Mortgage Asset Research Institute
TWELFTH PERIODIC MORTGAGE FRAUD CASE REPORT

April 2010

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Mortgage Asset Research Institute
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Executive Summary

Fraud continues to be a pervasive issue, growing and escalating in complexity. The market is attempting to recover from devastating financial losses and reputational harm due to the lack of controls, and denial and greed that enabled a fallacy of flourishing profits during the mortgage industry boom years. In 2009, we saw the beginning of a laser-focused effort to realign this industry back to the basics of sensible and accountable business practices. The findings throughout this report qualify the need for greater visibility into industry processes, professionals and consumers. Incidents reported by subscribers to LexisNexis® Mortgage Asset Research Institute reflect verified experiences of unscrupulous activities perpetrated by industry professionals who may or may not have involved complicit consumers. The bad news is that because of its adaptability, fraud can never be completely eradicated—but the good news is that, using industry-submitted information like that used to generate this report and proper due diligence standards, it can be proactively defeated.

> Reported mortgage fraud and misrepresentation increased 7 percent from 2008 to 2009. Though a smaller increase than in recent year-to-year comparisons, this increase over 2008's record-setting submission volume remains a marker of strong reporting activity.

As this report will indicate, reported mortgage fraud and misrepresentation increased 7 percent from 2008 to 2009. Though a smaller increase than in recent year-to-year comparisons, this increase over 2008's record-setting submission volume remains a marker of strong reporting activity. The market experienced a meltdown, housing inventories are at an all-time high and it is next to impossible to obtain credit; so why is reported fraud and misrepresentation *still* increasing? There are various reasons for the increase, including new opportunities to take advantage of consumers, maintenance of lifestyles obtained during the boom period, consumers who are desperate for the American dream of homeownership, and the need for new, creative methods of moving illicit funds. How is fraud still being facilitated? Technology has provided fraudsters with the ability to access information, conduct criminal activities and remain anonymous via the internet, and manipulate processes that rely on the need for expediency. Although technology is an enabler of fraud perpetration, for the scammer there must be a system to beat and/or a victim to manipulate. Fraudsters are opportunistic and often prey upon the vulnerable within society. Systems and processes that can be beaten are the easiest targets and are often selected. For example, 2009 saw record foreclosures in several major metropolitan areas, a trend which led to the emergence of several different types of foreclosure rescue scams. In these scenarios, vulnerable homeowners in danger of losing their houses are being taken advantage of by fraudsters ahead of the fraud curve. They know that it will take time for the industry to catch up. This slow-moving reactive lag time is what must change.

In 2009 and beyond, the industry-at-large has been forced to succumb to constant change in what is considered acceptable business practices. Many lenders have adapted and adjusted their methods of verifying the information presented to them for varying consumer products provided by their organization; however, some have not and continue to remain seemingly unresponsive to change. Driven primarily by legislation and influential secondary market participants, technology vendors are also under tremendous pressure to maintain parity with these constant changes. The government, responding to and trying to force regulated responsiveness, is under the same—some would say greater—pressure to generate measurable results quickly. Congress introduced significant legislation and amendments to existing mandates in an effort to push the onus of responsibility down to the financial community or those closest to the consumer. This report will identify employment and income misrepresentation as high on the list of reported incidents for 2009. Recent relevant legislation includes amendments to the Truth in Lending Act (TILA)—one in particular focuses on the consumer's ability to repay a debt when the debt is considered high priced or nonprime. Although the legislation is somewhat ambiguous, as it does not specify the type of verification and by whom the verification should be sourced, its purpose is valid. Lenders seeking a defense against falsified employment, income, and other loan file documentation should leverage third party sources with no vested interest in the financial transaction. Unfortunately (and rather unbelievably), there are some lenders who continue to rely upon stated information and borrower sourced documentation. The standard for lending due diligence must be elevated. The current distractions facing lenders with regard to loss mitigation and righting past wrongs is ripening the opportunities for and complexities of fraud in other areas. Lenders are more aware of the adverse activities that contributed to the current state of the industry. Unfortunately, fraudsters are also paying attention and evolving their practices to be more complex and difficult to detect. New frauds emerge daily—the industry must react in real time.

This is the twelfth annual report by LexisNexis® Mortgage Asset Research Institute. These annual reports examine the current composition of residential mortgage fraud and misrepresentation in the United States. (See Appendix I at the end of this report for information about the Mortgage Asset Research Institute and the methods it uses to collect data on mortgage fraud.) This year's report will continue that trend, but will also explore the impact of mortgage fraud on the current mortgage market environment.

The highlights of this annual report include:

- With close to three times the expected amount of reported mortgage fraud and misrepresentation for its origination volume, Florida is ranked first in the country for reported mortgage fraud and misrepresentation.
- New states to enter the top ten include Arizona, New Jersey, and Virginia.
- The most noticeable increase in reported fraud and misrepresentation type for loans originated during the 2009 year involves the appraisal.

The body of this report presents the data and reasoning behind the conclusions cited above.

Data and Information Sources Used in This Case Report

For almost two decades, major mortgage lenders, agencies and insurers have been submitting information describing incidents of alleged fraud and material misrepresentation to a central database, known as MIDEX (the Mortgage Industry Data Exchange), in order to share their experiences within the mortgage industry. Subscribers use the MIDEX service to help combat mortgage fraud by performing background checks on mortgage professionals and companies as part of their business relationship credentialing process. The Mortgage Asset Research Institute utilizes this database to obtain statistics on a wide range of mortgage fraud and misrepresentation characteristics. Findings from this research are presented in these Case Reports on a periodic basis as a means of highlighting mortgage fraud trends.

