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Executives with criminal records slip through FHA crackdown, documents show

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A crackdown on reckless mortgage lenders by the Federal Housing Administration has failed to root out several executives with criminal records whose firms continue to do business with the agency in violation of federal law, according to government documents, court records and interviews.

The get-tough campaign has also been hamstrung because, even when the FHA can ban mortgage companies for wrongdoing or an excessive default rate, the agency does not have the legal power to stop their executives from landing jobs at other lenders, or open new firms.

After the collapse of the home loan market, the FHA launched an effort aimed at reducing losses on mortgages it insures by weeding reckless lenders out of the program.

But documents and interviews reveal that more than 34,000 home loans have been issued over the past two years by a dozen FHA-approved lenders that have employed people who were convicted of felonies, banned from the securities industry or previously worked for firms barred by the agency.

More than 3,000 of those loans, about 9 percent, were seriously delinquent or already a claim on the FHA insurance fund as of June 30. That's nearly triple the rate for all loans made by FHA lenders over the past two years, about 3.4 million.

Compared with other regulators, critics of the FHA say it rarely cracks down on company executives. "In the securities industry, you bar people for life. You don't see that a lot with the FHA," says Mark Calabria, director for financial regulation studies at the Cato Institute.

Policing the cubicles and corner suites of FHA lenders is crucial because the agency, which encourages home ownership by insuring mortgages made by qualified lenders, has become a cornerstone of the U.S. housing market. Its portfolio of guaranteed loans has grown to $800 billion in March from $466 billion in fiscal 2008. The agency's insurance program is financed by premiums paid by FHA borrowers, but taxpayers would be on the line if those funds are depleted.

The agency has long struggled to stop companies from slipping risky loans under its protective umbrella. It has done this in part by barring lenders if too many of their borrowers default.

FHA Commissioner David H. Stevens has vigorously defended the agency's bid to drop lenders with higher than average default rates or evidence of fraudulent loans. "No one can feign that we're not all over fraud now, in this administration," Stevens says. Since January, the agency has fined or withdrawn the approval of more than 1,100 lenders to issue federally insured mortgages, according to records provided by the FHA.

But he added, "By no means do I think are we are out of the woods, yet. . . . There are going to be some of these guys who slip through."

The internal watchdog at the Department of Housing and Urban Development, which oversees the FHA, says the agency has failed to systematically monitor the people making home loans. In recent congressional testimony, he called for "a new mind-set at the FHA to know your participants and not just the entity."

Legislation passed by Congress last year bars any individual from working for an FHA lender in a range of positions if convicted of a felony that "involved an act of fraud, dishonesty, or a breach of trust, or money laundering." The law, which broadly addressed foreclosure prevention efforts and housing policies, also rendered an FHA lender ineligible if it employs a person convicted of an offense "that reflects adversely" upon the company.

According to HUD and FHA documents, court records and interviews, at least five convicted felons are now working for FHA lenders or worked for them in recent years.

Gregg S. Marcus, for example, was co-owner of a mortgage company called Gettysburg Funding Corp. when he pled guilty in 1998 to federal tax evasion in New York following an investigation of false loan applications at that company, according to court records. Marcus was sentenced to five years probation and fined $50,000. His business partner at Gettysburg Funding pled guilty to bank fraud.

Marcus went on to become executive director at another mortgage lender, Somerset Investors Corp. A HUD database shows Somerset remains an FHA-approved lender. The company's status as an FHA lender did not change after a March 2010 audit by HUD's inspector general recommended Somerset return $2.8 million in insurance payments to the agency because of "significant underwriting deficiencies" in the firm's loans. The government auditors, who had not set out to examine individual executives, didn't identify Marcus as a convicted felon.

HUD officials declined to comment on Marcus and his criminal conviction. In a statement, HUD said that the president of Somerset recently certified that none of company's employees "were currently in, or had been involved in, an investigation that could result or has resulted in a criminal conviction. If the information was false, the certification would be inaccurate and may warrant administrative action by HUD."

Marcus and his wife, Randi, who is the president of Somerset, did not respond to certified letters requesting comment for this article. Phone calls and e-mails sent to Somerset were not returned.

While HUD says it tries to keep felons out of the FHA program, housing officials say they cannot bar other individuals just because they had previously worked for a banned lender.

"Termination of a lender does not specifically prohibit its principals and senior executives from seeking employment with approved lenders or forming a new company that may seek approval," HUD said in a statement.

HUD's own inspector general, Kenneth Donohue, warned at a Senate subcommittee hearing in May that FHA suffers from a "systemic weakness" by allowing these individuals to continue doing business with the agency.

"Without specific citations against individuals (FHA) could not link principals of a defunct company to those same individuals who would go on to form new entities," Donohue said. "We see this type of maneuver too often and it makes the FHA program too easy a target for those intent on abusing the program."

At least four FHA lenders employ executives who previously worked at companies banned from doing business with the agency, according to documents and interviews.

Lend America was banned by HUD last December after the Justice Department accused the company of originating fraudulent loans insured by the FHA. Lend America's chief business strategist, Michael Ashley, was barred from the FHA for life in March. But at least one of the firm's other senior executives now works as a sales manager at a company currently approved to make FHA loans.

In another instance, a former senior executive with BSM Financial, an FHA lender based in Allen, Tex., has worked for two other FHA lenders since that company was barred from the program in 2009. The executive is currently a top official at another FHA lender in Texas, according to documents and interviews.

BSM had run into trouble in 2006 with auditors from HUD's Office of Inspector General, who reported that "the lender approved mortgages on overvalued properties for borrowers that were less than creditworthy." The auditors recommended BSM reimburse $2 million in losses on foreclosed homes, along with other penalties. In April 2009, BSM was banned from the FHA program because the firm never made the first payment required by a settlement agreement following the audit.

In a statement responding to questions about why the executives have been able to move between various FHA lenders, HUD says, "misconduct or poor performance by a company does not necessarily extend to its officers or employees absent evidence that the officers or employees participated in, directed, knew about or had reason to know about specific violations or misconduct."

Stevens, the FHA commissioner, said his agency follows the principle of due process when deciding which individuals to bar.

"You can't just throw someone out because you don't like them," he said. "They have to violate a law; they have to commit a crime."

HUD officials acknowledge that most background checks on lender employees are generally limited to "principals" -- individuals identified by FHA firms as senior executives or owners of the company.

Because HUD allows lenders to identify their own principals, firms sometimes do not disclose the senior role played by convicted felons.

According to the Justice Department lawsuit filed against Lend America, for example, its chief business strategist, Michael Ashley, had a 10-year history of state sanctions and a federal conviction related to a mortgage fraud scheme. The Justice Department alleged that he directly controlled sales at the firm. Yet Lend America never identified Ashley as one of its principals.

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