage of less than half a million dollars is a money-loser for the bank, it said.

As of Jan. 1, 2008, about two out of three loans made by Emigrant did not include a default rider in the contract, the bank said.

But of those loans that have failed, many included the default

rate, according to an iWatch News analysis of mortgage documents for borrowers in foreclosure.

In New York, foreclosures must go through state courts. iWatch News randomly selected 54 Emigrant residential foreclosures to examine out of 401 currently categorized as “active” by the courts. Of those failed home loans, 44, or 81 percent, included a default interest rate of 18 percent.

Emigrant said default rate riders were included in certain loan programs offered by Emigrant because they were deemed to be of higher risk.

“So it is quite natural that a greater portion of loans in foreclosure would include that rider,” the bank said.

The bank also said that no Emigrant loan ever went in to default because of an 18 percent interest rate and that default interest is always waived as part of Emigrant’s loan modification process.

Lynn Armentrout, who heads a nonprofit project that helps people facing foreclosure co-sponsored by New York’s City Bar Justice Center and the Federal Reserve Bank of New York, said she has reviewed hundreds of mortgages from every major lender in the New York

area. Emigrant is the only lender she knows of in New York City that made loans with an default interest rate as high as 18 percent, she said.

“Although we can only speak specifically for Emigrant, we are aware that other banks that have included a default rate in their loan documents,” the bank said. “In addition, we know that the U.S. government, [New York state] government, credit cards and others, charged — and still charge — a default rate of 18 percent or more.” Last year, in an opinion issued in another Emigrant foreclosure case in Suffolk County, N.Y., state court judge Jeffrey Spinner wrote that the mortgage agreement was “starkly revealing and greatly disturbing.” That loan was made with an initial adjustable interest rate of 11.65 percent, and it included the 18 percent default rate.

“It is a virtual certainty that [the borrowers] were not afforded the opportunity to freely bargain and negotiate in reaching the operative terms that are now subject to this Court’s scrutiny,” Judge Spinner said.

The lawsuit later was settled for undisclosed terms, and the opinion was rescinded, after what Judge Spinner described as “continuing

good faith negotiations” by both Emigrant and the homeowner.

### **New rules may have helped borrowers**

Regulators and lawmakers have already taken steps to address the type of unfair default interest rate allegations made by Emigrant borrowers in their court challenges.

The New York State Banking Department said it cannot discuss lending practices at specific banks. But in 2007, the agency warned state banks against making nontraditional or subprime loans that include the possibility of “significant payment shock” for a borrower such as a sudden increase in the interest rate.

Rholda Ricketts, Deputy Superintendent of Banks for Mortgage Banking, told iWatch News that the regulator strongly supported a 2008 law that made it illegal for New York banks to include triggers in loan documents that significantly boost interest rates on subprime loans after default. That law went into effect Sept. 1, 2008. Emigrant said that loans made with the 18 percent default rate were not subprime loans as defined under New York law, and that it didn’t stop making loans with

that rate in response to the new law. Emigrant’s default interest rates in New York were reduced to 16 percent on February 1, 2009, and to 3 percent above the contract rate on Oct. 1, 2010.

These reductions applied to loans existing in the portfolio that were originated prior to these dates, as well as to new loans, Emigrant said.

Moreover, the bank said it also now waives all default interest if a loan is reinstated within five months of the first default.

Regulators have also moved to make illegal a bonus system that many have said encouraged mortgage brokers to convince borrowers with the worst possible credit to apply for loans.

In some instances, Emigrant, like many other banks, paid brokers a “yield spread premium” bonus to brokers for bringing in higher interest rate loans.

For example, a broker who helped Gail Greene borrow nearly \$500,000 to refinance her home near LaGuardia Airport in Queens got a “yield spread premium” of \$2,460 bonus for selling a loan with an interest rate of nearly 12 percent.

Emigrant says that it was not unusual for banks to pay yield spread premiums, and that it complies with

all regulations for mortgage broker compensation.

The Federal Reserve recently outlawed these types of bonuses, which the regulator said give brokers incentive to steer borrowers to more expensive products.

Consumer advocates applaud such moves, but say that the CFPB should move to set clear and tough rules governing mortgage brokers and mortgage loans that would apply to the entire country.

Future borrowers may benefit from new rules that the CFPB is considering that would simplify mortgage disclosure forms. The agency is requesting feedback from consumers on draft versions of short, concise forms as part of the agency's "know before you owe" initiative.

### **An uphill fight**

Lawyers who have handled similar cases say Mosunic faces an uphill fight against Emigrant.

But "winning" for most homeowners facing foreclosure is not a court decision ruling against a bank. What they really want is a mortgage modification on favorable terms that lets them keep their home.

Emigrant said it offers "the best modification program of any major

bank, with better results than the federal [Home Affordable Modification Program]."

Not surprisingly, Mosunic's lawyer and the bank dispute whether a fair offer was ever made.

In early 2009, the bank offered to release the \$150,000 it is holding in escrow, but Mosunic's lawyer — at the time, an attorney working pro bono for the New York City Bar Association — advised she reject the offer because it also called for her to waive most of her legal rights to fight foreclosure.

In September of that year, the bank said it presented Mosunic's attorney with an Emigrant loan modification package. A few weeks later, the bank said, the "loan modification offer was turned down by the borrower."

Lawyers for both sides met before a court-appointed referee in November of 2009. In a filing, that referee noted that Mosunic had not appeared in person nor had submitted financial information needed to evaluate her case. With no deal on the table, the referee ordered the foreclosure case to proceed.

But Lynch said no modification "offer" was ever made and that Mosunic did not qualify under the bank's own rules. The modification



application made clear near the top that Mosunic did not qualify for a modification because she had received more than 10 percent of the loan value in cash, Lynch said.

A year later, Emigrant filed a motion stating that the “loan was not eligible for a modification under the Emigrant guidelines as the Defendant received over \$90,000 cash at closing and did not submit any paperwork to establish a hardship.”

In mid-August, after a 19-month draught, the two sides began talking again.

The bank offered to send one of its engineers, free of charge, to inspect the house to see what repairs would be needed to make the first floor apartment livable, Lynch said. From there, Emigrant would allow Ms. Mosunic to use her \$150,000 escrow to pay for the repairs. Whatever money was left over would be applied to the principal.

Emigrant said in an email to iWatch News that once the repairs are complete, the loan would then be modified at 6 percent, with all default interest waived. “This is essentially what we were prepared to do more than two years ago,” the bank said.

But Lynch said the bank declined to discuss with her specific terms

of a modification beyond the repair work. The first she heard of a 6 percent offer was from iWatch News, she said.

Lynch also said that waiving of delinquent interest is not the same as waiving all interest charged and that many details—such as whether the bank would charge interest on the entire \$300,000 loan, or on just the \$150,000 that it had paid out—would need to be hammered out.

In addition, she said, the maximum interest rate under a HAMP modification is currently about 4.5 percent—a better deal than what Emigrant said it is willing to make Mosunic.

For now, Mosunic remains in limbo.

She borrowed money from friends to continue repairs on the downstairs rental apartment, but there is still work to be done. She can’t rent it out until the foreclosure is resolved.

“My mother and father worked too hard to buy a house when they came here,” she said of her decision to continue to fight the foreclosure.

“What’s peculiar is just the word ‘Emigrant’ and me being in an immigrant, which is derived from the same word,” she said. “I just want to keep my home.” ■

# Soldiers battle car dealers over inflated prices, loan terms

Lawsuits accuse some dealers near U.S. bases of aggressive tactics that drain young recruits' bank accounts and affect mission readiness

By Michael Hudson

Published Online | July 25, 2011

**L**ORI MENDOZA saw an advertisement last year from South Colorado Springs Nissan, a dealership that promotes itself as “Proudly Serving our Military” and promises bargains for men and women in uniform.

