



Curbing Mortgage Fraud: Proactive Strategies

WHITE
PAPER



This white paper is provided solely for general informational purposes and presents only summary discussions about the topic(s). The white paper does not represent legal advice as to any factual situation; nor does it represent an undertaking to keep readers advised of all relevant developments. Readers should consult their attorneys, compliance departments and other professional advisors about any questions they may have as to the subject matter of the white paper.

Table of Contents

Measuring the Problem of Mortgage Fraud.....	3
A Perfect Storm.....	4
The Players.....	4
Identity Risk Management.....	6
Available Mortgage Fraud Data.....	7
Looking Ahead.....	8
Mortgage Fraud Types.....	9
Mortgage Fraud Indicators.....	11
Conclusion	11
About ChoicePoint.....	12
About MARI.....	12

Measuring the Problem of Mortgage Fraud

Mortgage fraud is a vast and growing problem. It seems to grab headlines nearly every day, yet it can be difficult to visualize just how pervasive and costly it has become:

- In March of 2008, the Federal Bureau of Investigation (FBI) was investigating more than 1,200 mortgage fraud cases, representing “a 50 percent increase from the level recorded in fiscal year 2006.”¹
- Approximately half of the mortgage fraud cases under investigation report losses exceeding \$1 million, and a number exceed \$10 million.²
- The number of suspicious activity reports (SARs) submitted relating to mortgage loan fraud increased 1,411 percent from 1996 to 2005.³
- During 2008, federally regulated lenders are expected to file more than 60,000 mortgage-related SARs, with roughly 15,000 already filed in the first quarter.⁴
- Losses from mortgage fraud could reach \$2.5 billion in 2008, and comparable losses are expected for each of the next few years.⁵

These statistics support the idea that mortgage fraud could have played a role in the current market turbulence and financial crisis in the sub-prime mortgage industry, contributing to the downfall of major financial institutions. For example, Bank of America was able to purchase Countrywide Home Loans “on the cheap”.⁶ An investor consortium led by Fort Worth-based TPG is reportedly in advanced talks to buy a minority stake in Washington Mutual, and JPMorgan Chase is well into a government-brokered purchase of Bear Stearns, “another victim of the mortgage meltdown.”⁷

But, these scenarios are the tip of the iceberg. Mortgage fraud and the mortgage crisis can impact international financial markets. During 2007 in Germany alone, two banks received emergency funding as a result of failed investments in the souring U.S. mortgage-backed securities market. One of the banks, Sachsen LB, had exposure that was more than 10 times its core capital and more than one-fourth of its total assets.⁸

¹ FBI: Mortgage Fraud Cases Up 50%, *National Mortgage News*, Daily Briefing, March 6, 2008, <http://www.nationalmortgagenews.com/premium/archive/?ts=1204822811> (April 3, 2008).

² Ibid.

³ Financial Crimes Enforcement Network (FinCEN), “FinCEN Assessment Reveals Suspected Mortgage Loan Fraud Continues to Rise,” November 2006, http://www.fincen.gov/mortgage_fraud.html, (April 2, 2008).

⁴ Anticipating 60,000 Mortgage SARs in FY, *National Mortgage News*, Daily Briefing, March 17, 2008, <http://www.nationalmortgagenews.com/premium/archive/?ts=1205769606>.

⁵ National Mortgage News, Daily Briefing, Weekend Edition: News Recap, 3/28/2008, Mortgage Fraud Losses Forecast at \$2.5B, <http://www.nationalmortgagenews.com/weekend/fullnews.html>, (April 4, 2008).

⁶ Associated Press, “Bank of America to acquire Countrywide,” *msnbc Business*, Jan 11, 2008, <<http://www.msnbc.msn.com/id/22606833/>>, (9 Apr 2008).

⁷ Hamilton, Walter, “Angels come to WaMu’s rescue,” *Los Angeles Times*, Apr 8, 2008, <<http://www.latimes.com/business/investing/la-fi-wamu8apr08,1,5031597.story>>, (9 Apr 2008).

