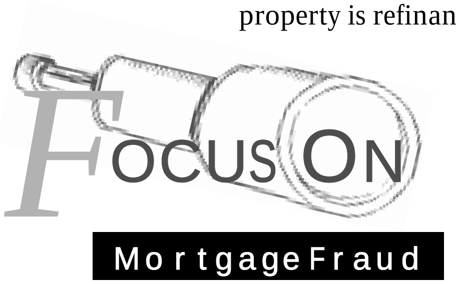
Industry skullduggery: Understanding the who, what, where, when and how of mortgage fraud

Mortgage fraudsters can sometimes be like magicians. With several sleight-of-hand maneuvers, some well-placed mirrors and a few puffs of smoke, they can trick everyone from consumers to mortgage lenders into believing their illusions.

Unfortunately, title agents often end up as unwitting participants in the fraud, getting pulled into court battles and, in the end, scrambling to repair a tarnished reputation.

According to Stephen Gott, CEO and chairman of AppIntelligence Inc., mortgage fraud has gotten so bad that "it's epidemic. It is so significant that I'm not sure all the lenders have identified the depth to which it's occurring."



Rachel Dollar, partner at the mortgage fraud litigation practice of Dollar & Graves, LLP, concurred, but also specified that "while industry sources estimate that 5 to 10 percent of all mortgage loan applications contain some type of fraud or misrepresentation, investors are looking at severity as an increasingly important metric. A catastrophic loss may involve only a small number of loans, but create high loss exposure."

Those "industry sources" Dollar mentioned were also cited at the recent hearing on mortgage fraud held by the House Subcommittee on Housing and Community Opportunity on Oct. 6. At the hearing, Chris Swecker, assistant director of the criminal investigative division of the FBI said, "Based on industry reports and FBI analysis, mortgage fraud is pervasive and growing."

Another witness at the hearing, William Matthews, vice president and general manager of the Mortgage Asset Research Institute (MARI), agreed. "Mortgage fraud is a significant problem," he said. "Based on submissions to MARI's database, it is not only increasing, but the types of fraud are becoming more severe."

The cozener's bag of tricks

As front line witnesses at the closing table, agents sometimes are the first ones to spot the red flag. But recognizing schemes requires some understanding of what methods of fraud or out there.

Both Dollar and Gott agreed that property flipping is one of the most prevalent and damaging forms of mortgage skullduggery out there.

Dollar went on to identify more of the "popular schemes" she has witnessed occurring in the industry, one being fraudulent reconveyance and sale. "The perpetrators record falsified documents indicating that a property has been sold and the mortgage has been paid off when, in fact, the true owners continue to own and occupy the property. Shortly thereafter, the property is refinanced with cash out to the new owner. This scheme is usually not discovered until the true owners are facing foreclosure of the loan."

Down payment/equity scams, are also on the rise, Dollar noted. "The sales price is inflated by the amount of the lender-required down payment. The down payment proceeds are either contributed by the seller (and received back through the loan proceeds), or are returned to the borrower at the close of the transaction. In some scams, the borrowers are promised the return of their investment either at close or through repairs to the property, and this is not received."

Dollar also discussed chunking scams, wherein "a company recruits borrowers by telling them that they can be 'landlords' or own investment properties. The company will locate the properties, arrange for the loans, find tenants for the property, manage the property, remit the payments on the loan to the lender and, in a year, will sell the property at a profit on behalf of the borrower/investor. The borrower often never sees the property prior to purchase. The company often receives a cash 'commission' from the closing (often disguised as rehabilitation or remodel costs). The company does not place tenants, does not make the mortgage payments and does not arrange for the sale of the property. The borrowers are left with properties that are not worth the amount of the mortgages and with no knowledge of how to rent or sell the properties."

Lackadaisical lenders?

With fraud numbers increasing, the FBI recently announced Operation Continued Action, the bureau's largest nationwide enforcement action directed specifically at mortgage fraud—but what are the lenders doing?

Not enough, said Gott. "A lot of lenders perceive this as the cost of doing business and are not realizing how much they could have saved if they'd spotted it earlier in the origination process. Unless companies take it seriously and realize that the write-offs that they have could easily be dropped, it's going to continue to grow rampantly," he said.

He continued by estimating that roughly 97 percent of the industry is still lagging behind in terms of fraud protection and detection.

Similarly, Dollar said, "We recently recovered a million-dollar plus loss for a lender because they moved early in the fraud scheme — but we saw other lenders injured in that scheme that did not move early and were therefore less able to recover, or recovered nothing at all. Early identification is everything."

Gott's company, AppIntell, represents the growing group of companies aimed specifically at providing early fraud detection software to mortgage lenders. In emphasizing the importance of his product, he said, "You have to realize that mortgage fraud only becomes fraud after the loan closes and the money changes hands. If you turn the app down before it closes, then it's not fraud. It's fraud in that they tried to commit fraud, but the actual dollar amount never happened. That's why our business has positioned itself to concentrating on stopping it at the front-end."

According to Dollar, companies really should "employ pre-funding, due diligence measures and provide training to underwriters and other pre-funding staff." She emphasized, "Closing instructions are key, and should always require that the settlement agent notify the lender of certain conditions indicating a flip transaction."

Additionally, she noted, "On the back end, auditing EPD loans can identify fraud schemes early so that continued funding of loans within a scheme can be halted. Also, lenders should look at their closing protection letter policies for states that allow them. CPL's generally require a lender's countersignature before they are effective. While it is possible to avoid denials of coverage because a lender has failed to countersign a CPL, it is a move in the right direction to protect the lender."

Gott described AppIntell's fraud protection technology by saying, "In 10 seconds we can take an entire mortgage application and with greater than 85 percent probability, we will find the fraud before they close the loan and are stuck with it. We provide 350 checks with the mortgage loan and those 350 checks cover every part of the mortgage application."

Additionally, Gott spoke about the history of fraud protection technologies, saying that they have "probably surfaced maybe in the last two years." And why has it taken so long? Gott said, "It is only now that most mortgage companies have converted to standard loan origination systems whereby all of the mortgage applications are entered into a system that can electronically connect to companies like myself."

He continued, "What happens is that since all of these loan origination systems are now liberated throughout the mortgage industry, it's much easier to get a direct data feed on a mortgage application sent to us, where we then take that data, go out to all types of depositories and check people's credit, check the house comps—it's all done electronically."

Thus, "It's only with the fast data connection, the Internet and the standardization of loan origination systems that's brought technology for protection," Gott said.

Education is key

However, he also noted that, along with developing new and better fraud technology, educating lenders on fraud was important as well. Gott said that AppIntell teaches fraud prevention for the MBA, as well as the CIA and FBI with training on mortgage fraud.

Dollar is also active on the education end. "As a product of seeing hundreds of schemes each year, we often present a 'Lessons Learned' symposium after large fraud schemes get resolved—so that lenders can morph their practices to avoid catastrophic losses."

And it appears that while lenders are learning some of those lessons, too many of them are doing it the hard way. Nevertheless, Dollar said, "Lenders are getting smarter. If investors can identify particular schemes early, and design a recovery strategy — they can shorten the lifespan of that scheme and lower their exposure."

So what has caused the mortgage fraud problem to snowball? Can legislators do anything about it? What can agents do to protect themselves from the schemes out there? And with everyone in the industry blaming each other for the perpetuation of mortgage fraud, who really has the greatest ability to minimize the damage? Will answer these questions and more in the next edition of *The Legal Description*. ■