That sounded good to Mendoza, an active-duty soldier stationed at nearby Fort Carson (Colo.) Army Base. With help from her mother, who co-signed on the deal, she traded in an older BMW and drove away with a 2010 Nissan Rogue.

Then things took a wrong turn, according to a lawsuit Mendoza filed in federal court in Colorado.

The dealership, she claimed, boosted the cost of the transaction from the agreed-upon \$27,000 to \$35,000, admitting it had made a “mistake” only after she caught the



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discrepancy. Then, the suit said, it gave her a runaround about nailing down the financing she said it had guaranteed on the deal.

When Mendoza came back to the dealership to return the Rogue and cancel the transaction, another snafu emerged: The dealership claimed, the suit said, that it had already auctioned away the BMW trade-in. Later, when she demanded



Eugene Hoshiko/The Associated Press

**Marines at Camp Lejeune, N.C. have been allegedly victimized by aggressive car salesmen who offered free weekend trips to the beach but refused to bring service members back unless they bought a car; promised a free airline ticket but added the cost into financing for a new vehicle; refused to return down payments; and held trade-in vehicles hostage until a new car was purchased, according to a retired Marine lawyer.**

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copies of her sales contract and the federal “truth-in-lending” disclosures, the suit alleged, a dealership staffer refused, saying he didn’t want Mendoza using the documents as “ammo” against the dealership.

Wyn Taylor, an attorney for South Colorado Springs Nissan,

said the BMW was eventually returned to Mendoza and her mother. Steve Kern, the dealership’s general manager since February, told iWatch News that “we work very hard to help our men and women in the military.”

In a written statement about the

case, Taylor asserts the dealership acted properly, and that documents signed by Mendoza showed the total cost of the deal was always in the \$35,000 range. The statement also says the financing was never guaranteed and Mendoza knew, even though she was allowed to start driving Rogue, that the deal couldn't be consummated until the loan was approved.

For Mendoza, the issue is now settled — she and dealership resolved the lawsuit on undisclosed terms. Many other men and women in uniform, though, are still vexed by car financing deals gone bad.

Consumer advocates and military officials claim that some car dealers target soldiers, sailors, Marines and other service members for predatory financing and other tricks that drain their bank accounts and, in some instances, interfere with their ability to do their duties.

"I think it happens every day of a week," said Michael Archer, a retired Marine officer who serves as director of legal assistance for Marine bases in the Carolinas and Georgia. "I think it's at least as likely as not that when a troop buys a car, he's overpaying either on the price of the car or the price of the loan."

When it comes to dealers that fly American flags and post signs that say "Welcome Military," consumer advocates often joke that "the bigger the flag, the worse their practices are," said Rosemary Shahan, president of Consumers for Auto Reliability and Safety, a California-based advocacy group.

The practices at some dealers are enough of a concern that the Federal Trade Commission has invited Archer, Shahan and other experts to speak at a public hearing Aug. 2 in San Antonio to focus on the problems servicemen and women face when they try to buy cars on credit. Industry officials deny that car dealers routinely take advantage of members of the armed forces.

"I don't see military being targeted. I don't see that," said Larry Laskowski, executive director of the Independent Automobile Dealers Association of California, which represents some 450 used-car dealers in a state that is home to more than two dozen military bases.

In instances where there are bad apples that "don't adhere to a code of ethics," Laskowski said, there are laws on the books that are designed to protect service members and other consumers.

The National Automobile Dealers Association didn't address questions from iWatch News about military members who purchase cars on credit, but it told the FTC "any abuses which may have occurred" in auto financing "are isolated and most assuredly are not prevalent."

### Easy targets

Next month's FTC hearing is another sign of the increasing attention on consumer problems faced by members of the U.S. military.

In recent months, three of the nation's largest financial institutions — Bank of America Corp., Morgan Stanley and JPMorgan Chase & Co. — committed nearly \$80 million among them to settle claims they improperly foreclosed on military personnel or overcharged them on their mortgages.

The new federal Consumer Financial Protection Bureau (CFPB), which officially kicked off operations on Thursday, has signaled it will make protecting military consumers a priority.

On July 6, the CFPB and the military's top uniformed lawyers released a "joint statement of principles" aimed at providing better protections for service members when

they borrow money or buy things on credit. Officials said they've set up procedures to work together on addressing consumer complaints and improving financial literacy for servicemen and women.

"Service members and their families sacrifice a great deal for our country and they deserve advocates who will use every available resource to protect them from financial threats," said Holly Petraeus, the consumer bureau's assistant director for the Office of Servicemember Affairs and the wife of Army general and newly confirmed Central Intelligence Agency chief David Petraeus.

"Through this partnership and our other efforts," she said, "we will work to make sure that the days of military families being easy targets for predatory practices and unscrupulous lenders are a thing of the past."

When it comes to policing auto loans, the CFPB is handicapped because of a loophole written into last year's Dodd-Frank financial reform law after intense lobbying by car dealers: The bureau has authority over auto lenders, but it generally won't have authority over car dealers, which play a crucial role in the auto financing process. Dealers of-

ten prepare loan applications and work hand-in-hand with lenders in hammering out loan terms.

As part of a legislative compromise, the law increased

the FTC's rulemaking authority over car dealers. An FTC spokesman told iWatch News that the agency has "has done extensive military outreach to provide service members with consumer education about finances and avoiding fraud." The FTC is also working to coordinate its efforts with the CFPB, including talks about how about sharing access to complaints, the spokesman said.

### **Battlefield promotion**

For their part, military brass have spent much time in recent years documenting the problems caused by lenders and car dealers that cater to men and women in uniform. When soldiers get ensnared in bad deals, military officials say, the fallout can affect their "mission readiness" and, if their credit is ruined, put their security clearances at risk.

"It absolutely affects their ability to perform their mission," Archer, the Marine regional legal director, said. "When you have a lance corporal who literally has his finger on

the trigger, he needs to be focused entirely on the front post site and where he's shooting, rather on extraneous personal concerns about whether somebody is going to take away his car or his house."

Some car dealers like to locate near military bases because many of the troops stationed there "are of an age when they're probably going to get their first car, and they're all concentrated in one place," Archer said.

A November 2009 memorandum by Archer sketched out several examples of the sales tactics and credit practices that car dealers used to fleece young Marines stationed at Camp Lejeune in North Carolina and at other installations in the Southeast.

One bold car salesman trespassed onto Camp Lejeune, "conducting an impromptu class to our most junior Marines on how car dealers will rip them off. Yet the salesman describes how he can 'hook them up' with a reputable dealer to avoid scams." At least one "class," Archer wrote, "is held when the salesman sneaks into the auditorium during a break between legitimate orientation classes."

In another instance, the memo said, a dealership tricked a Ma-

rine lance corporal into buying an overpriced car by promising him free round-trip airfare to visit his parents in a distant time zone for Thanksgiving. It turned out the airfare wasn't free — it had been financed into the loan contract at 13 percent interest.

Across the country in Southern California, three Marines stationed at Camp Pendleton are pressing lawsuits claiming that a nearby car dealer, Certified Auto Sales, falsified information on their credit applications.

In one of the three lawsuits in San Diego County Circuit Court, Areon Simon claims the dealership gave him an imaginary promotion on his credit application — listing him as a corporal when he was in fact a private.

Another Marine, Logan Turk, claims Certified Auto Sales reported on the credit application that he was buying a 2006 Mitsubishi even though he was really buying a 1997 Camaro.