In addition to MIDEX data, this report utilizes Home Mortgage Disclosure Act (HMDA) data provided by the Mortgage Bankers Association (MBA), which is key to calculating a state's Mortgage Asset Research Institute Fraud Index (MFI) value. Please refer to Appendix II for information on the MFI and its computation.

Mortgage Asset Research Institute Reports and SAR Filing Trends

The Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) is the agency that collects Suspicious Activity Reports (SARs) from all federally-insured financial institutions. Using data provided by the FBI, Table 1 shows the increase in mortgage fraud SAR submissions to FinCEN over the past several years.[1] From 2008 to 2009, the total number of mortgage fraud SARs rose 5 percent. From 2007 to 2008, the number rose 36 percent. From 2006 to 2007, that number increased by 31 percent. These increases mirror increases in reporting incidents of fraud and material misrepresentation to the Mortgage Asset Research Institute: from 2008 to 2009, we received a 7 percent increase in submissions from our subscribers; from 2007 to 2008, a 26 percent increase; and from 2006 to 2007, a 25 percent increase.

From 2008 to 2009, the total number of mortgage fraud Suspicious Activity Reports rose 5 percent. From 2007 to 2008, the number rose 36 percent. From 2006 to 2007, that number increased by 31 percent. These increases mirror increases in reporting incidents of fraud and material misrepresentation to the Mortgage Asset Research Institute.

Table 1

Mortgage Fraud SARs	
Fiscal Year	**SAR Submissions**
2009	67,190
2008	63,713
2007	46,717
2006	35,617
2005	21,994
2004	17,127
2003	6,936
2002	5,609
2001	4,210
2000	3,245

Prior Mortgage Asset Research Institute Case Reports explained how these year-over-year increases in SAR submissions are not entirely reflective of fraud activity. SAR submissions are currently only required of federally-insured financial institutions and their affiliates. Therefore, the fraud experiences of independent mortgage banking companies are not reflected in Table 1. These companies are represented, among others, in the MIDEX data. In addition, data submitted to the Mortgage Asset Research Institute must be verified, material misrepresentation, criteria that is slightly different from SAR reporting rules that include unverified suspicious activities.

Geographical Distribution of Mortgage Fraud

Table 2 was developed from fraud and misrepresentation cases submitted to the Mortgage Asset Research Institute by MIDEX subscribers. The first three columns of the table show the rankings of states with the most serious mortgage fraud and misrepresentation problems in loans originated[2] during 2009. The remaining columns of the table show the rankings and a numerical measure of the same ten states in the years from 2008 back to 2005.

The numerical measure of each state's fraud problem is represented by the Mortgage Asset Research Institute Fraud Index (MFI). An MFI of 0 would indicate no reported fraud and misrepresentation from a state. An MFI of 100 would indicate that the reported fraud and misrepresentation for a state is exactly what one would expect in terms of fraud rates, given the level of loan originations in that state. That is, a state that has 5 percent of the cases in MIDEX for 2009 and also has 5 percent of the country's loan originations in the same year would have an MFI of 100. Appendix II at the end of this report explains in detail how the MFI is calculated.

Table 2 details how states rank against one another for reported fraud and misrepresentation in the past five years. Based on reports submitted to the Mortgage Asset Research Institute through the first quarter of 2010, Florida ranked first in the nation for loans with misrepresentation originated in 2009. The reported rate was almost three times ($MFI_{FL/2009}$ = 292) what we would expect, based solely on its origination volume. This is a decrease from its updated fraud and misrepresentation rate for loans originated in 2008 ($MFI_{FL/2008}$ = 430) and 2007 ($MFI_{FL/2007}$ = 360).

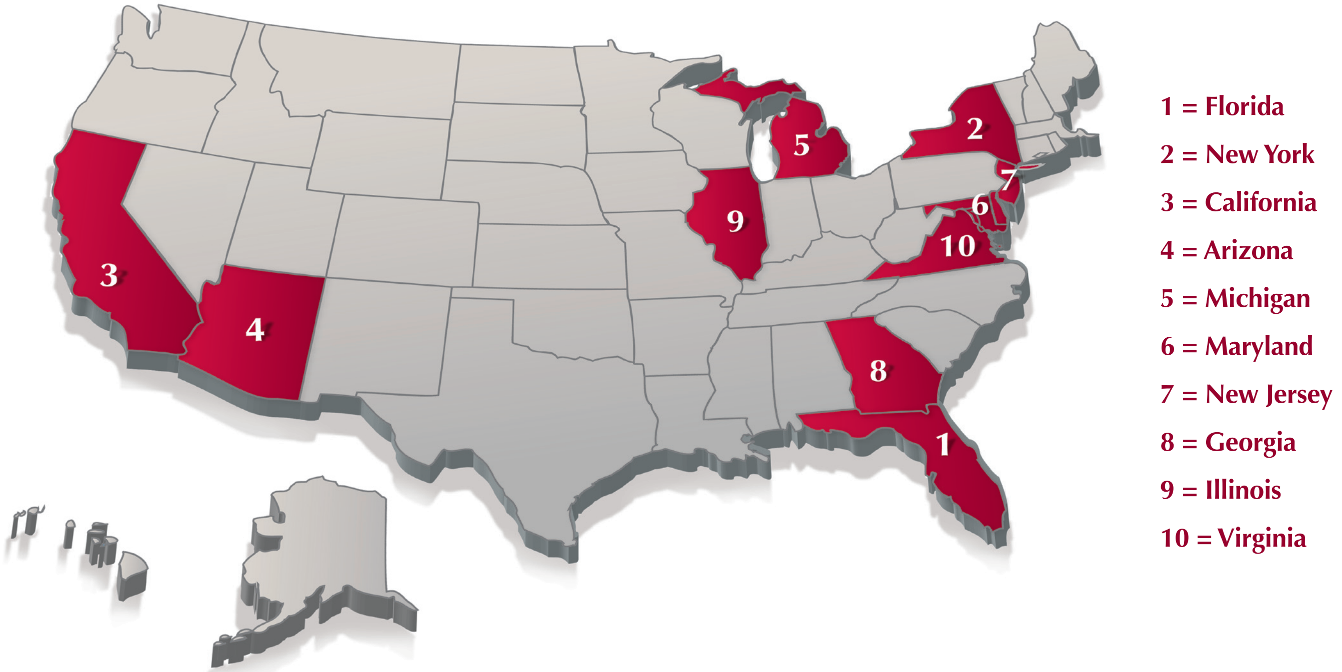
Based on fraud reports submitted to the Mortgage Asset Research Institute through the first quarter of 2010, Florida ranked first in the nation for loans with misrepresentation originated in 2009. The reported fraud rate was almost three times what we would expect, based solely on its origination volume.

