REPORT OF THE COMMITTEE TO STUDY ISSUES REGARDING FINANCIAL RESOURCES MORTGAGE, INC. (FRM)

(HB178, Ch. 119, Laws of 2011)

November 30, 2011

Committee Members:

Representatives

Kenneth L. Weyler

Wyman E. Shuler III

Sean M. McGuinness

Senators

Raymond M. White

Jeanie L. Forrester

Be it enacted by the Senate and House of Representatives in General Court Convened:

119:1 Committee Established . There is established a committee to study the issues regarding the Financial Resources Mortgage, Inc.

119:2 Membership and compensation.

(a) Three members of the house of representatives, appointed by the speaker of the house of representatives.

(b) Two members of the senate, appointed by the president of the senate.

II. Members of the committee shall receive mileage at the legislative rate when attending to the duties of the committee.

119:3 Duties. The committee shall study issues regarding Financial Resources Mortgage, Inc.

119:4 Chairperson; Quorum. The members of the study committee shall elect a chairperson from among the members. The first meeting of the committee shall be held within 45 days of the effective date of this section. Four members of the committee shall constitute a quorum.

119:5 Report. The committee shall report its findings and any recommendations for proposed legislation to the speaker of the house of representatives, the president of the senate, the house clerk, the senate clerk, the governor, and the state library on or before December 1, 2011.

119:6 Effective Date. This act shall take effect upon its passage.

Approved: June 2, 2011

Effective Date: June 2, 2011

MATERIALS REVIEWED

State of New Hampshire

Banking Department

Consumer Credit Administration Division

Report of Examination

May 19, 2003, October 11, 2004, and November 17, 2008

Report of the Attorney General

To the Governor and Executive Council

Financial Resources Mortgage, Inc.

May 12, 2010

Report of the Joint Legislative Committee to Review the State Regulatory Oversight Over Financial Resources Mortgage, Inc.

November 23, 2010

State of New Hampshire

Findings of Fact – Financial Resources Mortgage, Inc.

Charles W. Chandler, Presiding Officer

April 11, 2011

Persons Interviewed by the Committee:

1. Banking Department: Ingrid White, (hearings officer who attended all meetings.) Ronald Wilbur, Commissioner (he replaced Peter C. Hildreth, who was allowed to resign when this scandal was uncovered.)
2. Office of the Attorney General: Attorney Richard W. Head, (he had been the head of the Consumer Bureau, then was made an Associate Attorney General, and authored DOJ report.
3. Bureau of Security Regulation: Kevin Moquin (he attended almost all hearings.) Joseph Long, Director (he had been an expert witness prior to his appointment due to his being the attorney for the North American Securities Regulation Association.) Mark Connolly (he had been the Director during the investigation, and resigned so that he would be able to testify freely to all investigations.)
4. Secretary of State: William M. Gardner (the BSR falls under his office, he appointed the Directors, and appointed Charles W. Chandler to produce his report.)
5. Representative Donna Schlachman: Rep. Schlachman had been Vice-Chair of the Joint Committee which made the report in 2010.
6. Victims: these were people who had invested money with FRM, and some who held mortgages to protect their investments: Ken Miller, Al and Susan McIlvene, Peter Martino.
7. Charles W. Chandler: Former State Rep., retired attorney, appointed by Sec. of State Gardner to do an independent investigation into FRM. He served without pay so as to avoid any accusation of influence. He put all testifying under oath.

Findings About the Role of the Departments and Their Comments

The committee would first like to state for the record that each state department brings a perspective that is driven by their "institutional inertia" and historical biases that are built into these departments. These are often the department's greatest strength, but can be a source of weakness if not recognized and acknowledged by the departments themselves. The attorney general office has a bend toward fierce independence, in an effort to be impartial, but this can create an air of unaccountability. The Bureau of Securities Regulation which according to legislation is supported by fines and enforcement has a culture of openness, which may lead to avoidance of disclosure by those it regulates, and hard feelings in interactions with other state agencies. The Banking Department has a long history of secrecy to protect the institutions it regulates, which is important so that the reputation of these firms is not unnecessarily sullied, but this can cause a lack of pertinent information sharing with other regulators, which it certainly did in the case of FRM. The Secretary of State has an independence which can be divisive when trying to work cooperatively with other regulatory agencies that are part of the executive branch.

We would call on each department to recognize the strengths and historical underpinnings of their agency, but also to have a time of self-examination to ensure a critical look at whether or not those built-in tendencies did not cause them to come up short in their duties and obligations in the matter of FRM

The following are some thoughts and observations about each department and their testimony before the committee.