A third Marine, Mark Splawn II, alleges that the dealer socked him with what amounted to a hidden finance charge, increasing the price of his 2006 Mazda because he had a poor credit history. It also promised him that the Mazda was

in good condition, his suit says, but he soon discovered the vehicle had serious defects, including a leaking battery and “worn and unsafe” tires and front brakes.

Christopher Ramey, an attorney for Certified Auto, denied that the dealership engaged in fraud or did anything improper.

In Simon's case, for example, Ramey said the dealership didn't submit any information about Simon's rank or employment to the lender — that was Simon's responsibility, the lawyer said. “Mr. Simon signed and delivered the application to the lender,” Ramey told iWatch News.

He added that the dealership made it clear to Splawn, Turk and Simon that the vehicles were being sold “as is,” and that they were welcome to take them elsewhere if they wanted to have an independent mechanic check them out. He said a judge ruled in the dealership's favor in November in a similar case of another Marine who claimed that he'd been sold a defective vehicle, finding that the “as is” label meant just that — “as is.”

Certified Auto's owner, Joseph Romero, “is a small-town dealer,” Ramey said. “He's probably one of the nicest guys I've ever met. It's unfortunate that Mr. Romero has

been victimized” by consumer attorneys seeking to generate fees for themselves.

The three Marines’ lawyer, Halen Rosner, says his clients’ stories are examples of how poorly service members often fare when they buy cars on credit.

Rosner, who frequently represents service members in credit disputes, says many are young and aren’t “future-oriented” — which is understandable, he said, since they’re often waiting to be transferred to overseas war zones. Car dealers like them as customers, he

said, because they’re “bankable” — they have steady incomes and ready access to loans from military credit unions.

“They’re a vulnerable group, like any other group that gets exploited,” Rosner said. The Navy and Marine Corps maintain lists of off-limits car dealerships that sailors and Marines aren’t supposed to set foot on, he said, but “it takes an awful lot to be put on that banned list.” ■

*iWatch News intern reporter Shirley Gao contributed reporting to this story.*

# DEBT DECEPTION

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# Small town teacher seeks help for big debt, ends up in bankruptcy

Illinois, W.Virginia accuse some debt settlement companies of using legal loophole to charge high up-front fee

By Shirley Gao

Published Online | July 20, 2011

**F**TIRED schoolteacher Mary Linville looked around the dinner table and smiled. It was an evening late in November 2008, and she was surrounded by friends who had come to unwind after the hectic Thanksgiving holiday. To her left sat her husband, and to her right were friends from church with whom she often went horseback riding. Her son Jamie, a county sheriff's deputy, sat across from her.

The dinner at Linville's middle-class home in the rural West Virginia town of Alkol was interrupted by a knock on the door. One of her son's co-workers, armed and wearing his badge, stood awkwardly at the door and served Linville with a lawsuit filed by Discover for failing to pay off her credit card.



## BORROWERS NIGHTMARES

The court summons alarmed Linville, who seven months earlier had hired what she calls a “debt settlement firm” that promised to cut her \$72,000 debt in half by negotiating repayments to creditors. Instead, Linville became one of many Americans who have found themselves even deeper in debt after seeking help through debt settlement ser-



Linville family photo

**Mary Linville, center, with her son, Jamie, and daughter, Ronna. The West Virginia attorney general sued Morgan Drexen, Inc. on behalf of the retired schoolteacher and 400 other consumers who paid up-front fees for debt relief and say they did not receive the promised services.**

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vices, an industry the new Consumer Financial Protection Bureau aims to regulate.

More than 500,000 Americans with about \$15 billion of debt are currently enrolled in debt settlement programs, said Andrew Housser, executive board member of the American Fair Credit Council

[3]. The industry group represents about 45 debt settlement companies which together handle about \$2 billion in consumer debt.

“People in debt have several options,” Housser said. “They can file bankruptcy, seek debt settlement, or do nothing. Debt settlement is appropriate for those people who

have the desire to do something about their debt, who have the ability and willingness to slowly pay it off.”

Seven months before that memorable November dinner, Linville had hired California-based Morgan Drexen, Inc. when a telemarketer called to advertise the firm’s services.

Linville said the company told her it would charge her monthly installments of \$771.25, and the initial payments would be applied toward Morgan Drexen’s engagement fee of \$4,101.53, and fees for maintaining Linville’s checking account. In return, Morgan Drexen promised to deal with her creditors directly and settle her debt for less than half of the original amount, she said.

“I was so surprised, I had no idea I was in trouble,” said Linville, 63, recalling the court summons that turned her financial world upside down. “I thought they were doing what they promised to be doing for me.”

But Morgan Drexen did not deliver the promised services, Linville claims. Instead, the firm took — and kept — about \$7,000 from her checking account but never paid a cent to Discover, Bank of America, Lowes and most other creditors,

she said. Shortly before the Christmas holiday in 2008, she filed for personal bankruptcy.

### ‘Head over heels’ in debt

“By the time I realized what was going on, I was head over heels, way over my head in debt,” Linville said. “I was falling behind in payments, and interest kept collecting. There was no way I could get caught up.”

Linville, who taught elementary school for 36 years until she retired, complained to the West Virginia state attorney general, which filed a lawsuit against Morgan Drexen two months ago on behalf of her and other consumers.

The company describes itself on its website as a software and support service provider to 35 U.S. law firms. Morgan Drexen is “NOT a debt settlement company,” wrote Raychel Harvey-Jones, vice president of media relations, in an email to iWatch News. “Morgan Drexen provides a platform where attorneys, clients and businesses can reach amicable solutions together. Clients and their attorneys use this platform in a variety of situations including bankruptcy, personal injury and resolution of claims by creditors.”

While the company may not call

itself a debt settlement company, the West Virginia attorney general and Linville allege that for all intents and purposes, it is. Defining exactly what constitutes a debt settlement company is one of the early challenges for the federal Consumer Financial Protection Bureau to tackle in regulating the industry.

Just last month, the bureau announced debt relief services were among a half-dozen high-priority areas it was targeting with its new powers under the Dodd-Frank financial reform law. As a first step, the Consumer Financial Protection Bureau said it must clarify which debt settlement companies are “a larger participant” in the industry.

“Statistics on the size of [the debt counseling and debt settlement] industries, as well as the size of other debt relief services, are not readily available. The CFPB will need to consider carefully how to define any debt relief provider market or markets included in an initial rule,” the agency said in its announcement.

Linville is not alone in claiming that Morgan Drexen’s work failed to bring results.

The Better Business Bureau, which said it has received some 217 customer complaints in the past

three years about Morgan Drexen, gives the company an ‘F’ rating. Customers complained that as Morgan Drexen automatically deducted monthly fees from their bank accounts, the company failed to disclose where the funds were being held and debts remained unsettled, according to the BBB.

### Loophole for lawyers

The debt settlement industry is a complicated one to regulate because it involves so many parties — the creditor, the debt settlement provider, a consumer, and, in Morgan Drexen’s case, lawyers who negotiate the debt.

According to Harvey-Jones’ email, “1,000’s of consumers have used MD [Morgan Drexen] supported attorneys to assist them with resolving their disputes with their creditors. MD has processed \$266M of debt for just over \$100M [in] over 72,000 settlements.”

“The figures above speak for themselves. The attorney-based debt resolution program is successful,” Harvey-Jones said.

The involvement of a lawyer in debt settlements is an important advantage for companies that promise to settle their clients’ debts.

Just last fall, the U.S. Federal Trade Commission amended its telemarketing regulations to prohibit companies that sell debt settlement services over the telephone from collecting fees until a client's debt is settled. However, the rules allow

lawyers who perform debt settlement services to collect legal fees up front from consumers.