Table 2

Mortgage Asset Research Institute Fraud Index[3] By State (2005-2009 All Originations)

State	2009		2008		2007		2006		2005	
	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	292	1	430	1	360	1	230	3	184
New York	2	217	3	191	18	59	12	81	11	100
California	3	159	7	158	4	157	2	172	8	119
Arizona	4	158	10	107	8	117	9	106	21	54
Michigan	5	136	4	185	2	207	4	157	2	196
Maryland	6	136[4]	5	182	13	67	14	68	28	45
New Jersey	7	135	11	102	19	57	20	57	18	65
Georgia	8	124	8	156	6	129	5	142	1	297
Illinois	9	107	6	161	7	124	6	126	5	146
Virginia	10	103	24	46	11	73	13	72	24	49

Figure 1 (Top Ten States for 2009)



It should be noted that the 2005 through 2008 MFI values for all states listed in Table 2 differ somewhat from those shown in the same table of last year's Case Report. This is due to the fact that Table 2 is based on an additional year of submissions, some of which were reported on loans originated in years 2005 through 2008.

Based on updated data, last year's highest ranked state, Rhode Island, is now ranked second for 2008. Rhode Island is not officially listed in the top ten states for 2009—but that does not necessarily mean that its MFI has improved. Rhode Island's fraud rate for 2009 loans is $MFI_{RI/2009} = 421$; its updated rate for 2008 is $MFI_{RI/2008} = 323$. Historically, the Mortgage Asset Research Institute has not included states wherein the sample size of reports received does not meet a historically-set minimum threshold. For 2009, Rhode Island does not meet this requirement. To preserve statistical continuity and methodology, the state has been removed from the official rankings for this reason. It is possible that as more submissions for loans originated in 2009 are received, Rhode Island will again meet the inclusion criteria.

Further analysis of Table 2 and the map yields the following:

- Florida owns the highest 2009 MFI value, 292. This indicates that Florida has close to three times the expected amount of reported mortgage fraud and misrepresentation for its origination volume.
- New York, ranked third last year, has risen to second place. Its MFI increased from 191 in 2008 to 217 in 2009.
- With an MFI of 158, Arizona has moved into the top five for the first time.
- Eight of the top ten states are in the eastern half of the country.
- Georgia, ranked fourth in our analysis of 2008 loans a year ago, is now ranked eighth for both 2008 and 2009.
- New Jersey and Virginia make their first appearances in the top ten for loans originated in 2009.

At the Metropolitan Statistical Area (MSA) level, the top national areas for 2009 loans are evidenced in Table 3.

Table 3

Top National MSAs	Percentage of All Reports Received
New York City-Northern New Jersey-Long Island	12%
Los Angeles-Riverside-Orange County, CA	8%
Chicago-Gary-Kenosha, IL-IN-WI	5%
Miami-Fort Lauderdale, FL	4%
Washington-Baltimore, DC-MD-VA	4%

Although the states of New York and New Jersey are ranked second and seventh, respectively, the New York City-Northern New Jersey-Long Island MSA is the highest ranked MSA nationally for all types of reported mortgage fraud and misrepresentation. The top-ranked state, Florida, has the fourth highest national MSA with the Miami-Ft. Lauderdale area.

The following data and analysis, provided by Lender Processing Services (LPS)[5], breaks down delinquency rates for the top three mortgage fraud MSAs listed above. Tables 4 - 6 provide delinquency rates in New York City-Northern New Jersey-Long Island (Table 4), Los Angeles-Riverside-Orange County (Table 5), and Chicago-Gary-Kenosha (Table 6). To further illustrate the composition in each MSA, LPS provided the percentage of loans that are delinquent in each area, as well as the exotic loan types in each sample (i.e. Subprime, Interest Only, Pay Option Arms, etc.).