Attorney General

The committee felt like the Attorney General office was not as interested in being helpful to our task as some of the other agencies. We also felt they had the most culpability to the victims, particularly with their unilateral decision to put this case into Chapter 7 bankruptcy. Until the very end of the hearings, they never had representation at the meetings we conducted. Once they did finally attend, the hour and a half of testimony the committee heard from Richard Head, although it admittedly did contain some important information, it often seemed like a self-serving defense of the AG office relative to their role in all of this. It also seems as if the AG believes they are beyond the reach of the Legislature or any other agency, that they are the "top dog" and that they are able to make decisions in a vacuum, because they are answerable to no one. The committee appreciates the need for DOJ to be independent, but that does not mean unaccountable.

Bureau of Securities Regulation

They had a constant presence at the hearings, which the committee is grateful for, but the sense of the committee is that at-times-their testimony was self-serving, that is to say they sought-to protect themselves from blame or culpability as well. Sen. White, being a participant in the securities industry, felt that the BSR had clear authority to get much more involved from a regulatory standpoint with this FRM situation, and much earlier. Not only was there preferred stock involved at one point, but from his understanding, he felt that once these loans were co-mingled, they became securities. The Chandler Report discovered that there was no document that could be described as a security after 2005. In addition, there were corporate irregularities, and since BSR resides in the Secretary of State's office, there should have been a natural sharing of information about all of these matters that could have led to regulatory intervention sooner.

Secretary of State Office

Although the committee applauds this office for conducting the most comprehensive and even-handed investigation of the FRM matter, the committee still had an underlying feeling that this office was also trying to defend their turf, just like every other department, and had a problem with the Attorney General's office, which was palatable throughout their reports and testimony. The committee was certainly most impressed by the report they commissioned by Charles Chandler, and it would be difficult to assess the FRM matter without that report. However, this committee also needed to explore the topic of combining agencies for better cooperation, and this was always met with skepticism and hostility during the hearings by this office, no different from all the other departments as well.

Banking Department

Like BSR, they were to be commended for participating in the hearings fully and at all times. This department has probably shouldered the most blame in the FRM matter up to this point, and paid the biggest price thus far in actual consequence, given the fact that the sitting commissioner was forced to resign. It is very evident that the Governor and Executive Council made a huge mistake by not following through with the removal proceedings of the commissioner, rather than letting him resign. Much important and relevant testimony was lost as a result of that poor political decision. It was an act of political expediency rather than service to the state of New Hampshire, which is unfortunate.

This agency also probably bears the most fault in allowing this scandal to grow, prosper and continue, as it had the most in-house knowledge of legitimate complaints years earlier than the other departments. This department seemed to be more preoccupied with parsing the definition of commercial mortgage lending, versus residential mortgage lending, acquiescing the pressure from FRM and its lawyers put on the department to be sidetracked with questions about it's jurisdictional authority.

New Hampshire Auto Dealers Association

They attended virtually all of the hearings, because they felt they had a possibility of becoming "collateral damage" if this committee made recommendations about combining departments or changes in the consumer protection laws of the state of New Hampshire. They had no direct interest in any of these proceedings, but apparently attended out of an abundance of caution for their own self-interest.

Department of Insurance

Much like the Auto Dealers, they attended and participated in the hearings, not wanting to be swept up in any attempt by the committee to combining departments or change jurisdictional responsibilities in financial matters. There were never really any charges that they bore any responsibility in the FRM matter.

Summary

In summary, the committee thanks and wants to give due recognition to all of these departments for their active role in answering our questions and trying to bring to light some of the failures and shortcomings that led to this financial scandal. This is tempered by the understanding of the committee that each participant had a strong parochial interest in their own departments and their own regulatory jurisdiction. This creates a tension between necessary self-examination, which this committee was trying to get each department to engage in, and getting to the unbiased truth in this matter. We believe this will always be the case as long as fallible human beings are involved, because it is part of our innate human nature toward self-preservation and blame shifting. Even the best-crafted legislation is no substitute for people of goodwill and exemplary character to head these departments, and to staff these departments with like-minded people of fairness and goodwill. There is no solution this committee can possibly create or recommend that can substitute for this most important characteristic of department heads and their staff. There is no way to mandate inter-agency cooperation, because even if a suitable framework is put in place, it still is people that must use good judgment to execute even the best defined plans.