Morgan Drexen has also taken note of the FTC's new rule. "Although it is unclear at this time whether or not the FTC has the authority to govern the practice of law, it is the intention of the law firms as well as Morgan Drexen, to make certain that all services and support operations comply fully with the new rule or are exempt from its application," the company says on its website.

Consumer advocates say debt settlement companies are using the law firm exemption as a loophole to get around regulations.

For example, debt settlement companies using this model may advertise that lawyers will serve as an active negotiator between a debtor and creditor, critics said. Recent lawsuits against these companies, however, allege that the lawyers do little and are involved only so that

a debt settlement company can collect advance fees.

"It's like a cat and mouse game," Stuart Sloan, a consumer lawyer based in North Carolina, said. "Of course there are regulations, but we see these debt settlement outfits morph. They make a new name and a new strategy to get around these rules."

### Lawsuits in 10 states

In the past year, consumers or state officials have filed suit against Morgan Drexen and similar businesses in at least 10 states, including Colorado, Virginia, Washington, New Jersey, Kansas, Ohio, Michigan, New Hampshire, Illinois and West Virginia. The lawsuits accuse the named companies of charging illegal up-front fees, giving clients little or no contact with an attorney, and failing to settle clients' debts.

In May, West Virginia Attorney General Darrell McGraw accused Morgan Drexen of failing to deliver its advertised services, failing to disclose adverse consequences of debt settlement programs, and collecting fees that exceeded legal limits for debt pooling, among other allegations.

"Morgan Drexen purports to

merely provide paralegal services to lawyers engaged in debt settlement activities on behalf of clients,” the West Virginia complaint states. “In reality, Morgan Drexen provides all of the meaningful debt settlement services while lawyers it recruits merely ‘rent’ their bar licenses and company ‘letterhead’ to Morgan Drexen.”

In return for partnering with Morgan Drexen, the lawyers are paid a monthly fee based on the number of clients they supervise, the lawsuit alleged. A contract one West Virginia lawyer supplied to the attorney general’s office showed she was paid a minimum of \$500.00 each month for the first 300 clients she oversaw, plus \$2.00 for each additional client.

“The appearance of licensed lawyers providing debt settlement services enables Morgan Drexen to evade state regulation of its activities,” the West Virginia attorney general’s lawsuit said. Lawyers have no active role in negotiating debt with creditors, communicating with creditors or consumers, or billing consumers, it said. “All of these activities are performed by Morgan Drexen,” it said.

Morgan Drexen’s Harvey-Jones said that the company is “vigorously”

defending itself. “[The] AG’s allegations relate to clients of the law firm that were engaged pre-TSR [Telemarketing Sales Rule] amendment. To the extent that the [West Virginia Attorney General] alleges that MD collected fees, that allegation has been denied,” Harvey-Jones said.

Another company, Legal Helpers Debt Resolution which calls

**“In reality, Morgan Drexen provides all of the meaningful debt settlement services while lawyers it recruits merely ‘rent’ their bar licenses and company ‘letterhead’ to Morgan Drexen.”**

itself one of the largest in the industry, faces a similar lawsuit filed in March by Illinois Attorney General Lisa Madigan.

That lawsuit accused Legal Helpers of collecting excessive fees from more than 1,000 Illinois clients, which include a \$500 retainer, a \$49 monthly

charge, and 15 percent of the total debts. While Legal Helpers states or implies that “consumers will be represented by a law firm ... in fact all debt negotiation and related services are provided by non-law firm third parties and LHDR is merely a

referral source for these same third parties,” the Illinois attorney general’s complaint said.

The allegations are “totally incorrect,” Jason Searns, general counsel for Legal Helpers, told iWatch News. “The client’s cases are reviewed by our attorneys, and if they are sued, we represent them. They remain our clients the entire time.”

“We are not referring any services to non attorney third parties. We work with a support group who is under contract with us, and we constantly supervise their work,” Searns said.

Sloan, the consumer rights lawyer, is also suing Legal Helpers on behalf of clients who claim the company didn’t deliver what it promised.

“With debt, you get really desperate and can get suckered into working with these companies,” Sloan said. “But here’s the dirty little secret: you don’t need them. Credit card companies will negotiate directly with the debtor — you don’t need the middle man.”

## Robo-calls

For some consumers who have racked up thousands of dollars in debt, though, there are few things

scarier than speaking with creditors. That fear makes them easy targets for debt settlement companies.

Linville began receiving unsolicited phone calls in early 2008 from companies offering debt settlement services that claimed she could be debt-free in less than a year.

“They told me that if I paid the minimal amount of my credit card, it would take me 40 years. They said they could get me debt free in one year,” said Linville, who lives in a one-story home built in the late 1970s in the scenic West Virginia mountains.

At first, she hung up on the robo-calls, but by April 2008, Linville figured she had nothing to lose. A salesman on behalf of Morgan Drexen assured her that it would settle her debt for a lower amount than she could find anywhere else. Her monthly payments would be \$771.25 — “something I could live with,” Linville said.

The package from Morgan Drexen even provided Linville with a script so that she knew what to say if any of her creditors phoned to ask why she had stopped making payments.

Morgan Drexen continued taking payments from her on the 15th of every month, Linville said, which

she believed went into a special account that would be used to pay off creditors. Linville said she had no sense that anything was wrong until November when her dinner with friends was interrupted by the sheriff's deputy serving her with a lawsuit.

**Once a consumer stops paying the creditor, he or she may be charged interest and late fees, as well as charges for exceeding a credit limit — all of which can eventually double or triple the consumer's original debt amount.**

Like many consumers, Linville was unaware that there is no guarantee that creditors will accept a partial payment of a debt. In fact, once a consumer stops paying the creditor, he or she may be charged interest and late fees, as well as charges for exceeding a credit limit — all of which can eventually double or triple the consumer's original

debt amount.

"These companies might get you a settlement of 65 percent, but you do the math and add in the upfront fees. The client might be paying

over 85 percent of the debt's principal balance, and that's not great at all," Sloan said. "And that's even before you add in the extra fees the creditor is charging you."

While creditors have no obligation to negotiate consumer debt, they are legally required to accurately report a consumer's failure to make monthly payments to credit reporting agencies. In some cases, creditors may sue a consumer to recover money owed.

Harvey-Jones acknowledged that not every consumer who engages in debt settlement sees results. "There are many factors that decide the success of a client," her email said. "The attorneys representing the consumer cannot, nor do they guarantee a result. The prospective clients are advised of this in no less than three locations."

The morning after she received her court summons to appear in court in mid-December 2008, Linville said she called Morgan Drexen and asked for a lawyer to represent her in court. The firm referred her to Lawrence W. Williamson, Jr., an attorney in Wichita, Kan.

"He would talk over the phone and tell me what I should say in court, but he refused to show up there with me," Linville said.



The West Virginia attorney general identifies Williamson as a lawyer that Morgan Drexen assigns to most of its clients in the state, though he is not licensed to practice there. The state's lawsuit alleges that Williamson, Jr. is practicing law in West Virginia or "is knowingly misleading consumers and creditors into believing he is."

Williamson told iWatch News that the state accusations were unfounded.

"I have not provided any acts that constitute the practice of law in West Virginia," he said, adding that his law firm works with local counsel to advise West Virginia consumers, a practice allowed by the West Virginia bar rules.

"Instead of taking a toothpick and removing all the bad cells, the attorney general is taking a huge paper towel to wipe everything off the table," Williamson said. "They are judging us for the things other people are doing. It's an unfair picture."