These delinquency charts show the change in delinquency buckets from June 30, 2009 through December 31, 2009, as well as the latest percentage of delinquent loans and foreclosures in each MSA. The number of foreclosures, the percentage of foreclosures and the volume of REO are also provided for each area. The 90+ day velocity illustrates the number of months it will take the average delinquent loan to reach the 90+ day delinquency mark. This number is provided for each MSA, so it can be compared to the nationwide number, 50.5 days. The report also provides the weighted average age of all loans in each MSA, the number of ARM loans, as well as the weighted average time until the initial rate adjustment for ARM loans occurs. The weighted average FICO relates to the loans in each MSA's mortgage sample at time the loan was originated. In summary, the tables on the following tables, provided by LPS, give a 6-month snapshot of delinquencies, foreclosures and REO inventory, augmented by relevant characteristics that can be used to understand the mortgage market in specific areas.

Tables 4 - 6 provide break down delinquency rates for the top three mortgage fraud MSAs: in New York City-Northern New Jersey-Long Island (Table 4), Los Angeles-Riverside-Orange County (Table 5), and Chicago-Gary-Kenosha (Table 6).

Table 4 (Courtesy of LPS)

New York-Northern New Jersey-Long Island, NY-NJ-PA					
		(Mortgage Sample: 1,968,855 Loans)			
Mortgage Risk Concentrations		Exotic Loans		(Subprime, Interest Only, Short Dated ARMs, Pay Option ARMs)	
Total Delinquencies:	173,360	Delinquency Percentage:	8.84%	Foreclosure Percentage:	3.96%
Weighted Average Age:	43.1	Weighted Average FICO:	720	Weighted Average LTV:	69%
Weighted Average Months to Initial Roll (ARMs):		43	Total ARM Loans:	274,993	
90+ Day Velocity:	47.3	90+ Day Velocity Nationwide:		50.5	

Delinquency	6/30/2009	9/30/2009	12/31/2009
Current	1,756,439	1,728,520	1,711,053
30 Days Delinquent	53,765	56,189	54,621
60 Days Delinquent	23,840	25,882	25,946
90 Days Delinquent	14,538	16,091	17,187
120+ Days Delinquent	47,411	54,943	68,317
Delinquent BKs	6,142	6,969	7,289
Total Delinquencies	***145,696***	***160,074***	***173,360***
Foreclosure	63,919	73,159	77,729
REO	6,524	6,519	6,713

Table 5 (Courtesy of LPS)

Los Angeles-Long Beach-Santa Ana, CA					
		(Mortgage Sample: 1,604,167 Loans)			
Mortgage Risk Concentrations		Exotic Loans		(Subprime, Interest Only, Short Dated ARMs, Pay Option ARMs)	
Total Delinquencies:	170,646	Delinquency Percentage:	10.74%	Foreclosure Percentage:	3.61%
Weighted Average Age:	42.9	Weighted Average FICO:	727	Weighted Average LTV:	68%
Weighted Average Months to Initial Roll (ARMs):		42	Total ARM Loans:	437,780	
90+ Day Velocity:	43.5	90+ Day Velocity Nationwide:		50.5	

Delinquency	6/30/2009	9/30/2009	12/31/2009
Current	1,393,232	1,374,632	1,360,755
30 Days Delinquent	37,340	38,110	37,643
60 Days Delinquent	20,847	22,748	22,191
90 Days Delinquent	15,228	15,862	16,273
120+ Days Delinquent	61,338	68,596	82,787
Delinquent BKs	7,996	10,971	11,752
Total Delinquencies	***142,749***	***156,287***	***170,646***
Foreclosure	57,506	59,668	57,403
REO	16,368	15,704	15,363

Table 6 (Courtesy of LPS)

Chicago-Naperville-Joliet, IL-IN-WI					
		(Mortgage Sample: 1,388,865 Loans)			
Mortgage Risk Concentrations		Exotic Loans		(Subprime, Interest Only, Short Dated ARMs, Pay Option ARMs)	
Total Delinquencies:	143,674	Delinquency Percentage:	10.45%	Foreclosure Percentage:	4.20%
Weighted Average Age:	41.8	Weighted Average FICO:	717	Weighted Average LTV:	75%
Weighted Average Months to Initial Roll (ARMs):		35	Total ARM Loans:	221,580	
90+ Day Velocity:	47.4	90+ Day Velocity Nationwide:		50.5	

Delinquency	6/30/2009	9/30/2009	12/31/2009
Current	1,221,845	1,199,296	1,174,017
30 Days Delinquent	42,763	42,855	41,513
60 Days Delinquent	20,305	21,863	21,318
90 Days Delinquent	12,530	14,353	14,743
120+ Days Delinquent	37,235	44,576	56,354
Delinquent BKs	8,933	9,448	9,746
Total Delinquencies	***121,766***	***133,095***	***143,674***
Foreclosure	45,961	53,513	57,784
REO	13,542	13,911	13,390

Types of Fraud Reported

The Mortgage Asset Research Institute's MIDEX system classifies the types of alleged fraud involved in each incident reported by its cooperating subscribers. These classifications are shown in Table 7 for loans originated in the five-year period from 2005 through 2009. Again, it should be noted that the numbers for 2009 loans are preliminary, since fraud perpetrated in 2009 will continue to surface and be reported for another two years or more.