⁸ *The New York Times*, “Mortgage Crisis Forces Sale of German Bank,” August 27, 2007. <http://www.nytimes.com/2007/08/27/business/worldbusiness/27german.html>

A Perfect Storm

An analysis of how the industry reached this point shows a proverbial “perfect storm” of factors, some of which include:

- Rising real estate values during the past few years which led some individuals to attempt purchases before they had adequate resources to pay for the investment.
- Hoping for continuing increases in property values, investors speculated on real estate, and some investors falsified applications to obtain multiple properties.
- Unscrupulous professionals or industry insiders who have keen knowledge of the origination process took advantage of the system in an effort to defraud their lender partners by falsifying borrower documentation or even creating false loan applications.
- Credit standards were frequently lowered, and documentation requirements were either relaxed or not inspected during a period where transactions occurred at a frenzied pace.
- Tempted by get-rich-quick schemes, fraudsters pursued roles in the real estate origination process lacking knowledge, licenses and credentials, yet represented themselves as “professionals.”
- Motivated by greed, unethical industry professionals jumped at the opportunity, in many cases initiating multiple fraudulent activities, in the hope that loan irregularities would be lost in the volume or hidden by a profitable sale on the collateral.⁹

The mortgage fraud problem was not born during the most recent real estate boom, but it certainly has grown monetarily and geographically as a byproduct. In the United States, Florida remains the leading state in mortgage fraud, but the crime is becoming more evenly spread among all states instead of being concentrated in just a few. Following Florida in order of severity are: Nevada, Michigan, California, Utah, Georgia, Virginia, Illinois, New York and Minnesota.¹⁰

The Players

One way to classify fraud is to look at the underlying motivation. In fraud for property, information about the buyers is falsified in order to make sure they qualify for the mortgage. By misrepresenting their income, for example, they may qualify for a more expensive home. These buyers typically do not expect to gain pocket cash, although cash back features may provide the borrowers’ down payment—or increase it for a lower interest rate.

Fraud for profit, which accounts for as much as 80 percent of all mortgage fraud,¹¹ occurs when the underlying motivator is cash. It typically involves collusion of so-called “professionals” in the mortgage industry, and it is typically those same professionals who abscond with the cash, leaving the buyer to face problems in the future. One way a lender can help protect itself is to

⁹ Ibid.

¹⁰ 2008 Mortgage Asset Research Institute, LLC, “Tenth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association,” March 2008, <http://www.marissolutions.com/pdfs/mba/mortgage-fraud-report-10th.pdf>.

¹¹ Federal Bureau of Investigation, “Financial Crimes Report to the Public, Fiscal Year 2006,” www.fbi.gov/publications/financial/fcs_report2006/publicrpt06.pdf.

better know its vendors, and limit all business dealings with real estate and mortgage professionals to those who have passed a credentialing process, including verification of licenses.

Each day, it seems, new reports of brazen mortgage fraud surface in the nation's media. The following are a few examples of activities occurring across the country.

In the Northern Virginia suburbs of our nation's capital, an allegedly unscrupulous real estate investor, notary and title company colluded to defraud two individuals and a pension fund. In one case in particular fraudsters forged the unwitting property owners' driver's licenses, and used the stolen identities to obtain a deed to the property. The pension fund, which covers 1,200 workers, unwittingly financed a total of \$2 million in loans for the two properties. In addition, a loan company advanced exorbitant loans, and is now bankrupt.¹²

In Dallas, a real estate appraiser and seven individuals allegedly colluded to defraud Countrywide Home Loans of millions of dollars through fraudulent applications and inflated appraisals for residential homes. The individuals were paid for the use of their names and good credit, acting as "straw buyers" — persons through whom others would be allowed to obtain financing. More than 18 homes were included in the scheme in which the straw purchasers procured home equity lines of credit (HELOCs) in amounts between \$750,000 and \$1.9 million.¹³

In New Jersey, 13 people were indicted and seven more pled guilty in a \$20 million HELOC scheme. The individuals included loan brokers and clients of the loan brokerage company who obtained multiple HELOCs in excess of the value of the properties used as security. One individual used less than \$300,000 of equity in a property to obtain \$2.1 million in credit from nine different banks. The loan brokerage company assisted by misrepresenting its clients' income and submitting falsified tax returns to create the illusion that the applicants would be able to repay the loans.¹⁴

What do the examples have in common? Lenders are being deceived through:

- Fraudulent use of another's identity
- Application fraud
- Collusion involving an industry professional

Mortgage fraud has far-reaching impact. Fortunately, lenders have a growing pool of resources which can be used to combat these types of mortgage fraud.

¹² Lengel, Allan, *The Washington Post*, March 13, 2008, www.washingtonpost.com/w-p-dyn/content/article/2008/03/12.

