WASHINGTON -- An unusual alliance of mortgage bankers and consumer groups is criticizing a planned $3.4 billion program to compensate Mississippi victims of Hurricane Katrina, saying the grants of as much as $150,000 carry virtually no restrictions.

The Department of Housing and Urban Development is taking the heat because it advised Mississippi officials to give homeowners wider discretion than usual in spending the federal grants intended for rebuilding homes. Critics say the new, relaxed rules are an invitation to fraud and abuse, and nothing would stop recipients from gambling away the grant money.

"Once someone goes and loses all their money in a casino, a scandal will unfold," said Anne Canfield, executive director of the Consumer Mortgage Coalition, which represents mortgage-servicing companies.

The dispute involves a HUD-approved state program funded by $3.4 billion in federal taxpayer money. The funds, which have been appropriated, will be distributed directly to an estimated 30,000 Mississippi homeowners who live outside a flood zone and suffered flood damage.

Standard practice in rebuilding homes after natural disasters is for lenders -- not homeowners -- to handle the money from grants or insurance payments in escrow accounts. The lenders pay the contractors only after repair work has been completed and satisfies mortgage obligations. Mortgage bankers say that it is in the interest of both lenders and residents to rebuild homes whenever possible as a way to maintain neighborhood housing values.

The traditional system has shortcomings, as evidenced by the 1,000 complaints Mississippi and Louisiana regulators have received from homeowners who reported they have had trouble getting banks to release insurance-claim funds. Because the names of policyholders and mortgage lenders are printed on claim checks, homeowners must turn over the money to lenders. After mortgage obligations are subtracted, insurers are supposed to forward the remaining money to policyholders without delay.

In the new Mississippi program, the money is given directly to homeowners. Lenders worry that some borrowers might leave the state without paying off mortgages and repairing homes, and consumer groups say their concern is homeowners will be ripped off by unscrupulous contractors.
One reason for concern: Government officials found that thousands of state residents fraudulently obtained emergency grants from the Federal Emergency Management Agency immediately after last year's hurricane.

"The [traditional] process in general insulates the consumer from predatory practices from contractors, who are minimally regulated," according to an April 3 letter to HUD Secretary Alphonso Jackson signed by 13 consumer, relief and civil-rights groups. Mortgage-banking trade groups also sent similar letters to state officials.

Alliance members say the program was developed when HUD regional-office officials advised the state to adopt a cash-payout plan as a way to get money quickly to homeowners and get around various environmental rebuilding reviews, which the federal agency said it had the authority to waive. Later, it turned out that HUD doesn't have authority to waive most of the environmental restrictions.

Brian Sullivan, a HUD spokesman in Washington, said that the state made its own decision on the best approach for distributing the grant money and that "fears [of potential fraud and abuse] may be unfounded."

"HUD recommended a compensation program that would have potentially lessened some environmental regulations, but it was not the case," said Scott Hamilton, a spokesman for the Mississippi Development Authority, which administers the program. Mr. Hamilton added that state officials selected the cash-payment system as a way to "get as much money as possible in the hands of homeowners as quickly as possible."

The state is offering fraud-prevention advice to grant recipients. In addition, qualified Mississippi homeowners have the option of requesting that their lender assist them in paying contractors by placing the grant money in escrow.