

Lenders Pressed on Fraud-Prevention Efforts

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By [Erick Bergquist](#)

Discovering that a brokered loan you funded was fraudulent may seem like its own punishment, but regulators and law enforcement agencies have begun cracking down on lenders and others high in the mortgage food chain for doing too little to prevent third-party fraud.

A [recent example](#) is the Sept. 6 cease-and-desist order from the Georgia Department of Banking and Finance signed by Argent Mortgage Co. LLC, the wholesale unit of ACC Capital Holdings (which also owns Ameriquest Mortgage). Several industry observers said the order stands out for its specific underwriting instructions.

Rick Tangum, a mortgage division attorney for the department, said the order established the minimum requirements for staying within his agency's good graces on fraud detection and prevention - not only for Argent but for the rest of the industry.

If the department finds that another lender violates one of the laws or rules it enforces, and that the lender's fraud measures fall short of the practices the order laid out, the lender could face similar orders, depending on the severity of their lapses, Mr. Tangum said.

Though minimum standards in the form of the order are "not as strong" as an actual agency rule, he said, they have the same effect, and "we expect ... [lenders] to live by" the standards. Mr. Tangum said he was unsure whether they would eventually be made into a rule.

The Georgia order includes no fines.

Adam Bass, the senior executive vice president of ACC Capital, said: "What we see is that the industry and our regulators and everyone involved in the process need to work together for our joint goal of eradicating the problem.

"Mortgage fraud is an issue of concern at the national level ... and we have the shared goal with all responsible parties to find it, fight it, stop it, wherever it occurs," he said.

"This is a broad, industrywide issue, and we are happy to be at the forefront of continuously working to eradicate the problem."

The order was at least the second time this year an agency has cited a lender for inadequate fraud controls. In March, Option One Mortgage Corp. agreed to reform its practices and pay \$100,000 to Philadelphia-area community groups after a U.S. Attorney's Office investigation found the H&R Block unit had funded fraudulent loans for Pennsylvania brokers.

This summer the Office of Federal Housing Enterprise Oversight finalized a rule that requires

Fannie Mae and Freddie Mac to report frauds and "possible frauds" to the safety-and-soundness regulator soon after they become suspicious.

Laurence Platt, a partner with the Washington office of the law firm Kirkpatrick & Lockhart Nicholson Grant LLP, said that in both the Argent and Option One cases, "regulators seem to be criminalizing sloppiness, the mere fact that the lender itself didn't engage in any illegal or fraudulent activity but it failed to discern either [that] the broker was ineligible or the loan itself had deficiencies."

There has been a "troubling trend" of regulators taking the view that "a lender should have known" when fraud occurred on any of its loans, he said; the two areas where this attitude appears most frequently are appraisals and stated-income loans.

The Georgia order gives Argent firm instructions with respect to stated-income loans. It must follow "common sense underwriting procedures to ensure that terms and conditions of loan programs match the status of the borrowers," the order says. For example, it says a borrower with a salary from a large employer should have to provide full documentation, instead of taking a stated-income loan.

Robert Simpson, a co-founder and the president and chief executive of Investors Mortgage Asset Recovery Co. LLC, an Irvine, Calif., unit of American International Group that litigates small mortgage fraud cases, said that restriction seemed unusual, but he also said it was a good idea for all lenders.

If stated-income loans were not offered to typical wage earners "it would improve our credit quality dramatically," Mr. Simpson said. The downside is that the practice "would cost some production, too."

Brokers should usually know an applicant's income, he said. "If they didn't ask a borrower, then they are committing origination malpractice" by not doing their best to get a borrower into the right loan.

The order also says that Argent may not make purchase loans on properties that were sold less than a year earlier, nor may it get a new appraisal for such properties when it makes a refinancing.

Arthur J. Prieston, the chairman of the San Rafael, Calif., mortgage-fraud prevention firm Prieston Group, called those restrictions "possible over-regulation." Though they are clearly meant to prevent property-flipping schemes, "it's the simultaneous flips ... where homes are bought and sold in 15 to 20 minutes between a few lenders ... that are the problem."

