

# The Federal Government's Search for Mortgage Industry Whistleblowers



By **Brian M. Feldman Esq.**

On Aug. 5, 2011, six months before she received her \$31 million reward, Sherry Hunt quietly filed a whistleblower action against her employer, CitiMortgage. Hunt had been a quality control (QC) manager at CitiMortgage since 2008, covering Federal Housing Administration (FHA)-insured mortgages. She had been in the mortgage industry for nearly her entire career, spanning over three decades. In her complaint, Hunt described mortgages that CitiMortgage's Direct Endorsement underwriters should not have certified as eligible for FHA mortgage insurance, but which the underwriters certified anyhow. She also described problems within her QC department, including CitiMortgage's failure to review early payment defaults. Her action was immediately sealed by the Court, and remained secret until Feb. 15, 2012.

According to a Reuters story, Hunt never intended to become a whistleblower, but she grew frustrated with CitiMortgage's response to her complaints, which she made internally. Hunt said that she reported all of these problems up the chain, through human resources and ethics, and that nothing more than a cursory investigation took place. No one told her she had her facts wrong. Yet, no one told her she was right, and that things were going to change. Instead, she felt that CitiMortgage was pressuring her and her QC staff to overlook defects. She spoke with an attorney, and together, they put her story into a complaint, and brought it to the attention of the U.S. Department of Justice.

In the six months

between August 2011-February 2012, the Justice Department looked into Hunt's sealed complaint and negotiated its resolution with CitiMortgage. As a result, Hunt was completely vindicated. On Feb. 15, 2012, the Justice Department announced that CitiMortgage had admitted responsibility for improperly endorsing loans for FHA mortgage insurance and for failing to review all early payment defaults, just as Hunt had alleged. Moreover, CitiMortgage paid a very large sum of money to the Government to settle these claims. Hunt, for her part, walked away with a reward of more than \$31 million in cash. Over the course of just six months, Hunt's frustrations about her employer ignoring her concerns had transformed Hunt—a Missouri suburbanite, living just outside St. Louis—into a millionaire, 30 times over.

Hunt's story has lessons for the mortgage industry and for mortgage

professionals. For the industry, the lessons include that there is enormous exposure for errors in the mortgage underwriting process, and that it is perilous to ignore employee concerns. For mortgage professionals, the lesson is that, even if your employer is not interested in listening to your concerns, the federal government may be. And the rewards may be tremendous.

## Who can be a whistleblower

It is important for companies and employees to understand that nearly anyone with inside information about a company's practices could potentially be a whistleblower. There are various federal laws and programs in place to encourage individuals (or entities) to step forward and report problems to the federal government. By far, the most significant has been a federal law dating back to the Civil War era, called the False Claims Act.

Under the

False Claims Act, persons or entities may be whistleblowers if they are the first to step forward and report misconduct (that is, before the government or media discover the issues), or, even if they are not the first, if they have additional information that could help the Government make a case. These rules mean that company insiders, at almost any level, may be well positioned to become whistleblowers.

In the mortgage industry, the list of potential whistleblowers is long. QC professionals, like Sherry Hunt, obviously fit the bill. Those professionals might include anyone in the QC process, whether within a mortgage lending firm or outside the firm, including contractors. Along with QC professionals, underwriters—especially direct endorsement underwriters—may also have inside information useful to the government. Executives could be great whistleblowers as well from the government's perspective, as they may have knowledge of the financial incentives in place to encourage reckless lending practices or the extent to which a company ignored promises it made to government insurance programs, like the Federal Housing Administration (FHA).

In other words, when thinking about who could become a whistleblower, it is important to brush aside any preconceived notions: In the mortgage industry, people at all levels, inside and outside of a mortgage lending firm, may have information that the government might need to bring a case, and any of those people could become a whistleblower. For this reason, it is vital that lenders seriously investigate complaints at all levels, and that employees, from the executive suites in Manhattan, to the satellite offices throughout the country, recognize that they may have the power to become a whistleblower.

