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18 **UNITED STATES DISTRICT COURT**
19 **CENTRAL DISTRICT OF CALIFORNIA**
20 **Western Division**

21 SECURITIES AND EXCHANGE
22 COMMISSION,

23 Plaintiff,

24 vs.

25 FIRST MORTGAGE CORPORATION, INC.,
26 CLEMENT ZIROLI, SR.,
27 CLEMENT ZIROLI, JR.,
28 PAC W. DONG,
RONALD T. VARGUS,
SCOTT LEHRER, AND
EDWARD JOSEPH SANDERS,

Defendants.

Case No.

COMPLAINT

1 Plaintiff United States Securities and Exchange Commission (“Commission”)
2 makes the following allegations against Defendants First Mortgage Corporation
3 (“FMC”), Clement Zirolì, Sr. (“Zirolì Sr.”), Clement Zirolì, Jr. (“Zirolì Jr.”), Pac W.
4 Dong (“Dong”), Ronald T. Vargas (“Vargas”), Scott Lehrer (“Lehrer”) and Edward
5 Joseph Sanders (“Sanders”).

6 JURISDICTION AND VENUE

7
8 1. This Court has jurisdiction over this action pursuant to Sections 20(b)
9 and (d) and 22(a) of the Securities Act [15 U.S.C. §§77t(b), (d), 77v(a)] and Sections
10 21(d) and 27(a) of the Exchange Act [15 U.S.C. §§78u(d), 78aa(a)].

11 2. Defendants transacted business related to the scheme in this judicial
12 district and, directly or indirectly, made use of the means or instruments of
13 transportation or communication in interstate commerce, or of the mails, in
14 connection with transactions, acts, practices and courses of business alleged in this
15 Complaint.

16 3. Venue is proper in this district pursuant to Section 22(a) of the Securities
17 Act, 15 U.S.C. § 77v(a), and Section 27(a) of the Exchange Act, 15 U.S.C. § 78aa(a).
18 because certain of the transactions, acts, practices and courses of conduct constituting
19 violations of the federal securities laws occurred within this district. In addition,
20 venue is proper in this district because Defendant First Mortgage is based in this
21 District and certain other Defendants reside in this district, as detailed below.

22 SUMMARY

23 4. From March 2011 through March 2015, FMC and the individual
24 defendants misled investors in residential mortgage-backed securities guaranteed by
25 the Government National Mortgage Association (GNMA RMBS). FMC, the issuer
26 of the securities, did so by falsely claiming to both GNMA and investors that certain
27 mortgage loans in these securities were delinquent when, in fact, such loans were
28 current. FMC then bought these current loans out of GNMA RMBS loan pools at

1 lower prices applicable to delinquent loans. Because, in reality, these loans were
2 current, FMC could then resell the loans into new GNMA RMBS loan pools at higher
3 prices applicable to current loans for an immediate, nearly risk-free profit. The
4 investors, however, were deprived of the benefit of their investment in these
5 securities – the interest payments on the loans.

6 5. FMC is a privately-held mortgage company which, among other things,
7 originated and acquired residential mortgages. FMC sold, or “pooled,” these
8 mortgages for residential mortgage backed securities which were then guaranteed by
9 GNMA, a U.S. Government corporation within the U.S. Department of Housing and
10 Urban Development. FMC was an approved issuer of these GNMA RMBS and sold
11 these securities to investors.

12 6. GNMA rules give issuers an option to repurchase loans that are three or
13 more months delinquent (“DQ3+”) out of GNMA RMBS pools at a price of “par,”
14 which is essentially the remaining principal balance on the loan (the “DQ3+
15 Repurchase Option”). GNMA rules also allow issuers to repool those loans for new
16 GNMA securities if they become current after the repurchase.

17 7. However, FMC improperly exercised the DQ3+ Repurchase Option
18 because it had received payments from or on behalf of borrowers that had fully cured
19 the delinquencies before FMC repurchased the loans. FMC delayed depositing the
20 curing borrower payments until after it had repurchased the loans and placed them
21 back into FMC inventory. As a result, neither GNMA nor the GNMA RMBS
22 investors knew that these loans had actually been brought current, and thus were not
23 eligible for repurchase pursuant to the DQ3+ Repurchase Option.