In a five-year fraud assessment, Table 7 shows each type of fraud and misrepresentation as a percentage of all cases submitted to the MIDEX database. For instance, 59 percent of all fraud incidents reported to the database for mortgages originated in 2009 contained application fraud. Misrepresentation on the application ranks as the highest percentage among other fraud types for 2008, 2007, 2006, and 2005 as well. These percentages are hardly surprising, given that the application form is comprehensive in collecting borrower personal identity, employment, asset and liability information. However, the slight downward trend in overall application fraud and misrepresentation—from a high of 67 percent in 2005 and 2006 to 59 percent in 2009—should be noted.

Fifty-nine percent of all fraud incidents reported to the database for mortgages originated in 2009 contained application fraud. Misrepresentation on the application ranks as the highest percentage among other fraud types for 2008, 2007, 2006, and 2005 as well.

Table 7

2009 Mortgage Fraud and Misrepresentation Types[6]					
Fraud Classification	Mortgage Origination Year (All States)				
	2009	2008	2007	2006	2005
Application[7]	59%	61%	62%	67%	67%
Tax Return/Financial Statements	26%	28%	17%	18%	18%
Appraisal/Valuation	33%	22%	19%	16%	20%
Verification of Deposit (VOD)	14%	21%	24%	19%	17%
Verification of Employment (VOE)	9%	15%	12%	11%	10%
Escrow/Closing Documents	7%	10%	12%	11%	11%
Credit Report	3%	4%	9%	14%	11%

Many of the percentage figures shown in this table are similar to those the Mortgage Asset Research Institute has reported for several years. Notable differences in the 2009 data include:

- Beginning in 2008 and continuing through 2009, the percentage of reports of tax return and financial statement misrepresentation nationwide is higher than in previous years.
- The most noticeable increase for loans originated during the 2009 year is in appraisal fraud and misrepresentation. A more detailed discussion of the year's appraisal fraud and misrepresentation occurs in a later section of this report.

Table 8 presents a closer look at 2009's top three states and the most prevalent mortgage fraud issues within those states, compared to the same reported issues for 2008.

Table 8

Analysis of Top Three States						
Fraud and Misrepresentation Classification	Florida 2009	Florida 2008	New York 2009	New York 2008	California 2009	California 2008
Application	**42%**	67%	**47%**	74%	**55%**	56%
Verification of Employment (VOE)	**15%**	21%	**10%**	21%	**14%**	14%
Verification of Deposit (VOD) and/or Bank Statement	**11%**	20%	**20%**	27%	**18%**	37%
Tax Return and/ or Financial Statement	**26%**	29%	**37%**	32%	**21%**	26%
Appraisal	**36%**	18%	**20%**	15%	**25%**	14%
Credit History Documentation	**4%**	4%	**0%**	12%	**2%**	3%
Escrow and/ or Closing Document	**2%**	10%	**7%**	15%	**5%**	7%

This breakdown of state-specific trends reveals the following:

- All three of the top states show a decrease from past years in reported fraud and/or misrepresentation on the loan application—Florida and New York the most dramatically.
- At 36 percent, Florida has the highest reported appraisal fraud and misrepresentation. This is an increase from 18 percent for loans originated in 2008.
- New York, with 37 percent, has the highest reported tax return and financial statement fraud and misrepresentation. As seen in Table 7, the national average for this type of fraud and misrepresentation is 26 percent.
- California experienced a decrease in reported fraud and misrepresentation on the VOD and bank documents.

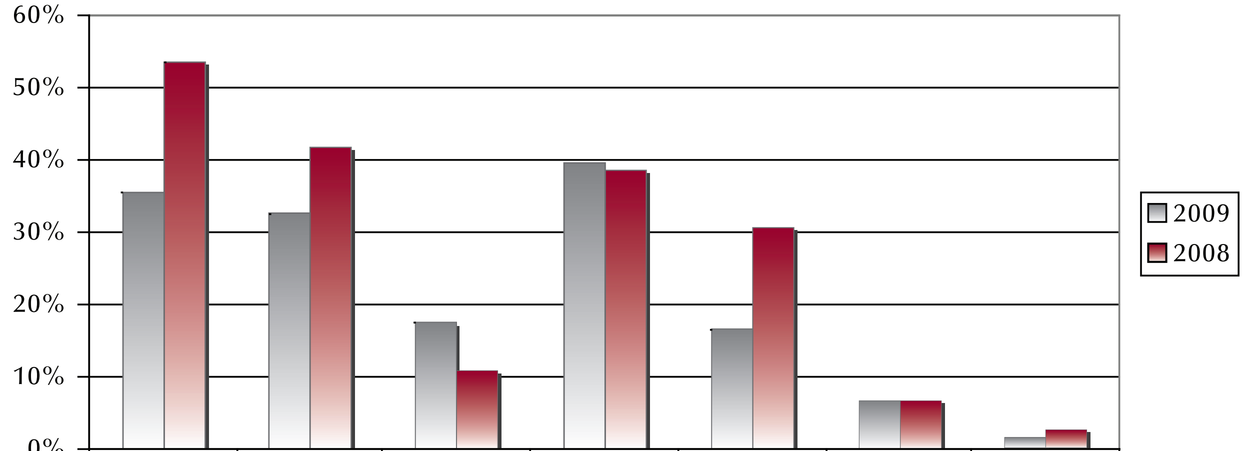
Spotlight on Appraisal Fraud and Misrepresentation

As was noted in the discussion of Table 7, the most noticeable increase in reported fraud type for loans originated during the 2009 year is in appraisal fraud and misrepresentation. Up from a low of 16 percent in 2006, this year 33 percent of all loans reported to the Mortgage Asset Research Institute involved some type of appraisal fraud and/or misrepresentation.