Findings About the Victims and Their Testimony

Virtually every week the committee heard from the victims in the FRM matter. In some respects, there was a sense of helplessness on the part of the committee, because of the great financial and personal loss many of the victims have suffered and the perceived lack of responsiveness from the victim's perspective on the part of the Government of the State New Hampshire. The victims saw this committee as an extension of each and every regulatory agency and also of the entire legislature itself, and we could sense the anger, frustration, helplessness and cry for help they were trying to express to the committee. Unfortunately, the role of government in a matter like this is limited, as all government ultimately is. We are a free society with free commerce, and although there is a certain amount of regulatory oversight and control in the transaction of commerce to provide for a somewhat orderly marketplace, the fact of the matter is criminal activity have in the past and will again in the future occur, and governmental remedies are not limitless.

This report will try to summarize some of the main points brought forward by the victims, and will comment on some of them.

The Decision to Engage in Chapter 7 Bankruptcy

Without question, this is the most current pressing issue facing all of the victims in the FRM matter. When the FRM matter came to a head, as in indictments and criminal prosecution began, and as regulators swooped in to assess the damage, in what proved to be a hugely damaging decision for many victims, it was decided to place this case in the federal system through an involuntary Chapter 7 bankruptcy liquidation proceeding.

This decision was made on the basis of believing that unless all claims against the estate of FRM were aggregated, that some victims were going to be compensated to a greater extent than others. In addition, the belief was that because this was fundamentally a Ponzi scheme, even creditors who had been repaid some or all of what they had been owed, were done so with unjustly-obtained proceeds, so all of those proceeds needed to be "clawed back" in order to be redistributed fairly to every victim having a claim of the estate.

The dilemma for the committee is that we do not want to necessarily second-guess that decision, as the committee lacks the required time as well as the financial and regulatory expertise to render a definitive judgment on that topic. However, the committee does have grave concerns about the ramifications of this decision, and even more grave concerns about how it was arrived at in such a short fashion. The following question set was used to guide investigations of these matters. Was the decision done for political expediency? Were the ramifications to be victims adequately considered? Who was consulted in the decision-making process? Why was the director of BSR at the time, Mark Connolly, specifically excluded from being consulted regarding this decision? Why did the State of New Hampshire pursue receivership in the matter of Noble Trust (a somewhat similar and cotemporaneous fraudulent financial scheme), but Chapter 7 in this case? Why is there no consistency? Who made the decision, what was the process followed, and were victims consulted or informed? Is there a defined process and procedure for this type of a decision should it ever be necessary in the future?

Furthermore, we question if all victims of the FRM matter were indeed similarly situated. Although it is a nice sentiment to say that everybody should be treated "fairly" in this matter, it does appear that not all of the victims find themselves in the same situation, and "fairness" is subject to the eye of the beholder. Some victims had recorded deeds on specific properties, in fact even being insured with title insurance. Other loans were pooled, and had more of the characteristics of a security than a mortgage. Some were so fraudulent they had no discernible security interest whatsoever; the money was simply stolen with no attempt to even conceal the fraud. The following set of questions was used to guide investigations of these matters. Some victims pursued great due diligence before entering into their transactions, others did not. Should those who did not be treated in the same manner as those who did? Should those who were diligent about pursuing a security interest by the universally accepted means of doing so be dragged back into this estate, or should they be allowed to pursue their claims individually rather than in the aggregate. Is the bankruptcy trustee treating the situation fairly? Now that this is in the hands of a bankruptcy trustee, should our Attorney General play any role in safeguarding the interest of our citizens by policing the actions of the bankruptcy trustee? Is there a matter of long-accepted and settled real estate law that is being ignored by the bankruptcy trustee to the harm of some victims? Do the state and the DOJ in particular, have a duty to defend those principles? Is the bankruptcy trustee going to consume the recoverable estate in billable legal fees to the exclusion and/or harm of the victims? Do those that made the decision to place the case in chapter 7 now have a responsibility to make sure things go as well as they possibly could for the victims going forward?

Restitution for Victims

The case was made time and again by the victims that they feel they are owed restitution by the State of NH. They base this claim on the belief that many of them did proper due diligence by inquiring of regulatory agencies if FRM was engaging in legitimate business activity, if they were properly licensed, if there had been any complaints about them, and if they were under any regulatory surveillance.