Williamson also said that Linville's claims were false. "We never refuse to represent someone in court," he said. "They might not be able to afford a full-fledged representation lawyer, but we can help provide help in the courtroom."

But unable to come up with the \$7,000 demanded by Discover in its lawsuit, Linville said she had no option but to file for personal bankruptcy in early December 2008, days before a scheduled court appearance. "I was so scared, I didn't

know what to do," she said.

**"This was the most embarrassing part," Linville said. "We just weren't raised that way. I live in rural West Virginia. We give our word, and that's all you need."**

"This was the most embarrassing part," Linville said. "We just weren't raised that way. I live in rural West Virginia. We give our word, and that's all you need."

While Linville and her husband, Ronnie, managed to hang on to their home and vehicles, they lost the good credit rating they had built up over several decades, which meant that they could no longer finance any purchase through borrowing. Ronnie Linville, who is also retired, receives a small payment for preaching at a local Church of Christ but says he donates most of that to the church.

Equally as painful was the damage to her family's reputation in the

small West Virginia town of 1,300 residents.

“People just sit on their porches and gossip about you,” said Linville’s son, Jamie, who lives just 200 yards down the road from his parents’ home.

“Nobody has to say anything to your face, but you know when you see them that they know what’s up,” Jamie Linville said. “For months after the bankruptcy, my parents were so ashamed to be seen out in public that they drove 40 miles away to Charleston to buy groceries. The only time they would leave the house would be to go to church.”

The shame and embarrassment only got worse when news of the bankruptcy made the pages of The Lincoln County Journal, which has a circulation of 15,000. That is when Mary Linville’s elderly mother first learned of it.

“My grandma yelled at her for 20 minutes straight,” said Jamie, 37. “And mom just cried and cried. It was a tough pill for her to swallow.”

### What will CFPB do?

The Linvilles say they hope that the new Consumer Financial Protection Bureau, which officially opens

its doors for business on July 21, will help families get the debt settlement help they pay for.

The bureau has promised, along with the Federal Trade Commission, to regulate debt settlement companies. The two agencies will share enforcement and coordinate on rule making, but only the CFPB will have supervision and examination authority over debt settlement companies, said Betsy Lordan, an FTC spokeswoman.

**“For months after the bankruptcy, my parents were so ashamed to be seen out in public that they drove 40 miles away to Charleston to buy groceries. The only time they would leave the house would be to go to church.”**

“The CFPB and the FTC are negotiating a memorandum of understanding to coordinate their rulemaking, law enforcement, consumer education, and other activities so that the agencies operate as efficiently as possible, apply consistent standards to regulated entities, and provide consumers with useful and consistent information to make well-informed decisions,” Lordan

told iWatch News in an email.

State attorneys general will be involved in enforcing any regulation of debt settlement companies, along with the CFPB and the FTC. “Debt settlement was identified as a priority area by the states, but there has not been anything more specific on

this issue,” said Noelle Talley, a spokeswoman for North Carolina’s Justice Department, which has been working with the CFPB as it develops its regulatory agenda.

How aggressively the CFPB will move to regulate debt settlement companies remains unclear, especially because the agency cannot propose new regulations until it has a full-time director confirmed by the U.S. Senate. Senate Republicans have threatened to reject any presidential nominee for the top job until the new agency is restructured to weaken its power.

A CFPB spokeswoman declined to comment on the bureau’s plans for debt settlement companies.

Meanwhile, Linville is closely watching the West Virginia lawsuit against Morgan Drexen.

“You know, one thing stands out in my mind about this whole ordeal,” Linville said, recalling how she was always put on hold when

phoning Morgan Drexen. “While I was on hold, there would be a recording of people telling me stories of how Morgan Drexen saved their lives, improved their credit, et cetera. ‘Without them, I wouldn’t know what to do,’ ‘They were a life-saver’ — things like that.”

She paused.

“They said they would do the same for me, and minutes later, I was brainwashed. I really fell for that.” ■

**AUGUST 1, 2011 UPDATE:** *After this story was published, Morgan Drexen said the number of law firms it supports had increased to 42, up from 35 firms cited in two recent corporate blog entries on [www.MorganDrexenToday.com](http://www.MorganDrexenToday.com). A company spokeswoman also said that Mary Linville did not return her power-of-attorney documents until July 2008, and that resulted in an “unrealistic timeframe” to settle Linville’s entire \$72,000 debt. However, the attorney representing Linville did reduce one of her debts by 50 percent despite her relatively short time in the program, the spokeswoman said.*

# \$700 dormitory fee costs family its car

Auto-title loans are the credit of last resort, but are terms fair to borrowers?

By Amy Biegelsen

Published Online | July 15, 2011

**W**HEN MILDRED Morris's son won a coveted spot at the New York drama and performing arts college that trained singer-songwriter Jason Mraz and TV actor Jessie Tyler Ferguson of "Modern Family," she was overjoyed. The drama, however, extended beyond school.

Morris started the process of securing a college loan to pay tuition for her son, Jonathan, to attend the American Musical and Dramatic Academy, but she was caught off guard by an unexpected and sudden \$700 fee to hold a dormitory room for him.

A single mother of two in the town of Martinsburg, W.Va., 90 minutes northwest of Washington, D.C., Morris works in the technical support branch for the Coast Guard office that issues merchant seamen



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the equivalent of a driver's license. Although she had a steady federal job, Morris didn't have any savings or credit cards, and with the tough economy couldn't scrape together the \$700 fee from friends.

She did, however, own a sporty, green 2002 Pontiac Sunfire free and clear.

A friend told her about a place that gave quick cash if borrowers put up their cars as collateral. Obtaining the



Amy Biegelsen/Center for Public Integrity

**Mildred Morris, a single mother in West Virginia, lost her car after using it to secure a \$700 title-loan to pay her son's freshman college dorm fee.**

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loan took just 30 minutes, she said, mostly to check her references. Morris signed a contract with Fast Auto Loans, took her check for \$700 and gave the company the title to her car, which Fast Auto Loans could repossess if she fell behind in repayments.

It wasn't until later that she realized how high the interest rate on her loan was — 300 percent annually.

"I should have taken time to go

over it," she acknowledged. "When I saw how large it was, and I was like, wow," she said. At first she tried to pay more than the monthly minimum, but with the cost of getting Jonathan moved and settled in New York, she started to fall behind in payments to Fast Auto Loans. Some months she could only pay \$210 and \$175 of that went to interest, barely lowering the loan principal.

Many months and over \$1,000 later, Morris called it quits, according to a complaint she filed with the West Virginia attorney general. The office is now investigating Fast Auto on behalf of Morris and other consumers.

When Morris fell behind on her payments, Fast Auto Loans employees began calling the references she had listed on the loan paperwork. "On the day the payment was due they would start calling people. It was ridiculous," she said. Her sister, her adult daughter, her friends — even her supervisor at work — got repeated calls from Fast Auto Loans.

Frustrated, Morris finally gave up and told the company it could take the car, according to a statement she filed with the West Virginia attorney general. One night, two men from Fast Auto Loans drove up to her townhouse on the edge of town. One hopped out and drove the car away. "I felt sick," Morris said. Kelley Blue Book estimates a car of the same make and model from that year would be worth at least \$2,000.

"I ended up losing my car over \$700," she said. "I didn't want to let my car go, but I didn't have a choice."

Consumer protection advocates have long raised concerns about this kind of credit.

Car-title loans, which are now reg-

ulated differently in each U.S. state, are on the list of priorities of the new Consumer Financial Protection Bureau (CFPB), which officially opens for business on July 21. Policing non-bank financial services "will be a crucial piece" of the bureau's business, Elizabeth Warren, who has been in charge of setting up the agency so far, told reporters at a June briefing.