¹³ "Countrywide Scammer Goes to Jail," *Originator Times*, January 30, 2008. <http://originatortimes.com/content/templates/standard.aspx?articleid=2800&zoneid=5>.

¹⁴ www.bankinfosecurity.com/regulations.php?reg_id=599, January 25, 2008.

Identity Risk Management

A large proportion of mortgage fraud is rooted in misrepresentations about the identity of individuals involved in the origination process, including agents, buyers, lenders, brokers, appraisers, etc. Lenders can mitigate their risk by adopting effective Identity Risk Management (IRM) programs. IRM solutions typically access and examine multiple data sources and allow a lender's employees to research customers, employees and vendors quickly through screening processes. An IRM program would assist lenders in knowing – truly knowing—the people with whom they choose to do business.

Most financial institutions implemented Customer Identification Programs (CIP) as a result of USA PATRIOT Act compliance. In addition, many developed Know Your Customer (KYC) programs to help understand both the opportunities and risks associated with their customers.

Recently, the Federal Trade Commission and the federal banking regulatory agencies introduced regulations requiring financial institutions and creditors to develop written identity theft prevention programs designed to detect, prevent and mitigate identity theft in connection with the opening of a covered account or any existing covered account.¹⁵ The rules, known as the ID Theft Red Flag Rules, call for a risk-based compliance program to be in place by November 1, 2008, on covered accounts. The definition provides examples to illustrate that these types of accounts include:

- Credit card
- Mortgage loan
- Auto loan
- Margin
- Cell phone
- Utility
- Checking
- Savings
- Any other account for which there is a reasonably foreseeable risk from identity theft¹⁶

Compliance activities already being performed can be leveraged for IRM through technology tools, and the results can prove extremely valuable in addressing a buyer's role in potential mortgage fraud. However, a financial institution's vulnerability to mortgage fraud extends beyond the borrower. As described above, mortgage fraud often involves collusion between other parties to the origination process, including brokers, appraisers, real estate agents, closing agents and lending personnel. When collusion does occur, the resulting losses tend to be greater.

Mortgage bank employees can be particularly valuable to organized fraud rings because of their knowledge of and access to personal information and system controls. By sharing profits with employees, criminals can gain information about an enormous number of people. For example,

¹⁵ Federal Trade Commission, et al., "Identity Theft Red Flags and Address Discrepancies under the Fair and Accurate Credit Transactions Act of 2003", *Federal Register*.

¹⁶ *Ibid.*

some fraud rings prey on property owners who are approaching foreclosure, and a list of at-risk customers could prove valuable. “Foreclosure rescue” scams take advantage of the fears of property owners facing foreclosure. But rather than providing a legitimate solution to their credit worries, homeowners risk losing their homes to the fraudsters.

Likewise, the use of third-party vendors as service providers can increase a lender’s exposure to mortgage fraud. Exposure to these risks can be reduced through proper IRM solutions, enabling lenders to credential customers, employees and vendors who meet established qualifications that the lender themselves create.

Available Mortgage Fraud Data

Collaborative information exchanges can be extremely valuable when lenders use them to compare information about the various parties involved in any given loan. The Mortgage Industry Data Exchange[®] (MIDEX[®]) has assisted mortgage lenders, agencies and insurers for more than a decade by providing a central database of voluntarily submitted information about incidents of fraud and material misrepresentation. Subscribers use MIDEX to help reduce mortgage fraud by performing background checks on mortgage companies and professionals as part of the business credentialing process. The Mortgage Asset Research Institute[™] (MARI[™]), a ChoicePoint service, also uses this data to obtain and report statistics on a wide range of mortgage fraud characteristics.¹⁷

In addition, the FBI compiles data about mortgage fraud through SARs filed by federally-insured financial institutions and the Department of Housing and Urban Development.¹⁸ Information shared during law enforcement investigations can be indispensable to successful prosecutions of fraudsters.

Effective technological tools exist to assist financial institutions and creditors with Identity Risk Management and mortgage fraud. ChoicePoint provides a comprehensive suite of IRM solutions designed to help organizations manage multiple risks and efficiently respond to compliance needs, including the new Red Flag rules.

ChoicePoint’s IRM tools can help battle fraud and achieve compliance goals by:

- Uncovering address discrepancies and identifying high-risk addresses
- Conducting phone number checks and providing alerts for invalid numbers
- Verifying Social Security numbers (SSNs) for living individuals
- Flagging mismatches between date of birth and SSN
- Performing online authentication quizzes through the call center or interactive voice response (IVR)
- Leveraging biometrics
- Performing due diligence

¹⁷ 2008 Mortgage Asset Research Institute, LLC, “Tenth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association,” March 2008.