Many of these victims felt they were sophisticated, seasoned, experienced and intelligent investors who were "victimized" as much by the State as they were by FRM. They point out that many implicit as well as explicit warning signs, complaints and investigations were found in the after-the-fact paper trail uncovered in the various FRM reports, that show the State had knowledge that at a minimum, questionable suspicious activity was occurring, and that in fact a trained regulatory eye had a duty to recognize this and report it to any consumer who made inquiry regarding this.

This begs a question about the role of government in general, as well as the duty regulators may or may not have to discuss ongoing investigations and/or allegations that have not yet been proved. It also raises issues about investor risk and behaviors. Lastly, it invites the questioning about the amount and scope of regulation in free-market commerce. How much of private, free market enterprise needs to be disclosed to inquiring regulators, and how much of that information that is involuntarily extracted from those being regulated should be available to the public (or their perhaps even their competitors)?

When asked about what recompense the State or it's agencies owed to aggrieved parties, and when specifically reminded that there are countless people who would describe themselves as such if a pot of money were to available to all of them, the victims made the case that theirs was a special, exceptional circumstance without prior precedent. They repeatedly insisted that their case was such an outlier both in size and scope, and regulatory agencies so greatly failed them in their incompetence that it deserved a unique response unlike any other the State had ever engaged in previously. To be succinct, they were "special"

It is important to note that the Senate ED & A Committee, of which Senator Raymond White is a member, retains a bill, SB185, that contemplates such restitution. A charge was made by one victim that Senator White had a conflict of interest because he had already publicly stated his opposition to retroactive restitution after a public hearing of the bill, and because he is in both the insurance and securities businesses, from which fines for funding of restitution might come. A letter was delivered to the committee and also the Senate President stating that he was unfit to serve on either of these 2 committees, and that he needed to be removed. Senator White dismissed this call for such action publicly, noting he had already disclosed these conflicts publicly, as required by ethics rules.

There was also discussion about the role of regulatory fines, the fact that much of that money is returned to the state treasury, and even some discussion about so-called "self-funded" agencies. Should such agencies be put in the general fund? What relationship is there, if any, between regulatory fines and victim restitution? What about the NH consumer protection laws that preempt the private right of action for certain regulated businesses? What is the victim's recourse in that environment?

The following question set was used to guide investigations of these matters. In a broader scope, does the State owe financial recompense when it mistakenly or purposefully harms a citizen, either directly or indirectly? How does one hold accountable "bad behavior" by state employees? What will be the long-term result for State government if no one is ever personally accountable or liable? Is it enough for agencies to say "mistakes were made", without a further consequence? If there is an appetite for restitution, how would it be funded and structured? On a case-by-case basis? Perhaps the funding should be taken from regulatory agency budgets to have a "punishing" effect and accountability by the agency? Is that fair, reasonable or even desirable?

Coming from the victim's standpoint, what about their personal responsibility and culpability? What happens in the future if a precedent is started with them for restitution? Are their unintended, long term consequences once a State goes down that path? Does it encourage careless future behavior by investors? Would it be fair to treat victims as class, or on a case-by-case basis, given that this report already established that all victims are not similarly situated? Is the FRM different than anything the State has ever dealt with, deserving of unique handling, or is that just the victim's standpoint? What about NH taxpayers, and fairness to them?

Consumer Complaints and Information Availability

The area of consumer complaints, regulatory investigations and actions, shared information by agencies and the public availability of this information was much discussed. Peripheral issues included various databases and their tracking components, the process of consumer complaints being directed to appropriate agencies or other destinations, follow up and public paper trail of such actions, and multi-jurisdictional, multi-licensed entities and the difficulties they can pose to regulators and consumers alike.

There was a sense by the victims that they never knew who had jurisdictional responsibility at any particular point in their dealings with state agencies. Richard Head from the AG office gave the committee a thorough report on how the AG office handle an inquiry and direct it to the proper destination based on their best judgment. Sometimes it is very clear, but at other times it is not. They do have a tracking system. Still, it is up to state agencies to decide for themselves if they have jurisdictional regulatory authority in any matter, and it appears things break down rapidly for the public if that jurisdictional decision is made in the negative. Many FRM victims felt the system broke down because they were handed off from regulator to regulator in a macabre game of jurisdictional "hot potato".

The questions around these issues are how should consumer complaints be tracked? Who should be the number one point of contact for the public? What happens next if a regulatory agency decides they do not have jurisdiction? Who stays with the consumer until someone does indeed take regulatory "ownership" of the issue? How can a spirit of interagency cooperation be fostered and developed further? Can there be 1 location, 1 database, 1 website, 1 point of contact for consumers to interact with and get what they are looking for?