24 8. Once the loans were in FMC inventory, the curing borrower payments
25 were then deposited, and entered into FMC’s records. The records then reflected the
26 true current status of the loans. These current loans could then be resold into new
27 GNMA RMBS pools at market rates, which resulted in a price that reflected a
28 premium over par. From March of 2011 through March of 2015, FMC engaged in at

1 least 532 transactions involving the improper repurchase and repooling of loans, with
2 total profits of \$7.5 million.

3 9. Defendants' practice of delaying the depositing of borrower payments in
4 order to buy out loans that were actually current, and then reselling those loans at a
5 profit, rendered statements in in the GNMA RMBS prospectus false and misleading.
6 Nevertheless, the practice was not disclosed to GNMA RMBS investors or GNMA.

7 10. The practice also operated as a fraudulent scheme and course of business
8 against GNMA RMBS investors and GNMA. It included several deceptive acts,
9 including false statements to GNMA, which were instrumental in inducing GNMA to
10 guarantee the securities issued by FMC. The practice harmed investors who
11 purchased GNMA RMBS issued by FMC because it resulted in improper early loan
12 pay-offs (or prepayments), depriving GNMA RMBS investors of the future interest
13 payments on the repurchased loans.

14 11. By their conduct, Defendants each violated Section 17(a) of the
15 Securities Act of 1933 ("Securities Act") [15 U.S.C. §77q(a)], Section 10(b) of the
16 Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78j(b)], and Rule
17 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5].

18 12. As a result of Defendants' conduct, the Commission seeks entry of a
19 final judgment ordering injunctive relief, ordering the payment of disgorgement and
20 pre-judgment interest, imposing officer and director bars, and imposing civil
21 penalties.

22 **THE DEFENDANTS**

23
24 13. First Mortgage Corporation is a California corporation based in Ontario,
25 California. During the relevant time period, FMC was approved by GNMA to issue
26 GNMA RMBS. In June 2015, GNMA terminated FMC from participating in the
27 GNMA mortgage- backed securities program as a result of the conduct described
28 herein.

1 14. Clement Ziroli, Sr. is a resident of Henderson, Nevada. Ziroli Sr. owns
2 roughly 89% of FMC and is its chairman and chief executive officer. During the
3 relevant timeframe, Ziroli, Jr. reported to Ziroli, Sr.

4 15. Clement Ziroli, Jr. is a resident of Las Vegas, Nevada. Ziroli Jr. owns
5 roughly 1% of FMC and is its president. During the relevant timeframe, Dong and
6 Vargas reported to Ziroli, Jr.

7 16. Pac W. Dong is a resident of Diamond Bar, California. Dong owns
8 roughly 10% of FMC and is its chief financial officer. During the relevant
9 timeframe, the Accounting Department, the Investor Reporting Department, and
10 Sanders and the Servicing Department reported to Dong.

11 17. Ronald T. Vargas is a resident of San Dimas, California. During the
12 relevant timeframe, Vargas was a senior vice president and the head of FMC's
13 Capital Markets Department, and Lehrer reported to Vargas. Vargas was responsible
14 for, among other things, the securitization (or pooling) of loans originated or acquired
15 by FMC into GNMA RMBS pools, as well as the sale of the GNMA RMBS to
16 investors.

17 18. Scott Lehrer is a resident of Pasadena, California. During the relevant
18 timeframe, Lehrer was a senior vice president in the Capital Markets Department at
19 FMC and a consultant to the Servicing Department. Lehrer was primarily responsible
20 for compliance with GNMA rules and certifications to GNMA related to such
21 compliance. Lehrer also participated in the sale of GNMA RMBS to investors.