¹⁸ Federal Bureau of Investigation, “Financial Crimes Report to the Public, Fiscal Year 2006,” www.fbi.gov/publications/financial/fcs_report2006/publicrpt06.pdf.

In addition, MARI has released its new MARI Loan Fraud Alert Service (LFAS). The tool enables lenders to better know with whom they are doing business and if there are potentially fraudulent relationships between vendors and customers. LFAS is a mortgage industry-contributed loan database that enables lenders and investors to identify potential application risk, fraud patterns and hidden relationships among transaction parties. By incorporating LFAS, lenders now have the ability to compare data against other contributing lenders' loan data.¹⁹

LFAS compares a lender's loan data, such as borrower, collateral and professional information, against industry-submitted loan application data obtained during the origination process. This comparison identifies seven different fraud patterns, including:

- Multiple closings for a single borrower
- Undisclosed second escrows or mortgages for the same property
- Inflated appraisals and documented closing activity for the same property within a short timeframe
- Multiple loan applications for the same property²⁰

The goal of LFAS is to prevent fraud and identify application discrepancies early in the origination process before it impacts a lender's loan portfolio. By helping to identify risk at the earliest stages, lenders can also improve their quality control processes and reduce redundant application reviews.²¹

Looking Ahead

Professional fraudsters will devise new and creative schemes to exploit the weaknesses in the loan origination process, and they will continue to use technology to their advantage. Mortgage fraud perpetrators often have technology as good as, or better than, many lenders. A large number of Web sites have already popped up on the Internet that enable unscrupulous individuals to create false names, boost credit scores, rent assets and create false documentation. Some fraudsters use technology to share information about vulnerabilities in the mortgage industry.

Mortgage fraud is expected to continue at high levels in the current weakened economy.²² Banks and other financial institutions can reduce their exposure by understanding and deploying the latest available IRM solutions. Lenders should trust customers, vendors and employees only after verification and appropriate credentialing. Financial organizations offering mortgages will benefit from automated IRM solutions to help mitigate the many risks and potential losses associated with mortgage fraud.

¹⁹ *National Mortgage News*, March 26, 2008, www.nationalmortgage.com/fraud/stories.?storyid=20080326c.htm.

²⁰ *Ibid.*

²¹ *Ibid.*

²² *National Mortgage News*, Daily Briefing, Weekend Edition: News Recap, 3/28/2008, Mortgage Fraud Losses Forecast at \$2.5B, <http://www.nationalmortgage.com/weekend/fullnews.html>, (April 4, 2008).

Mortgage Fraud Types

The following examples of common mortgage fraud schemes are based on descriptions in the Federal Bureau of Investigation's Financial Crimes Report to the Public, Fiscal Year 2006.²³

Property Flipping

Property is purchased, falsely appraised at a higher value, and then quickly sold. For example, a home worth \$20,000 may be appraised for \$80,000 or higher in this type of scheme. What makes the transaction illegal is that the appraisal information is fraudulent. These schemes typically involve fraudulent appraisals, doctored loan documentation, inflated buyer income, and/or kickbacks to buyers, investors, property/loan brokers, appraisers, title company employees, etc.

Solution: The MARI Loan Fraud Alert Service (LFAS) can help identify when a property has been appraised at a much higher value in a relatively short period of time, intended buyers and sellers of the property and when loan originators and appraisers may be working together to defraud lenders.

Silent Second

The buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.

Solution: MARI LFAS helps identify an undisclosed second escrow or mortgage for the same property.

Nominee Loans/Straw Buyers

The identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.

Solution: MARI LFAS reveals aliases associated with the borrower's Social Security Number and name. Additionally, ChoicePoint Authentication quizzes can complement verification processes by using out-of-wallet data to authenticate true loan applicants.

Fictitious/Stolen Identity

A fictitious/stolen identity may be used on the loan application. The applicant may be involved in an identity theft scheme: the applicant's name, personal identifying information and credit history are used without the true person's knowledge.

Solution: ChoicePoint Authentication tools help verify that an identity exists, and authentication quizzes leverage out-of-wallet data to help authenticate the true owner of an identity, verifying that an identity belongs to the loan applicant.

²³ Federal Bureau of Investigation, "Financial Crimes Report to the Public, Fiscal Year 2006," www.fbi.gov/publications/financial/fcs_report2006/publicrpt06.pdf.