Table 9 breaks down the most prevalent subcategories of appraisal fraud and misrepresentation for all states.

Table 9

Appraisal Fraud and Misrepresentation



	Incorrect Comparables	Material Omissions of Information	Inflated Value — Under 15%	Inflated Value — 15 - 30%	Inflated Value — Over - 30%	Invalid Adjustments	Incorrect Photos
2009	36%	33%	18%	40%	17%	7%	2%
2008	54%	42%	11%	39%	31%	7%	3%

The most prevalent types of appraisal fraud and misrepresentation for loans originated in 2009 involve incorrect (or fabricated) comparables, omitted information, and value inflation. Thirty-six percent of loans with reported appraisal fraud and/or misrepresentation have misused comparables. Thirty-three percent involve a material omission of relevant information that would have affected the value (examples of which are incorrect property condition, zoning, room count, square footage, etc.). Value inflation, subdivided into three categories, is also a large portion of reported appraisal fraud and misrepresentation: 18 percent of loans in this category reported inflated values under 15 percent; 40 percent had inflated values between 15 and 30 percent; and 17 percent had inflated values over 30 percent. Though a larger percentage of loans with appraisal fraud and/or misrepresentation was reported for 2009 loans than for those originated in 2008, within that reported pool of appraisal issues most subcategories experienced a decrease from reported appraisal issues in 2008. The most notable increase from 2008 to 2009 is in inflated values under 15%. Overall, 75 percent of 2009 loans reported with appraisal fraud and misrepresentation included some variety of value inflation, versus 81 percent of 2008 loans.

The 2009 states with the highest concentration of reported appraisal fraud and misrepresentation nationwide are all Midwestern states—Ohio, Illinois, and Michigan.[8] Sixty-seven percent of reported loans for properties in Ohio included some type of appraisal fraud and/or misrepresentation. In Illinois, appraisal issues were reported in 48 percent of submissions for this time period. Similarly, in Michigan, 43 percent of submissions involved appraisal fraud and/or misrepresentation.

The most prevalent types of appraisal fraud and misrepresentation for loans originated in 2009 involve incorrect comparables, omitted information, and value inflation. Thirty-six percent of loans with reported appraisal fraud and/or misrepresentation have misused comparables. Thirty-three percent involve a material omission of relevant information that would have affected the value. Value inflation, subdivided into three categories, is also a large portion of reported appraisal fraud and misrepresentation.

At the MSA level, the top areas for 2009 loans with reported appraisal problems are shown in Table 10.

Table 10

Appraisal Fraud and Misrepresentation	
Top National MSAs	Percentage of All Appraisal Reports Received
Los Angeles-Riverside-Orange County, CA	10%
New York City-Northern New Jersey-Long Island	7%
Chicago-Gary-Kenosha, IL-IN-WI	5%
Detroit-Ann Arbor-Flint, MI	4%
Boston-Worcester-Lawrence, MA-NH-ME-CT	4%

Collectively, these five MSAs make up 30 percent of all properties with reported appraisal fraud and/or misrepresentation in 2009. The top four MSAs belong to states in the overall 2009 top ten. The Chicago and Detroit MSAs also make up a significant portion of the reports for top appraisal fraud and misrepresentation states Illinois and Michigan.

See the supplement to this report prepared by VEROS for additional analysis and discussion of trends in appraisal fraud and misrepresentation in 2009.

In Conclusion: Adapt, Verify, and Report – A Message to the Industry

Collusion among insiders, employees and consumers is highly effective in times of recession because everyone has something to gain in times of desperation. Fraud and misrepresentation in the mortgage industry helped to facilitate the economic crisis, and reported issues as recent as those in 2009 are leading to new forms of collusion and opportunistic scamming. As we move forward into 2010, the seemingly simplistic back to basics approach is the best way to help thwart threats, both new and old. Don't just trust, verify. If information results in uncertainty, trust your instincts and stop. Pay attention.

There are many methods of leveraging information or attributes of consumer identifiers that give the appearance of legitimacy or innocent mistakes. If the identity of a potential customer cannot be vetted with certainty, your entire transaction is a risk. Did you know that current and prior addresses are frequently used in creating fraudulent identities? Fraudsters use this method because they are aware of the timing required to report new addresses. The fraudster's biggest weapon is your lack of real-time information and verification.

The implementation of evolving safeguards can seem time consuming and/or costly, but preventing uncertainty in funding decisions and losses as a result of questionable relationships is worth it. Think of the cost to combat fraud upfront like you would your automobile or home insurance premiums. Your prepaid investment provides for peace of mind that in the event of an unfortunate, unforeseen circumstance—your assets are covered.

The best defense for combating fraud is knowledge, through the power of information; process control, through the evolving methodologies of loan due diligence remediation; and prosecution of perpetrators that commit these unscrupulous acts. Reporting these activities enables heightened awareness across the banking community and consumers, strengthens prosecutorial programs, and increases the responsibility of our legislature to enact protective mandates.

The best defense for combating fraud is knowledge, through the power of information; process control, through the evolving methodologies of loan due diligence remediation; and prosecution of perpetrators that commit these unscrupulous acts. Reporting these activities enables heightened awareness across the banking community and consumers, strengthens prosecutorial programs, and increases the responsibility of our legislature to enact protective mandates. Adapt quickly, verify completely, and report thoroughly.