However, the bureau is expressly prohibited from setting limits on interest rates. And the still-leaderless CFPB cannot propose any new regulations until the U.S. Senate confirms a presidential nominee as director. Senate Republicans have threatened to block any nominee until the CFPB is restructured to weaken its power.

An important first step, said Ira Rheingold of the National Association of Consumer Advocates, is for the CFPB to use its research capacity to gather facts and data about car-title lending. "After they determine whether or not there's a social utility to this, or whether this is simply a predatory product, they then can craft rules and rulemaking based on that," he said.

Morris is all for it.

"I know there's a lot of single moms out there and how hard the economy is," Morris said, "but those

people are not there for you; they're there to rip you off."

Fast Auto Loans' parent company, Atlanta-based Community Loans of America, Inc. declined to comment, saying it has a policy of not issuing speaking to the press. An attorney representing Fast Auto Loans in West Virginia did not respond to requests for comment.

Defenders of car-title loans say they help people who have no other options. Title lenders advertise themselves as providers of fast, easy cash even for consumers with bad credit. "The whole process from application to receiving the funds will take about 15 minutes," according to the website for Cashpoint, a large title lender in Virginia, whose number is 1-888-EZ-BUCKS.

The American Association of Responsible Auto Lenders, an industry group, says most car-title loans are paid back in six months or less. Member companies "keep consumers' payments low enough so they are able to successfully pay off the loan and get their title back," the group says on its website.

A key feature of the title-loan business is that it does not require borrowers to have bank accounts. That distinguishes the industry from payday lenders, another short-term,

high-interest credit option that either requires the borrower to write a post-dated check or to provide electronic access to a bank account for automatic repayments.

Title loans typically are made for one month at a 300 percent annual rate. That means a borrower who needs \$500 must pay \$625 by the end of the month. If the borrower can only afford to cover the interest — \$125 — the loan is rolled over for another month and the borrower will owe another \$625.

### **A glimpse inside title industry**

It is difficult to get a clear picture of the title-loan industry and how big it is. Only 20 states allow auto-title lending, and regulation is scattered throughout different parts of each state's government.

The American Association of Responsible Auto Lenders, which did not respond to iWatch News requests for comment, does not publish industry statistics on its website. It describes the average borrower as 44 years old with a household income over \$50,000 and an "overwhelming majority have jobs."

However, a few state regulatory reports give a glimpse inside the industry

In Illinois in 2010, the average auto-title borrower earned about \$24,000 a year, according to data through November from that state's Department of Financial and Professional Regulation. The average title loan was for \$797 and took consumers over 300 days to repay plus an average additional \$1,542 in fees and interest.

Tennessee found similar results. At the end of 2006, nearly 90 percent of outstanding auto-title loans in the state had been renewed beyond the first month, according to a report from the Tennessee Department of Financial Institutions. And 14 percent of the borrowers had renewed their loans 10 times or more. Car-title lenders who used the state's maximum allowable annual rate of 264 percent made a 20 percent average profit margin, but would have needed to charge 211 percent to break even, the report said.

In Virginia, title companies repossessed 22,394 vehicles from 2004 to 2009, according to data that emerged during a state legislature debate on car-title lending. In 2008 and 2009, title loan repossessions accounted for more than 90 percent of all car repossessions in the state.

As costly to consumers as the lenders' practices may be, "the lack

of financial literacy among some citizens is a serious concern," the Tennessee report concluded, "and we believe it is often a root problem for some of the ills we see in the financial services sector."

Dana Wiggins operates the consumer help hotline for the Virginia Poverty Law Center and hears firsthand about the problems of some title-loan borrowers. "When they lost their car, they lost their job," she said. "That's their lifeline to get health care, to get their kids to school. It was really painful to hear that that's the only remedy for the loan."

Auto-title industry defenders say a tough choice is better than no choice.

Todd Zywicki, a law professor at George Mason University, has researched the business and says the loans play an important role. Since many title-loan borrowers have no bank account, their range of options is dramatically narrowed.

"Maybe taking people with limited choices and taking away some of those choices make them better off," he said, "but I find that hard to believe." Zywicki acknowledges that people can get in over their heads with title loans, but argues "people can borrow too much on a 30-year fixed-rate mortgage."

Uriah King, vice president of state



policy at the Center for Responsible Lending, sees car-title loans as no choice at all. “The entire business model is loans that are made without the ability to pay,” he said.

A borrower can easily get trapped in a cycle of debt if he or she falls behind in repayments, loses the car, and can no longer get to work, King said. A 2007 study by his organization of title-loan borrowers in Chicago found one-fifth of the loans were used to repay a previous loan with the same lender, he said.

The U.S. Congress has also been wary of the high-interest loans, and in 2006, passed a law that capped the interest rate at 30 percent for title loans to active-duty members of the armed services.

The car-title industry has stepped up its federal lobbying in recent years. According to disclosures filed with the U.S. Senate, the American Association of Responsible Auto Lenders has spent more than \$1 million to hire the powerful lobby shop Patton Boggs since 2008 to lobby on consumer credit issues and the powers of the CFPB.

## Interstate loans

Because title-loans are regulated at the state level, the tangle of com-

peting state rules is something advocates hope the new federal Consumer Financial Protection Bureau (CFPB) can tame.

When Morris wanted to obtain one on her Pontiac Sunfire to pay for her son’s dorm reservation, she had to drive 40 minutes east over the state line to Winchester, Va. Auto-title loans are prohibited in West Virginia, but along Valley Drive in Winchester three different title lenders dot the mix of fast food joints and strip malls. Fast Auto Loans’ sign features a cartoon rocket ship logo, blasting off for fast cash.

West Virginia’s usury laws ban similar loans with interest rates higher than 18 percent. While the state cannot block citizens from getting the loans in neighboring states, the state can regulate the debt collection process. West Virginia’s attorney general is investigating Fast Auto Loans on behalf of Morris and others.

West Virginia argues that Fast Auto’s repossession of Morris’ car shows that the company was doing business inside the state, and that its persistent debt collection calls violate the West Virginia Consumer Credit and Protection Act.

Fast Auto Loans, meanwhile,

has flatly denied that it does business in West Virginia.

The company's attorney, David Barnette, did not respond to iWatch News requests for comment, but in a court filing, he asserted that "Fast Auto is not registered to transact business in West Virginia and does not transact business in West Virginia."

The state attorney general's office is trying to persuade a West Virginia judge to enforce a subpoena to obtain company documents even though the business is in another state, a move Fast Auto's lawyer calls a "severe and unjustified intrusion of [his clients'] rights."

National standards and regulation of the auto-title industry are long overdue to save states the time and money needed to fight the same issues over and over, according to consumer advocates.

Wisconsin's attorney general, for example, recently joined a 10-year-old lawsuit filed by the Legal Aid Society of Milwaukee against Fast Auto Loans' parent company over a hidden-fees issue that the parent company had previously settled with Florida.

As with many other non-bank lending operations, before the Wall Street reform law created the Con-

sumer Financial Protection Bureau, there was no central regulator for title lending.

The practice itself is a by-product of a 1978 U.S. Supreme Court decision, says King. Before then, most states imposed "usury caps" on how much interest a lender could charge. But the high court ruled that a bank in one state making a loan to a borrower in another state could offer whatever interest rate was allowed in the lender's home state. Many states then lifted their usury caps to attract credit card companies, and title lending bloomed as an unintended consequence.

Jean Ann Fox, director of financial services for the Consumer Federation of America, says that other factors contributed to the growth of the industry, including effective lobbying from the industry to remain exempt from regulations that might squash it.