22 19. Edward Joseph Sanders is a resident of Ontario, California. Until
23 January 2013, Sanders was Vice President of Default Servicing for FMC. In January
24 2013, Sanders was promoted to Managing Director of the Servicing Department.

1 **THE FACTUAL ALLEGATIONS**
2 ***GNMA RMBS AND HOW THEY WORK***
3

4 20. GNMA RMBS securitize pools of loans insured mainly by the Federal
5 Housing Administration or guaranteed by the Department of Veterans Affairs.
6 GNMA guarantees investors the timely payment of principal and interest on GNMA
7 RMBS. GNMA’s guaranty carries the full faith and credit of the United States
8 government.

9 21. To become an approved issuer of GNMA RMBS, an entity must, among
10 other things, meet certain eligibility requirements, such as, for example, requirements
11 related to net worth, liquidity, and capitalization. An entity must also maintain
12 compliance with, among other things, the GNMA Mortgage-Backed Securities Guide
13 (the “GNMA Guide”).

14 22. With each new issuance of a GNMA RMBS, an issuer must certify on
15 Form HUD 11705 that it will comply with all terms and conditions of the GNMA
16 Guide, both for the new issuance and for all its then-existing GNMA RMBS.

17 23. Chapter 16 of the GNMA Guide, Section 16-9(A), requires that
18 borrower payments on loans in GNMA RMBS must be “credited to the applicable
19 custodial account generally by the first (1st) business day after they are received,” but
20 in any case, such payments “must be deposited into the applicable custodial account
21 no later than the second (2nd) business day following receipt.”

22 24. Chapter 18 of the GNMA Guide, Section 18-2, prohibits an issuer from
23 removing a loan from a GNMA RMBS “for any reason not specifically authorized”
24 by the GNMA Guide. One such specific authorization is found at Section 18-
25 3(B)(1)(c). This Section contains the DQ3+ Repurchase Option which grants a
26 GNMA RMBS issuer the option to repurchase a loan from one of its previously
27 issued GNMA RMBS loan pools if it is three or more months delinquent. Pursuant to
28 Chapter 18, Section 18-3(B)(3) of the GNMA Guide, the repurchase price for DQ3+

1 loans is the remaining principal balance on the loan (less any principal payments
2 advanced by the issuer), known as “par.”

3 25. Chapter 18, Section 18-3(B)(5) of the GNMA Guide allows repurchased
4 loans to be repooled and sold for new GNMA securities, but only if the repooled
5 loans satisfy the eligibility requirements in Chapter 9 of the GNMA Guide. Among
6 other eligibility requirements in Chapter 9, Section 9-2(E) of the GNMA Guide
7 provides that loans may be no more than one month delinquent to be eligible for
8 repooling.

9 26. With each repurchase of a loan pursuant to the DQ3+ Repurchase
10 Option, an issuer must file Form HUD 11710E reflecting, among other things, the
11 due date for the last payment received on the loan.

12 27. GNMA RMBS are issued pursuant to a standard form of prospectus
13 which states, in relevant part:

14 (a) “[I]f any Mortgage comes into default and continues in default for
15 a period of 90 days or more, the Issuer is permitted to purchase it from the
16 pool,” and

17 (b) “Under contractual arrangements between the Issuer and Ginnie
18 Mae, the Issuer is responsible for servicing and otherwise administering the
19 Mortgages in accordance with FHA, VA, [and other] requirements, as
20 applicable, Ginnie Mae requirements, and servicing practices generally
21 accepted in the mortgage lending industry.”

22 ***FMC’S MISCONDUCT***

23 28. In March 2011, FMC began to improperly use the DQ3+ Repurchase
24 Option for loans that were current at the time of FMC’s repurchase, but had been at
25 least three months delinquent at a prior point in time.

26 29. The practice was initially proposed by Sanders and approved by Zirol
27 Sr. In addition, each of the Defendants knew, at or around inception of this practice
28

1 that it involved repurchasing loans that had been at least three months delinquent but
2 were no longer delinquent at the time of repurchase. FMC's business model did not
3 include purchasing and holding loans in its inventory. FMC would not have
4 repurchased these loans had the Defendants not known that, in reality, the loans were
5 current and could be immediately resold at a profit.