Appendix I

Source and Analysis of the Mortgage Asset Research Institute's Mortgage Fraud Data

The statistical data presented in Tables 2, 3, and 7 - 10 of this report were derived from information in a cooperative mortgage fraud database operated by the Mortgage Asset Research Institute, a LexisNexis® service. The Mortgage Asset Research Institute has designed and offered various mortgage industry databases for the past 19 years. Its most recognized database system is the Mortgage Industry Data Exchange (MIDEX®) that contains information about licensing, public sanctions and incidents of alleged fraud and misrepresentation reported to the Mortgage Asset Research Institute by MIDEX subscribers.

The MIDEX statistical data discussed in this document were derived from the incidents that MIDEX subscribers describe in reports to the Mortgage Asset Research Institute. Only material misrepresentations are permitted to be included in these reports. That is, companies may only submit reports to MIDEX in those cases where, knowing what they know after thorough investigations, they would not have originated, bought or insured the loans in question.

The reports submitted to the Mortgage Asset Research Institute include the following information about each incident:

- Location of the collateral (state, city and address, to the extent known)
- Names of the originating entity and the loan officer who took the application
- Date the misrepresentation took place
- The method used to verify the existence of the reported misrepresentation(s)
- A short narrative description of the misrepresentation(s) found during the MIDEX subscriber's investigation
- Names of any other professionals who appear to be in a position to influence the accuracy of the information found to be misrepresented; e.g., the name of the appraiser and appraisal firm in cases where the property value is found to be significantly inflated
- A certification from an authorized individual at the submitting mortgage entity that the report is, to the best of his/her knowledge, complete and accurate

Mortgage Asset Research Institute staff reviews the reports to assure they meet submission standards for severity and consistency. Submissions are input directly by MIDEX subscribers via an online form, or data entry staffers convert hard copy submissions to a standard, searchable format for inclusion in the MIDEX system. After reading the report's narrative description, the Mortgage Asset Research Institute will classify the incident as involving one or more of the types of misrepresentations listed in Tables 7 - 9.

If the Mortgage Asset Research Institute makes any changes to a submitted report, it is returned to the submitting subscriber for review prior to its being entered into the system.

The subscribers participating in the MIDEX system represent a wide range of mortgage entities. They include secondary market agencies, major private mortgage insurance companies, and lenders that account for the vast majority of wholesale lending in the country.

Appendix II

Computation of the Mortgage Asset Research Institute Fraud Index (MFI)

The Mortgage Asset Research Institute Fraud Index, or MFI, is an indication of the amount of mortgage fraud and misrepresentation found through MIDEX subscribers' investigations in various geographical areas within any particular year. It involves very straightforward calculations.

To come up with Table 2's 2009 MFI for loans in a sample state, Florida, Mortgage Asset Research Institute staff determines the percentage of all U.S. MIDEX fraud reports that were submitted for Florida-originated loans in 2009. They determined that, to date, more than 14 percent of MIDEX reports submitted from across the country by subscribers for 2009 originations involved loans on Florida properties. But according to HMDA data, Florida had slightly under 5 percent of the nation's total 2008 mortgage originations—the most recent year such data are available.

If mortgage fraud were distributed throughout the country like originations, then we would expect approximately 5 percent of mortgage fraud to occur in Florida. But the 14 percent fraud figure for Florida in 2009 was more than double—almost triple—its origination figure. Therefore, the 2009 MFI for Florida, as of this report's date, is: $MFI_{FL/2009} = (14.29/4.90) \times 100 = 292$

This is, of course, a dynamic figure. Often, a fraud investigation is not completed until a year or two after the loan was originated. The Mortgage Asset Research Institute will continue to receive Florida fraud reports for another two to three years from its MIDEX subscribers that find misrepresentation in their 2005-2009 books of business. Therefore, Florida's (and all other states') MFI figures will continue to change somewhat in future Periodic Reports, especially those containing recent years like 2008 and 2009.

It should be noted that the MFI is based on the number of fraud and misrepresentation incidents reported for each state, and not the dollar amounts of those mortgages. Therefore, a fraud on a $120,000 loan in Des Moines, Iowa, is counted the same as a fraud on a $720,000 loan in Los Angeles, California. Also, there is currently no distinction made between purchases, refinances or home improvement loans in these figures.

Appendix III

About LPS

For nearly half a century, Lender Processing Services (LPS) and its predecessor companies have provided the technology and solutions that have powered the mortgage and real estate industries—delivering a wide depth and breadth of products and services.

LPS' comprehensive suite of technology and services to the mortgage industry, from origination and servicing to risk management and default, are used by leading banks and mortgage companies to sharpen their competitive edge. Today, each of the top 50 financial institutions in the country uses at least one of LPS' products or services.

The Need for Actionable Analytics from LPS

In today's environment, more than ever before, companies in the mortgage industry need comprehensive and actionable data, analytics and due diligence tools to better manage risk and protect their businesses. LPS offers a wide range of risk management solutions to benchmark loan portfolios; complete loan modifications more efficiently and successfully; assess borrower risk in real time; determine optimal modification terms, establish accurate property values; and much more. From the development of enterprise risk management strategies to sophisticated workflow and tracking technology to reach targeted risk management outcomes, LPS has the solutions to help reduce the frequency and severity of portfolio losses.