Fox says car-title loans are particularly problematic because a borrower is deemed fit for a loan based on the value of their car, not their ability to repay the loan.

"That's a recipe for getting caught in a debt trap and not getting out," she said.

She'd like to see the new consumer bureau require title lenders to take into account a borrower's abili-

ty to repay and outline a responsible small-dollar loan framework, similar to the one the Federal Deposit Insurance Corp. has put forward in a pilot program. The FDIC program recommends bankers adopt a 90-day loan limit and cap small loans at 36 percent annual interest.

The Center for Responsible Lending's King hopes to see the CFPB set limits on how often car-title loans can be renewed. They're meant to be short-term loans, but customers often end up rolling them over for months, paying the interest and fees and barely making a dent in the principal.

Although Wisconsin recently reopened the door for the industry, King says there's "not a lot of appetite" in states that currently prohibit the practice to let title loans grow.

"They're trying to find ways to export," their business to neighboring states that don't allow title lending, he says.

Although West Virginia, Washington D.C., Maryland and North Carolina don't allow title lending, Virginia enacted a law effective July 1 that specifically allows title-lenders there to offer loans on cars registered in other states.

"A family may be driving from Maine to Florida to go to Disney-

land and if they break down in Richmond, they may not [have been] able to get a loan," said Scott Daniel, who lobbied for Fast Auto Loans' parent company, Community Loans of America, to help extend the reach of Virginia's title lenders. Now, "they'll be able to get a loan."

Growing the business in Virginia has meant growing business for lobbyists, too. According to the Virginia Public Access Project, a nonprofit that collects Virginia's campaign finance and lobbying records, three major title lenders spent more than \$270,000 from 2008 to 2010 on lobbying around title loan issues.

Back in West Virginia, Jonathan is at home with his mom for the summer.

Losing the Sunfire was a blow, but Morris also had a truck — a red 2005 Ford pickup — that she used to get to work during the year. Without a second vehicle, though, it's been tough for Jonathan to find work this summer to help his mom defray the costs of performing arts college in New York. It's also been a challenge for him to get to dance classes so he can stay in shape for school in the fall. He's still looking for work.

"Losing the car really hurt us, but we have the truck so we'll get by," Morris said. "Not everyone will." ■

# Navy pension signed over as collateral for costly quick cash

By Jason McLure

Published Online | August 19, 2011

**I**T WAS A RUN of bad luck that put Dr. Louis Kroot and his wife, Kathie, in debt in late 2005.

A daughter with mental illness cost them thousands in medical and related bills for treatment in hospitals from London to San Antonio. An unexpected tax bill triggered by taking money out of a retirement plan led to more than \$100,000 in debts to the state of Kentucky and the Internal Revenue Service. A broken water pump caused \$12,000 in damage to their home.

"We were trying to figure out, how are you going to pay these bills?" says Louis. "And we were just scratching our heads."

But one of the Lexington, Ky., couple's most expensive moves was answering an ad in a military magazine from a company called Retired Military Financial Services that offered quick cash backed by Louis' pension from 23 years as a Navy doctor. Louis signed a contract with the company that gave



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him \$91,566.37 in a "lump-sum payment" in return for eight years of pension payments.

Including fees and other charges, the deal was equivalent to a loan at an annual percentage rate of over 30.7 percent — a rate that would be illegal under usury laws in many states. That's made the company the subject of two class-action lawsuits over the past decade, and a frequent plaintiff and defendant in bankruptcy courts around the country.

"We needed the cash flow to pay for what we needed paid for at that



Lee P. Thomas for iWatch News

**Dr. Louis Kroot and his wife, Kathie, of Lexington, Kentucky signed over his U.S. Navy pension to Structured Investments for eight years in exchange for nearly \$92,000 to pay urgent bills.**

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point in time,” says Kathie, 59. “To us, they were a godsend. We didn’t even know that people were filing lawsuits against them.”

Retired Military Financial Services, also known as Structured Investments, says its payments are “not a loan” and therefore not subject to usury laws. The company also says it provides an important

service to military retirees who could not otherwise monetize their pension payments.

Steven P. Covey, an Army veteran who is one of the founders, defends his company and says its business practices are legal.

“The position is: We’re purchasing at a discounted lump-sum, future cash flow,” he said in an inter-

view with iWatch News . “We’re not lenders. When you’re not lenders, you’re not dealing in potential usury areas.”

The Kroots are not the only military family to run into problems with what consumer advocates call predatory lenders. More than one in five active-duty military households have taken out auto title loans, tax refund “advances,” or other types of non-bank loans in the past five years, according to an online 2010 survey by the FINRA Investor Foundation.

Huntington Beach, Calif.-based Structured Investments Co., which does business as Retired Military Financial Services and U.S. Pension Funding., said it has given pension “buy-outs” to nearly 500 retired and disabled service members since the mid-1990s.

Structured Investments’ focus on lending to veterans could draw the attention of the newly launched Consumer Financial Protection Bureau, created by the Wall Street reform law signed last year. The CFPB has an office devoted to helping military service members, headed by Holly Petraeus, the wife of the former top U.S. commander in Afghanistan, Gen. David Petraeus.

She told Congress her office

would set and enforce rules to help military families clearly understand the costs and features of financial products. “One way to help is to enforce the laws that are already on the books to protect them,” Holly Petraeus said. “Another is to write new rules when needed.”

Heightened government oversight may have come too late for the Kroots. As required by Structured Investments, the Kroots used their lump sum to help pay off nearly \$60,000 in credit card debt, retire \$23,000 in tax debts and repay another nearly \$13,000 in loans from the Navy Federal Credit Union.

To do this they signed over 95 monthly pension payments — a total of \$2,457.37 per month after taxes — to an account controlled by Structured Investments. They also agreed to pay \$131.04 per month over six years for a \$180,000 life insurance policy that lists Structured Investments as a beneficiary — an assurance the company would be repaid if Louis dies and his pension payments end.

### **‘Taken to the cleaners’**

The contract with Structured Investments granted the company’s co-founders power of attorney over

the Kroots with authority “to take any and all necessary and lawful actions” to ensure the couple made their monthly payments. Structured Investments also prepared and provided Louis with waivers saying he had been advised to seek counsel from legal and financial advisors and declined to do so.

The 25-page contract with Structured Investments made no mention that the nearly \$92,000 lump sum payment carried the equivalent of an annual percentage interest rate of 30.7 percent. While loans must include interest rate information under the federal Truth in Lending Act, Structured Investments emphasized the transaction was “not a loan.” One letter told the Kroots their debt load would be “decreased if you exchange the lump sum for pay-off of current credit card or other debts.” It even suggested they could make tens of thousands of dollars over the next decade by taking the lump-sum payout and investing it. Their contract with the company termed the transaction an “Annuity Utilization Agreement,” and acknowledged it presented “novel and complex legal issues.”

The deal has proved a costly one for the Kroots.



Kroot family photo via Lee P. Thomas

**Dr. Lewis Kroot during his U.S. Navy career.**

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Including insurance premiums, the couple has paid \$178,600.29 through August of 2011, according to data provided by the Kroots and compiled by iWatch News. They are due to pay an additional \$64,153.70 through October of 2013. That means the Kroots will wind up paying \$242,753.99 over 95 months for the initial \$91,566.37 in cash.

The total due can rise, however, if a single monthly transfer is disrupted by the couple’s “failure to take reasonable steps” to ensure the continued payment of Dr. Kroot’s pension to Structured Investments. Should that occur, Structured Investments will penalize the couple with an additional two years of

pension and insurance payments, or \$62,121.84 payable through 2015.