Another requirement - that Argent boost its post-funding review rate to 25% of its Georgia loans, from 10% - could be "financially significant," Mr. Prieston said, since the reviews can cost \$100 each.

Rachel Dollar, a Santa Rosa, Calif., lawyer who specializes in defending lenders against mortgage fraud, said the Argent and Option One cases show a "shift in the way that authorities and regulators are looking at the mortgage fraud issue."

Historically, she said, fraud "has been viewed as ... a crime without a sympathetic victim." But with an increase in publicity about the effects of mortgage fraud on subprime borrowers, "you're seeing a blurring of the lines between predatory lending and mortgage fraud," Ms.

Dollar said. "Government agencies and regulatory agencies are starting to see this as a predatory-lending-type issue."

Agencies "used to focus on the conduct of lenders vis-a-vis borrowers," she said. "They are now looking at lender conduct vis-a-vis third parties within the origination process."

Marc Miller, the general counsel for Delta Financial Corp., a midsize, publicly traded nonprime lender in Woodbury, N.Y., took a slightly different tack.

"I'm not sure it's as much a major shift as a refocusing on ensuring that lenders are engaged in safe and sound lending practices," he said. "I haven't spoken to any regulators directly" about the issue, but recent events may indicate "a stronger focus" by state officials on lenders' efforts to "root out fraud before it can occur."

The Georgia department would not say what prompted the order against Argent, except to say the lender had done business with a company that was not licensed by the state. Nor would the agency say whether it was taking action against other lenders for problems dealing with brokers.

The order also reminds Argent that lenders must report suspicious broker activity to the agency and may not do business with unlicensed brokers.

Ms. Dollar said such reporting requirements raise another issue: potential lender liability for defaming brokers by turning them in to regulators. Federal law requires lenders affiliated with bank holding companies to file suspicious-activity reports with the Financial Crimes Enforcement Network if a company with which they do business raises suspicions. The lenders get a safe harbor from defamation suits when they file SARs.

But Ms. Dollar noted that other lenders are not required to file these reports and do not get the safe harbor.

However, the Georgia law stipulates that "no civil cause of action of any nature shall arise against" a lender reporting suspicious activity.

The issue came up last year when Fannie agreed in a consent order to forfeit \$7.5 million to the federal government for failing to warn the Government National Mortgage Agency that a lender had made fraudulent loans. The incident likely encouraged OFHEO to write the rule it finalized this summer.

When asked how he felt about reporting on brokers it suspects are involved in fraud, and the potential for a defamation suit, Mr. Bass of ACC Capital said he was not concerned. "We are going to work within the framework of the law."

He would not say how much Argent's costs might rise as a result of the order or what percentage of its business comes from Georgia.

Asked whether Argent would apply any of the practices listed in the Georgia order in other states where it does business, he said, "We will evaluate as we go forward."

Ms. Dollar said the order should not put Argent at a competitive disadvantage. Some of the measures it agreed to, such as "tightening up closing instructions" and "checking notices of

flips," are things she recommends to all her customers.

Most of the standards in the order were based on a 2003 [white paper](#) produced by a Federal Financial Institutions Examinations Council symposium.

A spokeswoman for Option One said it overhauled its fraud-detection program last year. In a prepared statement, the lender said, "We have best practices in fraud detection and prevention in place and are proactive in reporting suspected incidences of fraud."

Jody Shenn contributed to this report.

Required Vigilance

Under Georgia's cease-and-desist order, Argent must:

Alert state if broker submits loans without a license; check status of brokers' licenses weekly

Require full documentation from salaried workers at big firms

Avoid purchase loans on homes sold in last 12 months; when refinancing such homes, use the old appraisal

Hike quality reviews to 25% of Georgia loans from 10%

Source: Georgia Dept. of Banking and Finance

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