



12020 Sunrise Valley Drive
Suite 360
Reston, Virginia 20191
Tel: (703) 620-6262
Fax: (703) 620-9587

**CASE REPORT TO
MORTGAGE BANKERS ASSOCIATION OF AMERICA**

By

**D. James Croft
William H. Matthews
Catherine B. Montero**

Mortgage Asset Research Institute, Inc.

December 2001

**ANNUAL REPORT TO
MORTGAGE BANKERS ASSOCIATION OF AMERICA**

Report Summary

As the mortgage industry races toward a record-setting year for loan originations, it is also experiencing an increase in reported mortgage fraud. As the economy slows, additional cases are likely to surface at a rapid rate.

This is the fourth annual report by the Mortgage Asset Research Institute, Inc (MARI) to MBA members. The reports examine the current composition of mortgage fraud in the United States. The highlights of this report are as follows:

- Though underreported, appraisal fraud is the fastest growing fraud reported by major lenders in the country today.
- Historically, California and Florida have led the nation in cases of mortgage fraud; however, this year it appears that California has lost its hold on this distinction. Florida continues to have a very high rate, and problems are surging in several intermountain states.
- Major industry participants are becoming more comfortable with sharing information about their mortgage fraud experiences.

The body of this report presents information supporting the three conclusions cited above.

Information Sources

For the past six years, major mortgage lenders, agencies and insurers have been submitting information regarding incidents of alleged mortgage fraud to a central database. The database is MARI's Mortgage Industry Data Exchange (MIDEX). MARI classifies the types of alleged fraud involved in each incident. These classifications are shown in Table 1 below.

Table 1 shows the percentage of each fraud classification, as drawn from the information submitted to the central database. For instance, 77% of the incidents of fraud reported to the database for mortgages originated in 1995 contained application fraud. (This is not surprising given the comprehensive nature of the application form.)

Table 1

Mortgage Fraud Trends						
Fraud Classification	Mortgage Origination Year					
	1995	1996	1997	1998	1999	2000
Applications	77%	66%	64%	65%	60%	58%
Tax and Financial Statements	29%	37%	41%	33%	34%	30%
Verifications of Employment	47%	46%	35%	26%	24%	31%
Verifications of Deposit	25%	23%	23%	18%	17%	27%
Escrow/Closing	28%	19%	19%	15%	15%	15%
Appraisals/Valuations	5%	6%	8%	11%	14%	17%
Credit Reports	7%	6%	6%	4%	5%	5%

It is interesting to note that the total percentage for each year (the sum of each column in Table 1) is greater than 100%. This is due to the fact that most reported incidents involve more than one type of fraud.

It should also be noted that the numbers for 2000 are somewhat preliminary. Incidents of fraud in loans originated last year will likely be reported to the database in significant volumes during the next year or two.

Appraisal and Application Fraud

There are two clear trends shown in these numbers. The most obvious is that the amount of appraisal fraud reported, with somewhat lower than expected numbers, has more than tripled in the past six years. The low levels of reporting can be tied to the fact that the typical reported incident involves more than one type of fraud. If the reporting lender finds misrepresentation in the VOE and in occupancy status, that lender is not likely to spend the funds necessary to verify appraisal fraud, even if the appraisal appears to be invalid.

The significant increase in reported appraisal fraud appears to be tied to the rising number of incidents involving property flips. These cases have been heavily reported in the Baltimore-Washington corridor, Georgia, and several Midwest cities such as St. Louis, Milwaukee, Detroit and Chicago.

This rise in reported appraisal fraud is disconcerting in view of the increase in subprime lending. It is an accepted fact that underwriting of subprime loans relies heavily on the value of loan collateral.

The second trend noticeable in the Table 1 is the steady drop in reported application fraud. The authors have discussed this phenomenon with numerous lenders and their quality control departments. There is no consensus as to why this is taking place. Some have suggested, however, that low documentation loans are being submitted without a complete application form. (Most low-doc programs do not allow incomplete applications, but they appear in many programs nonetheless.) It's hard to report fraud on a blank entry.

The clearest overall conclusion we can draw from these trend figures is that, though underreported, appraisal fraud is the fastest growing fraud reported by major lenders in the country today.

Geographic Distribution of Mortgage Fraud

It has long been accepted that California leads the nation in incidents of mortgage fraud. This is true in terms of sheer numbers of cases, and this is to be expected since California is the most populous state in the country.

The authors have included variations in state population figures in their development of the MARI Fraud Index (MFI). The indices for the 15 jurisdictions with the largest numbers of incidents recorded in the MIDEX database over the last six years are presented in Table 2.