The AG office pointed out that they must make due with volunteers for many functions, raising the question about resources and whether or not the legislature is giving adequate resources to consumer protection in our regulatory agencies, or if they are set up for and doomed to failure due to a lack of resources.

Security Interest in Real Property

A major source of frustration for some of the victims is the belief that they had a first mortgage claim to a specific property, which carried with it all of the rights and recourse available to any lender on real property. They did not feel there was any pooling of their loan, nor did they envision they had any risk beyond the normal risks associated with a first mortgage position, i.e. that the loan could default and become nonperforming, necessitating the usual risks inherent in a foreclosure proceeding. They had done the usual and customary loan-to-value type of metrics in making their lending decisions, and assumed those risks they thought they knew about.

Due largely to the decision to bundle the FRM estate as a single package as described earlier in this report, these lenders found themselves in a position similar to an unsecured creditor, a position infinitely different than what they thought they agreed to. In addition, prior income and loan payments are being "clawed back" by the bankruptcy trustee as this report earlier described. Victims feel they are being victimized once again by the chapter 7 process and the involuntary (by them, the victims) comingling of the entire FRM estate, past and present. Some lenders who thought they were well clear of the FRM issue have now been revisited with this never-ending nightmare. Others have entered into disadvantageous settlements under pressure to simply "move on".

The questions arising from this situation go to the very foundations of the long understood and established mortgage and real property principles underpinning our entire lending system. This report enumerated them previously, but briefly, are there or should there be any circumstances that a properly recorded and documented first mortgage position in real property should be undermined by anyone regardless of circumstances? Is any mortgage position safe if this principle is not upheld without exception? Does the legislature need to act? Does the DOJ need to act?

FRM Recommendations

The Committee looked at several sets of recommendations from the various reports and interviews. These recommendations are included in Appendix A, along with a summary which attempts to organize them into a complete list. Many of these recommendations the committee decided not to include for various reasons. The following list is the result of our discussions, and therefore the recommendations of this report:

1. Create some way to address information sharing and cooperation among agencies, either formally or informally. Establish a consumer protection regulatory working group among similar regulating agencies. By whatever means, somehow critical information needs to be shared between various agencies charged with consumer protection.

Committee Response: Ask the Performance Audit Section of the Legislative Budget Assistant to do performance audits on the Attorney General Office, the State Banking Division, and the Bureau of Securities Regulation with these goals in mind:

a. Look for any MOU's for information sharing, and whether they are being implemented. Is there any ongoing process to assure that parties being regulated are not trying to avoid oversight by claiming to come under a different agency?

b. How much negative information is made available to the public?

c. Do the AG and the SBD overuse secrecy in dealing with the public, either by claiming attorney-client privilege, or by fear of a run on a bank.

d. How developed are any shared databases for both regulators and public?

e. How are complaints handled? Is there an emphasis on follow up or on sending them elsewhere? Can the public discover any results?

f. Is there a role for an Auditor General such as judging whether information should be shared between agencies, or which agency would have authority?

g. How are Hearings Officers used in the agencies under review? Is there enough work for them in each agency so that they become skilled in this duty, or should an alternate method be considered?

2. The Attorney General should be elected by the Joint Session of the Legislature, similar to the Secretary of State and the Treasurer.

3. Parties which deal with state agencies and also lobby the legislature should identify themselves in both milieus.

4. State laws need to be strengthened to protect mortgage holders rights in dealing with the court system.

5. The committee agreed that the following needs further study: Mandate a regulatory disclosure form. This form would identify which regulatory agency would have oversight over the transaction. Identify which is the lead agency ultimately responsible for consumer protection in specific circumstances.

FINAL CONCLUSIONS

The activity of the Financial Resources Mortgage, Inc was a criminal activity. It was well planned and well orchestrated, always trying to stay one step ahead of the regulators. This fact cannot be overstated, as the intent of the perpetrators was to conceal their criminal activity from regulatory agencies. Although this report has cited several deficiencies and been highly critical of aspects of regulatory agency conduct in the FRM matter, we must never forget that the criminal intentions were designed to deceive both the investor victims and the regulatory agencies, and for a long period of time they succeeded at both.

Respectfully submitted,

Rep. Kenneth L. Weyler, Chairman	Senator Raymond M. White
Rep. Wyman E. Shuler, III	Senator Jeanie L. Forrester
Rep. Sean M. McGuinness	