6 30. To carry out this practice, FMC's servicing department monitored loans
7 that had become at least three months delinquent. If FMC received a payment
8 sufficient to bring such a loan current, the payments were routed to Sanders in the
9 Servicing Department. The payments were typically in the form of a cashier's check
10 or money order that the borrower delivered to FMC. In some cases, curing funds
11 were transferred into an FMC account, on behalf of borrowers, from a government
12 program designed to assist delinquent borrowers. In such cases, FMC then generally
13 wrote a check from that account to itself, and delayed depositing it just as it did with
14 the checks that came directly from borrowers. In such instances, these checks were
15 signed by at least one (and usually two) of Defendants Zirola Sr., Zirola Jr., Dong,
16 Vargas, or Lehrer.

17 31. The GNMA Guide and generally accepted servicing industry standards
18 required that these checks and money orders be promptly deposited, but FMC did not
19 do so. Instead, the checks and money orders were simply held, for days and
20 sometimes weeks, in a folder in the Servicing Department.

21 32. Toward the end of each month between March 2011 and February 2015,
22 Sanders sent one or more emails to Vargas, Lehrer, sometimes Zirola Jr., and others in
23 FMC's Capital Markets, Accounting, and Investor Reporting Departments identifying
24 the loans that had been more than three months delinquent and for which FMC had
25 received full curing funds. One purpose of the emails was to notify all who had a role
26 to play in carrying out the repurchase/repool practice that these loans were to be
27 repurchased at month end, and would be available for repooling immediately in the
28 following month. Copies of these emails were sometimes forwarded to Zirola Jr. and

1 Zirolì Sr.

2 33. In connection with the repurchases, Lehrer prepared and signed Form
3 HUD 11708 in order to obtain loan documents from FMC's document custodian.
4 Lehrer emailed a completed form for each loan to the custodian and identified the
5 reason for obtaining the documents using the code for "repurchase of delinquent
6 loan." This representation was false because the loans were in fact not delinquent.

7 34. Vargas and Lehrer also reviewed the monthly email list to confirm that
8 the loans being repurchased would meet GNMA parameters for resale (such as
9 interest rate and term), and to prepare to immediately sell the loans to a new GNMA
10 RMBS pool.

11 35. At the end of each month, a Servicing Department employee prepared
12 and delivered to the Accounting Department a check request to issue checks drawn
13 on FMC's bank account to repurchase the loans. FMC repurchased the loans at par.
14 The repurchase checks required two signatures, and each of Zirolì Sr., Zirolì Jr.,
15 Dong, Vargas and Lehrer signed multiple repurchase checks. The checks were
16 typically signed on the last day of the month, and then the repurchase transaction was
17 entered into FMC's records on the same day. During the relevant timeframe, these
18 repurchases averaged approximately \$2 million per month.

19 36. Generally on the second business day of the month following the
20 repurchases, FMC's Investor Reporting Department, which reports to Dong,
21 completed and forwarded to GNMA numerous required monthly reports. Among
22 them were Forms HUD 11710E for loans repurchased pursuant to the DQ3+
23 Repurchase Option.

24 37. These forms contained the false assertion that FMC had not received any
25 payments on the loans for at least the three previous months. In reality, FMC had
26 received full curing payments during the month being reported, but it had yet to
27 deposit such payments.

28 38. Once the loans were officially back in FMC's inventory, the borrowers'

1 checks were deposited, and the payments officially entered into FMC's records. As a
2 result, FMC's records falsely reflected that borrower payments were received in the
3 month after they were actually received.

4 39. Once the borrowers' payments were deposited, FMC's records reflected
5 that the loans were current, and thus eligible for resale into a new GNMA RMBS
6 pool. The loans were then sold for new GNMA RMBS pools at market rates, which
7 reflected a premium over par. During the length of the repurchase/repool practice,
8 these premiums ranged from less than 1% to 11.75%, and averaged 7.5%.