Inflated Appraisals

An appraiser acts in collusion with a loan originator and provides a misleading appraisal report to the lender. The report inaccurately states an inflated property value.

Solution: MARI LFAS can help identify potentially fraudulent relationships between all parties in the transaction, as well as the exclusive use of a single appraiser. It can also help identify when a property has been appraised at a much higher value in a relatively short period of time.

Foreclosure Schemes

The perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. Perpetrators mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The perpetrator profits from these schemes by remortgaging the property or pocketing fees paid by the homeowner.

Solution: ChoicePoint's Web-based solutions can help lenders who ultimately provide the subsequent mortgage for the perpetrator, acting as a professional on behalf of the homeowner, with swift ability to investigate real property ownership and history, as well as the ability to identify prior foreclosure properties. Solutions can also help by performing background checks on mortgage companies and professionals as part of the business credentialing process.

Air Loans

This is a non-existent property loan where there is usually no collateral. An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.

Solution: ChoicePoint Authentication tools help verify that an identity exists. Subscribers use MARI MIDEX to help reduce mortgage fraud by performing background checks on mortgage companies and professionals as part of the business credentialing process. ChoicePoint offers several methods of accessing public filing information that assists with the due diligence of real property existence, property ownership and borrower identity authentication.

Mortgage Fraud Indicators

Risk managers and compliance personnel often ask for lists of mortgage fraud indicators. The following list is based on the Federal Bureau of Investigation's Financial Crimes Report to the Public, Fiscal Year 2006:²⁴

Inflated Appraisals

- Exclusive use of one appraiser

Increased Commissions/Bonuses — Brokers and Appraisers

- Bonuses paid (outside or at settlement) for fee-based services
- Higher than customary fees

Falsifications on Loan Applications

- Buyers told/explained how to falsify the mortgage application
- Requested to sign blank application

Fake Supporting Loan Documentation

- Requested to sign blank employee or bank forms
- Requested to sign other types of blank forms

Purchase Loans Disguised as Refinance

- Purchase loans that are disguised as refinances (requires less documentation/lender scrutiny)

Investors-Short Term Investments with Guaranteed Re-Purchase

- Investors used to flip property prices for fixed percentage
- Multiple "Holding Companies" utilized to increase property values

Conclusion

Mortgage fraud continues to increase in the current economy, forcing lenders and investors to balance the need to drive revenue and protect against preventable losses. While mortgage fraud schemes vary, they all have one primary thing in common: mortgage fraud is committed by individuals. Performing identity verification and due diligence on the people with whom you choose to do business can help mitigate fraud-associated losses and uncover hidden relationships between individuals working together to commit mortgage fraud.

ChoicePoint and MARI provide real estate lending institutions with Identity Risk Management solutions that help mitigate fraud and reduce risk with Know Your Customer, Know Your Employee and Know Your Vendor tools. These services aid in preventing several types of fraud unique to the mortgage industry, including fraud-for-profit, fraud-for-housing and identity fraud.

²⁴ Ibid.

MARI also provides tools to help conduct due diligence, credential vendors and even perform loss mitigation efforts.

Visit www.MARISolutions.com today—read more about ChoicePoint MARI’s several solutions for the mortgage industry. Or request your free product “walk through” of the MARI Loan Fraud Alert Service at www.MARISolutions.com/LFAS/.

About ChoicePoint

ChoicePoint (NYSE: CPS) provides businesses, government agencies and non-profit organizations with technology, software, information and marketing services to help manage economic and physical risks as well as identify business opportunities. Consumers have free access to the reports we create at www.ChoiceTrust.com. Learn what we do to protect consumer privacy by visiting www.PrivacyatChoicePoint.com and, for more information on our company, go to www.ChoicePoint.com.

About MARI

MARI, a ChoicePoint service, is a leading provider of information services to the Financial Services industry, to provide innovative solutions and expand upon fraud fighting services that include the Mortgage Industry Data Exchange (MIDEX®). MARI developed MIDEX as a powerful weapon used to defend its subscribers against mortgage fraud and the perpetrators of fraudulent schemes. Since 1990, MARI has grown to become an industry recognized leader and premiere provider of information solutions about mortgage professionals and companies. Learn more at www.MARISolutions.com.

ChoicePoint® is a LexisNexis® Company.

Copyright © 2008 ChoicePoint Asset Company LLC. All Rights Reserved.