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## What may be reported

It is also important to recognize that federal laws reward whistleblowers for reporting not merely cases of outright fraud, but also cases of recklessness. Under the False Claims Act, true to its name, the question is whether a false statement was made in support of a claim for federal money, and if so, whether the person making the statement knew the statement was false or recklessly disregarded, or deliberately ignored, the fact that it might be false. In the FHA insurance context, False Claims Act cases have often focused on Direct Endorsement certifications, which state that a loan is qualified for FHA mortgage insurance, when it is not. Under the False Claims Act, there is no need for the government to prove that a lender lied about a certification to defraud the FHA. Instead, the law allows the government to proceed if the lender either knew the loan did not qualify or failed to do the due diligence required to figure out if the loan qualified, and then certified the loan in any event.

The FHA's Direct Endorsement lending program has generated the most False Claims Act cases in this field. Those cases have primarily focused on three areas, each of which could form the basis of a whistleblower action. First, as described above, the government has examined whether Direct Endorsement certifications were false on large sets of loans. Second, as reflected in Hunt's complaint against CitiMortgage, the government has scrutinized QC programs, including whether or not lenders have actually reviewed all early payment defaults. Third, the government has looked at other Direct Endorsement lender rules, such as whether Direct Endorsement underwriters were actually making underwriting decisions themselves and whether lenders had properly disclosed branch locations.

These are just some of the types of cases the government could bring in this field. For instance, if the government can establish fraudulent intent, the Justice Department has the power to bring actions relating to conventional mortgages, too. In addition, the Securities & Exchange Commission (SEC) has a whistleblower program which rewards whistleblowers for stepping forward with information about securities violations, such as misrepresentations in the sale of mortgage-backed securities (MBS). With so many federal programs soliciting information from whistleblowers, lenders and employees should not assume, without consulting qualified legal counsel, that any particular misconduct lies beyond the reach or interest of the federal government.

## Financial rewards

The federal government's most successful whistleblower programs provide handsome rewards for those who come forward with information, in order to encourage whistleblowers to step forward. Under the False Claims Act, whistleblowers are generally entitled to rewards between 15-25 percent of the government's recovery against a defendant. For Hunt, that translated into

more than \$31 million. The SEC's whistleblower program offers rewards in the range of 10-30 percent, in cases involving sanctions of more than \$1 million. In the trillion-dollar mortgage industry, the financial rewards for whistleblowers can be staggering.

## The process

The particular process for initiating a whistleblower complaint depends on the circumstances, but the first step is always the same: Consult a qualified attorney for advice. Lawyers who practice in this area generally take whistleblower claims on contingency,

meaning that the lawyer will not charge for legal advice, unless and until a whistleblower succeeds in collecting a reward. Depending on how someone presents information to the government, that person ultimately might be considered a mere witness, rather than a whistleblower. Whistleblowers are entitled to rewards; witnesses are not. An experienced lawyer should be able to protect these and other interests of a would-be whistleblower, explain the process, and work cooperatively with the government in moving a case along.

It is unlikely that Hunt's story will be unique. Mortgage lenders and mortgage professionals need to recognize the potential for whistleblowing in the mortgage industry, so that lenders take their obliga-

tions and employee complaints seriously, and so that mortgage professionals understand the rewards available to them for reporting misconduct. Whistleblowing remains a new phenomenon in the mortgage industry. Yet, with ever-increasing federal scrutiny of the industry, the significance of whistleblowers is likely to continue to grow in the years ahead.

*Brian M. Feldman Esq., is an attorney with Harter Secrest & Emery LLP, whose work includes the representation of clients in False Claims Act cases. He previously worked with the Justice Department at the United States Attorney's Office for the Southern District of New York in Manhattan. He may be reached by phone at (585) 231-1201 or e-mail [bfeldman@hselaw.com](mailto:bfeldman@hselaw.com).*

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