9 40. For each new GNMA RMBS, FMC was required to and did make a
10 written certification to GNMA on Form HUD 11705, in which FMC agreed to
11 comply with GNMA rules and agreed that FMC's pools and loan packages would be
12 governed by GNMA rules. Lehrer signed most of these certifications. These
13 certifications were false because FMC was violating at least two provisions in the
14 GNMA Mortgage-Backed Securities Guide: the DQ3+ Repurchase Option at Section
15 18-3(B)(1)(c), and the requirement to deposit funds into custodial accounts no later
16 than two days after receipt at Section 16-9(A).

17 41. FMC, through Vargas and Lehrer, sold the securities to investors.
18 GNMA rules require that the securities be sold using an official GNMA prospectus.
19 As set forth above, the prospectus notifies investors that the issuer is permitted to
20 repurchase a loan "if any Mortgage comes into default and continues in default for a
21 period of 90 days or more." This disclosure was materially false and misleading
22 because FMC repurchased loans that were not in default at the time of repurchase,
23 and which were therefore ineligible for repurchase.

24 42. Also as set forth above, the prospectus stated that FMC would service
25 loans in accordance with GNMA requirements as well as practices generally accepted
26 in the mortgage lending industry. This disclosure was also materially false and
27 misleading because FMC's practice violated Section 16-9(A) of the GNMA Guide
28 and did not comport with generally accepted servicing standards.

1 43. Neither Vargas, Lehrer, nor anyone else at FMC disclosed the practice,
2 orally or otherwise, to the investors that purchased FMC-issued GNMA RMBS.

3 44. From the beginning of the practice in March 2011, FMC paid
4 compensation to Sanders directly related to the practice in the form of commissions
5 based on the principal balance of the repurchased and repooled loans. Zirolì Sr.,
6 Zirolì Jr., and Dong approved the commission structure. Through multiple
7 communications with Sanders concerning his commissions, Zirolì Sr., Zirolì Jr., and
8 Dong were made aware of the profits that FMC received as a result of the practice.

9 45. In addition, a portion of the bonuses and other profit-sharing or revenue-
10 sharing payments received by Zirolì Jr. included payments directly related to the
11 practice.

12 46. The practice included at least 532 repurchase/repooling transactions
13 between March 2011 and March 2015. FMC received \$7.5 million in illicit profits as
14 a result of the practice.

15 47. Each individual defendant took steps that were essential to carrying out
16 the scheme, and each individual defendant was at least reckless in disregarding the
17 fact that his conduct (a) rendered material statements in the official prospectuses in
18 GNMA RMBS offerings to be false and misleading, and (b) caused false information
19 to be transmitted to GNMA in connection with its agreement to guarantee FMC-
20 issued GNMA RMBS. Each individual defendant, at least recklessly, participated in
21 and allowed the scheme to proceed without taking steps to ensure that all the material
22 facts were disclosed to GNMA RMBS investors and to GNMA.

1 **FIRST CLAIM FOR RELIEF**

2 **Violations of Section 17(a) of the Securities Act**

3 **[15 U.S.C. §77q(a)]**

4 **(Against All Defendants)**

5 48. Paragraphs 1 through 47 of this Complaint are hereby restated and
6 incorporated herein by reference.

7 49. Defendants FMC, Zirola Sr., Zirola Jr., Dong, Vargas, Lehrer, and
8 Sanders, directly or indirectly, by the use of the means or instruments of
9 transportation or communication in interstate commerce, or by use of the mails, in the
10 offer or sale of securities, with scienter, employed a device, scheme, or artifice to
11 defraud; obtained money or property by means of an untrue statement of a material
12 fact or an omission of a material fact necessary in order to make the statements made,
13 in light of the circumstances under which they were made, not misleading; and
14 engaged in a transaction, practice, or course of business which operated as a fraud or
15 deceit upon the purchasers of GNMA RMBS.