"We're being taken to the cleaners," says Kathie. "I didn't think about how much more we were paying in interest."

Indeed, the Kroots used the lump-sum from Structured Investments to pay off creditors charging much lower effective interest rates. Their credit union charged 9.5 percent to 12.5 percent for personal loans, the state of Kentucky charges annual interest rates between 5 percent and 10 percent on tax debts. Even their highest interest credit card charged only 22.9 percent.

Had the couple instead consolidated their debts in late 2005 into a single loan with an interest rate of 18 percent — slightly higher than their average credit card rate — they could have made the same monthly payments and finished repaying the loan last year.

The Kroots aren't strangers to adversity. The couple has moved a half dozen times to accommodate Louis' career at U.S. military hospitals in Germany, Virginia, California and Maryland.

One of their sons, Joseph, died of a brain aneurysm at 13. His death spurred Kathie to become an advocate for organ donation and led the

couple to adopt two special-needs girls from the Kentucky foster-care system in 1997.

Other military retirees have taken lump-sum payments from Structured Investments that make credit card interest rates look good.

Kirkland Brogdon Sr., a former Marine from Janesville, Calif., took a payout of \$24,542 in 2003 in return for eight years of payments from his pension and the purchase of a \$60,000 life insurance policy assigned to Structured Investments. Including insurance premiums, his effective annual percentage rate topped 39 percent under the contract, according to documents in a class-action lawsuit against the company in California that was tentatively settled in 2007.

Daryl Henry, a disabled Navy veteran from Laurel, Md., took a \$42,131 payment from Structured Investments backed by his pension in 2003. Including life insurance premiums, his contract's effective annual interest rate was 28 percent, according to data in his class-action court filings.

"I went in eyes wide open. I knew they were screwing me," says Gary Infinger, 48, a former Army sergeant with multiple sclerosis. Infinger told iWatch News he took a



lump-sum payment from Structured Investments a decade ago backed by his veterans disability payments.

### **Lucrative company, legal woes**

Contracts such as those with the Kroots apparently have been lucrative for Structured Investments. By 2009, the company was no longer a start-up and had added two-full-time and two-part-time employees to help track its finances and its agreements with veterans.

Although Structured Investments collects returns on its pension buy-outs that banks could only dream of, it has a history of legal woes. Founded in southern California in 1996, two years after Covey, one of its co-founders, was convicted of felony bank fraud, Structured Investments began by selling membership interests to investors in companies whose purpose was to buy pensions from military veterans and retirees.

"We had a pensioner come to us who wanted to know if we could provide some lump sum amount of cash for him for a military pension he had," Covey told iWatch News. "We looked into it and essentially started purchasing these."

Investors in the company were promised an 8 percent return on

investments over \$50,000 for eight years, and were told it was an "opportunity to own a cash stream of payments generated from U.S. military service persons' government pensions," according to the California Department of Corporations.

Among those later hired to raise capital for the company was Andre Fite, a southern California man whose work with a collapsed Los Angeles-based investment pool led a federal court in 1997 to issue a permanent injunction barring him from "cheating and defrauding" people in the sale of commodities. Fite did not respond to numerous calls for response.

Though the company had marketed investments as having zero risk, Structured Investments halted payments to its investors in 2009, according to the California Department of Corporations. Earlier this year, the state agency barred Structured from using false statements to sell any additional securities after accusing it of failing to tell investors about a class action lawsuit it was facing and for failing to disclose Covey and Fite's prior legal issues.

### **Cash flow purchase**

Covey, who earned a law degree from the University of Southern

California, defends his company and says its business practices are legal.

The company may legally have control of bank accounts that Kroot and other veterans direct their pensions to, but Covey said, "It's quite clear that the pensioners have ultimate and unilateral control over where the government sends those funds," he says.

Structured Investments' lump-sum payments can be a better deal than credit cards for some pensioners, he says. "The interest rates credit cards charge their customers vary significantly," he says. "If you don't pay the principal, even leaving aside fees, you're talking about months and months of increases in the principal amount."

Structured Investments no longer buys veterans disability payments, Covey said. He also denied the company requires pensioners to pay off certain debts. When pensioners face debts, "We coordinate with them as to which accounts they would be best served paying off or down," he said.

Covey said he plans to contest the California ban on the sale of securities by him and his company, adding that he can't comment on the company's decision to stop pay-

ing its investors because the matter is subject to litigation

Covey doesn't dispute that the clause in company contracts penalizing pensioners who miss a single monthly payment with an additional two years of payments may be viewed by critics as onerous. "That's something that was put in there by the attorneys who drafted the documents for us in 1996," he said.

In 2005, the company was hit with a pair of class action lawsuits by retired servicemen who alleged that Structured Investments violated a California usury law capping loan rates and violated a federal law barring military retirees from "assigning" their pension benefits to someone else.

Structured Investments' lawyers argued in court in 2009 that veterans "all across the country" are unable to access credit from conventional lenders. "By purchasing portions of government-issued payment streams from retirees (including veterans), Structured provides a valuable service," wrote Justine Casey, a lawyer for the firm.

**UPDATE:** (*California class action lawsuit settled*) In late August, a state court in California found the contracts to be an ille-

*gal assignment of a military pension and awarded a group of former service members \$2.9 million plus attorneys' fees.*

An earlier class action suit reached a tentative settlement in 2007, with pensioners agreeing to receive between \$1,000 and \$1,200 from Structured Investments. The company also agreed to drop some fees and penalties from the pensioners' contracts.

Both the CFPB and the Defense Department declined to comment to iWatch News about Structured Investments' products.

Stuart Rossman, a lawyer with the National Consumer Law Center, which helped file the most recent class action suit against the company, scoffs at the company's assertion that its products are not loans. "If it walks like a duck and talks like a duck, it's a duck," he says.

### Stable and abusive

The company's website touts Structured Investments as the "go-to source for pension buyouts — sometimes referred to as pension loans" and informs potential customers that "banks don't recognize pensions as collateral."

And though dozens of companies advertise on the Internet to purchase income streams from lotteries, court settlements, and salaries, Structured Investments is likely to face continued scrutiny for its focus on veterans and other military retirees, says Christopher Peterson, a law professor at the University of Utah, who has researched alleged predatory lending to soldiers and other service members.

"There are few things more certain in our society than that our government will pay veterans their pension," he says. "To see a pension loan...being made at 30 percent, especially to a veteran, that's pretty abusive."

The Kroots, who did not join either of the class-action lawsuits, continue to send Louis' monthly Navy pension payments to Structured Investments. The disappearance of Louis's military pension has helped stall their retirement plans and Louis, 62, continues to work as an emergency room physician at a Veterans Administration hospital.

"We can't retire now," says Kathie. "We've got at least another 10 to 15 years." ■

*Reporter Shirley Gao contributed to this report*

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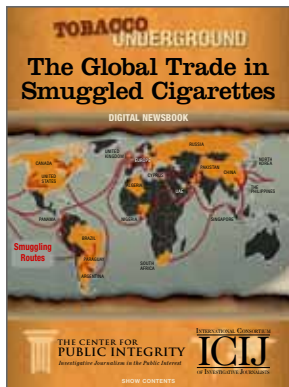


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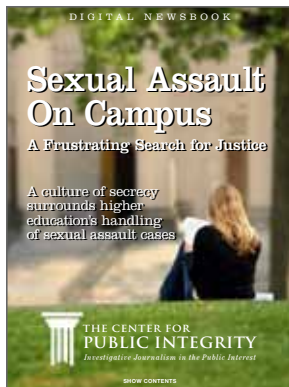
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