Table 2

MARI Fraud Index (MFI) By Year and State						
State	1996	1997	1998	1999	2000	2001
CA	144	106	142	114	136	84
CO	51	51	53	95	89	142
FL	207	227	200	192	124	174
GA	120	83	77	84	89	74
IL	71	65	58	109	89	92
MD	226	139	173	137	131	18
MI	29	53	81	93	113	114
NJ	37	77	89	66	80	91
NY	64	66	56	44	49	30
OH	12	12	22	37	102	90
PA	7	29	19	30	20	8
TX	33	29	30	43	31	38
UT	68	173	80	135	89	270
VA	129	121	76	46	27	41
DC	1003	1010	500	569	297	150

An MFI of 0 indicates no reported fraud. An MFI of 100 indicates that the reported fraud for a state is exactly what one would expect in terms of fraud rates, given its population size (that is, a state with an MFI of 100 is “average”).

These figures should be examined in view of certain limitations. First, it should be noted that Washington, DC, is a city, not a state. Since mortgage fraud tends to be an urban phenomenon, any major city will likely have a large MFI. If we are to compare Washington, DC, to other areas, it should be compared to Los Angeles, Chicago, Atlanta, etc.

Second, the indices for 2001 are based on incomplete information. Their preliminary nature should be taken into consideration.

Even in with these caveats, the indices in Table 2 show some interesting trends and comparisons. Some of the more obvious ones are discussed below.

The most interesting item is that California has had a historically high MFI, but it had the highest in the country only for the year 2000. It is also interesting to note that for the first ten months of 2001, California’s reported fraud rate (MFI = 84) was actually below the average of 100. Of course, this may change as MIDEX participants submit more reports of 2001 mortgage fraud found in California.

Of the reported states, Florida has been in the top three for the past six years (having had the highest rate of mortgage fraud in three of those years). Therefore, Florida is clearly the “leading” state in mortgage fraud, as measured by the MFI.

Maryland has had high rates of fraud over the past several years, but this year’s MFI stands at only 18. This may change as more cases are reported. Many Maryland cases in the past few years have involved property flips, and these may be taking longer to verify than cases found elsewhere.

Colorado and Michigan seem to be the states with the most consistent upward trend, with Colorado experiencing (tentatively) a significant jump in the past 10 months. Virginia appears to be the state with the most consistently declining MFI.

Pennsylvania and Texas make the “Top 15” list as measured by the number of cases reported to MARI, but they are consistently below average in mortgage fraud when the results are adjusted for population size.

Utah’s 2001 MFI (to date) is the highest of all the table entries, excluding Washington, DC. While this number will change as new data about 2001 fraud cases are reported, lenders operating in Utah may wish to increase their vigilance.

The most interesting (and somewhat surprising) conclusions from these data are that California has lost its hold on the distinction of having the highest mortgage fraud rate in the country; Florida continues to have a very high rate; and problems in several intermountain states are surging.

Growth of Information Sharing

For years, many members of the mortgage industry discussed the potential benefits of sharing information about fraud schemes, but efforts in this area were largely unproductive until 1993¹.

In that year, eleven major institutions in the industry² formed a Steering Committee that supervised the research required for such a cooperative effort and developed policies and procedures for operation of the system. However, even some of the Steering Committee members were somewhat concerned about sharing information that described their experiences with fraud.

¹ The immediately preceding years had produced a significant increase in fraud losses for the industry.

² The two largest secondary marketing agencies, the six largest mortgage insurance companies, and three large lenders.

The perceived difficulties associated with this cooperative effort were dissipating in the spring of 1998 when the MBA³ conducted an extensive review and endorsed the fraud information sharing approach established under Steering Committee guidance.

Following this breakthrough, participation rapidly grew to the point where approximately 275 lenders, insurers and agencies are now involved in mortgage fraud information sharing. The lenders in this group accounted for more than 80% of the wholesale lending business in 2000. All of the top 20 lenders (by overall origination volume) for the first half of 2001 are involved.

The results of these cooperative efforts are somewhat startling. The most recent statistics for companies doing due diligence on mortgage industry professionals (brokers, correspondents, appraisers, escrow agents, etc.) show that public and/or non-public information is obtained on 14% of the names researched through this cooperative information sharing system.⁴ The percentages for California and Florida are almost double this figure.

The information about the incidents of alleged mortgage fraud is circulating widely. Participants have reviewed more than 98% of the non-public incidents submitted to this cooperative information-sharing system⁵. Some of the incidents have been reviewed more than 100 times.

Many members of the industry are doing their part to identify mortgage fraud activity, and mortgage lenders are taking important steps to improve the country's lending environment. It is clear, at the close of 2001, that major industry participants are becoming more comfortable with sharing information about their mortgage fraud experiences.⁶

³ Under the leadership of Marc C. Smith

⁴ The split between non-public information contributed by participants and the public enforcement actions is 7% for each category.

⁵ When this figure was measured, cases had been in the database anywhere from a few days to more than six years, making the 98% figure all the more significant.

⁶ Other periodic MBA reports about mortgage fraud can be found at www.mari-inc.com under the button labeled "About MARI."