16 50. By reasons of the foregoing, Defendants FMC, Zirola Sr., Zirola Jr.,
17 Dong, Vargas, Lehrer, and Sanders each violated Section 17(a) of the Securities Act.

18 **SECOND CLAIM FOR RELIEF**

19 **Violations of Section 10(b) of the Exchange Act and**

20 **Rule 10b-5 (a) and (c) Promulgated Thereunder**

21 **[15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5(a) and (c)]**

22 **(Against All Defendants)**

23
24 51. Paragraphs 1 through 47 of this Complaint are hereby restated and
25 incorporated herein by reference.

26 52. Defendants FMC, Zirola Sr., Zirola Jr., Dong, Vargas, Lehrer, and
27 Sanders, directly or indirectly, by use of the means or instrumentality of interstate
28 commerce, or of the mails, or of any facility of any national securities exchange, in

1 connection with the purchase or sale of any security, with scienter, employed a
2 device, scheme, or artifice to defraud, and engaged in an act, practice, or course of
3 business which operated or would operate as a fraud or deceit upon any person.

4 53. By reasons of the foregoing, Defendants FMC, Zirolì Sr., Zirolì Jr.,
5 Dong, Vargas, Lehrer, and Sanders each violated Section 10(b) of the Exchange Act
6 and Rule 10b-5 (a) and (c) promulgated thereunder.

7 **THIRD CLAIM FOR RELIEF**

8 **Violations of Section 10(b) of the Exchange Act and**

9 **Rule 10b-5 (b) Promulgated Thereunder**

10 **[15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5(b)]**

11 **(Against Defendant FMC)**

12
13 54. Paragraphs 1 through 47 of this Complaint are hereby restated and
14 incorporated herein by reference.

15 55. Defendant FMC, directly or indirectly, by using any means or
16 instrumentality of interstate commerce, or of the mails, or of any facility of any
17 national securities exchange, in connection with the purchase or sale of any security,
18 with scienter, made an untrue statement of a material fact or omitted to state a
19 material fact necessary in order to make the statements made, in the light of the
20 circumstances under which they were made, not misleading,

21 56. By reasons of the foregoing, Defendant FMC violated Section 10(b) of
22 the Exchange Act and Rule 10b-5(b) promulgated thereunder.

23 **PRAYER FOR RELIEF**

24 WHEREFORE, the SEC respectfully requests that this Court enter a final
25 judgment:

26 A. permanently enjoining each of Defendants FMC, Zirolì Sr., Zirolì Jr.,
27 Dong, Vargas, Lehrer, and Sanders from violating Section 17(a) of the Securities Act
28 [15 U.S.C. §77q(a)];

1 B. permanently enjoining each of Defendants FMC, Zirola Sr., Zirola Jr.,
2 Dong, Vargas, Lehrer, and Sanders from violating Section 10(b) of the Exchange Act
3 and Rule 10b-5 promulgated thereunder [15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-
4 5];

5 C. ordering Defendants FMC, Zirola Jr., and Sanders to pay disgorgement
6 of ill-gotten gains from the scheme, plus pre-judgment interest;

7 D. ordering each of Defendants FMC, Zirola Sr., Zirola Jr., Dong, Vargas,
8 and Lehrer to pay a civil penalty pursuant to Section 20(d) of the Securities Act [15
9 U.S.C. §77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. §78u(d)];

10 E. ordering that each of the Defendants Zirola Sr., Zirola Jr., Dong, Vargas,
11 Lehrer, and Sanders, pursuant to Section 21(d)(2) of the Exchange Act [15 U.S.C.
12 § 78u(d)(2)] and Section 20(e) of the Securities Act [15 U.S.C. § 77t(e)], be
13 prohibited from acting as an officer or director of any issuer that has a class of
14 securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or
15 that is required to file reports pursuant to Section 15(d) of the Exchange Act [15
16 U.S.C. § 78o(d)]; and

17 F. granting such other relief as the Court deems just and appropriate.

18
19 Dated: May 31, 2016

Respectfully submitted,

20
21 /s/ Dugan Bliss

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