In fact, LPS' data and analytics, which include the industry's most comprehensive loan-level and real estate data*, are powerful information engines that enable improved portfolio management. Because knowing exactly what comprises your portfolio is critical to managing it effectively, the data and analytics provided by LPS enable greater portfolio transparency and improved portfolio health—all the while helping to reduce costs, increase efficiency and maintain a competitive advantage.

*LexisNexis does not warranty the accuracy of the information.

For more information, visit lexisnexis.com/risk/real-estate.aspx or call 866.858.7246

End Notes

1 For both the FBI and the Mortgage Asset Research Institute, these yearly submission totals equal all submissions received in a given year (for this year, 2009) and may include loans originated during years other than the submission year.

2 The dates used in the Mortgage Asset Research Institute's Fraud Index are when the fraud or misrepresentation occurred, typically the loan origination or closing dates. Subscribers to the MIDEX system may not discover that a loan involved fraud or misrepresentation for several months, or even one or two years after it was originated. As a result, numbers for recent years are dynamic.

3 Readers who compare the MFI figures in Table 2 for the same states as those found in previous Reports in this series will find that the rates have changed. This is due to the fact that MIDEX subscribers in 2009 continued to uncover and report fraud and misrepresentation findings from 2005 through 2008. Therefore all numbers in this Report are dynamic and will change as time passes.

4 MFIs are rounded up to the nearest whole number. Michigan's MFI is 136.18; Maryland's is 136.16.

5 See Appendix III for information about LPS.

6 It should be noted that percentages can exceed 100 percent, as most incidents contain more than one type of fraud and/or misrepresentation.

7 Application fraud and misrepresentation includes, but is not limited to, the following categories on the loan application: incorrect name(s) used for the borrower(s); occupancy, income, employment, debt, and asset misrepresentation; different signatures for the same name(s); invalid Social Security number(s); misrepresented citizen/alien status; incorrect address(es) and/or address history; and incorrect transaction type.

8 These statistics were generated among states whose data met sample size requirements.

Supplement to Mortgage Asset Research Institute TWELFTH PERIODIC MORTGAGE FRAUD CASE REPORT for 2009

April 2010

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Veros, President and CEO

Executive Summary

The Mortgage Asset Research Institute's report for 2009 is revealing, as always. Its findings are disturbing for an industry in crisis, struggling to battle market conditions and economic downturn, but bring a much-needed awareness of the threat of mortgage fraud to lenders and investors. As experts in valuations, trends and analytics, the increase in mortgage fraud is not news to Veros who has been following these developments for years. Fraud increases risk exponentially, and the industry must meet this threat head on, with all the intelligence and tools at its disposal. Fortunately, sophisticated tools are increasingly availability to address the challenges posed by perpetrators.

Among the report's revelations are findings that appraisal fraud is on the rise. Fraudulent comparables, material omissions and inflated values are cited as the most typical factors in appraisal fraud. Veros agrees with this finding, based on our own analysis and experience. The alarming trend from Florida has the potential to threaten that state's housing recovery more than others, given the area's track record in mortgage fraud and excess inventory, particularly in the condominium market.

Insights on Appraisal Issues

Although most attention is being given to outright fraud, i.e. fraudulent misrepresentation (intent to deceive), other forms of misrepresentation; innocent misrepresentation (the person committing innocent misrepresentation does not know they are wrong), and negligent misrepresentation—the person committing the negligent misrepresentation has no reasonable basis for knowing the statements are true, are equally likely to result in incorrect comparables, omitted information and value inflation.

It is worth noting that value inflation is almost always a direct consequence of incorrect, fabricated or omitted comparables and other information. Therefore this report will focus on those three troubling concerns.

Identifying Appraisal Fraud

Fabricated comparable sales have become much easier to identify in our data-rich and automated processing environment. Beginning very soon, every address in every appraisal report submitted to a GSE will be scrubbed for correct formatting and verified using sophisticated automated tools. This verification process takes less than one second per appraisal and will be discussed in more detail in a later section.

Determining whether or not comparables are appropriate requires knowing what additional choices the appraiser had when making comparable selections. The best option for lenders needing immediate answers is the use of some form of automation, whether a traditional AVM, appraisal or fraud scoring tool, or a simple automated sales search based on criteria set by the underwriter. The automated searches will typically results in a larger number of total possible "comparables" than those in the report. At a glance, one can usually tell whether or not the sales in the report are the closest, newest and most similar to the appraised property enabling a rapid means for identifying potentially incorrect (or fabricated) comparables, or whether better comparables were omitted.

Identifying omitted information, especially regarding property condition and functional utility, is the most difficult form of misrepresentation to confirm. Appraisers with the intent to misrepresent know in advance what they are doing and adjust their behavior to accommodate their intent to deceive. Failing to identify flaws in floor plans, or overlooking certain physical defects is nearly impossible to detect without a second set of eyes on the same property—automated tools simply cannot "know" the property at this level.

The Appraiser's Role in Fraud

Some appraisers have been effectively taught to overlook such problems by constant pressure (mostly pre-HVCC) to "make things work" in order to remain eligible for future appraisal work. There are some newer appraisers who, until quite recently, have never worked under any other conditions. In some cases, these appraisers do not realize the implications of their actions and have no awareness of better practices.

There are appraisers who know they are expected by their peers and by their professional standards to report property condition factually, but who still choose to overlook property defects because they view doing so as the path of least resistance. They have learned that there have never been significant negative consequences for this manner of appraising and see raising their standards as a potentially income-reducing move.

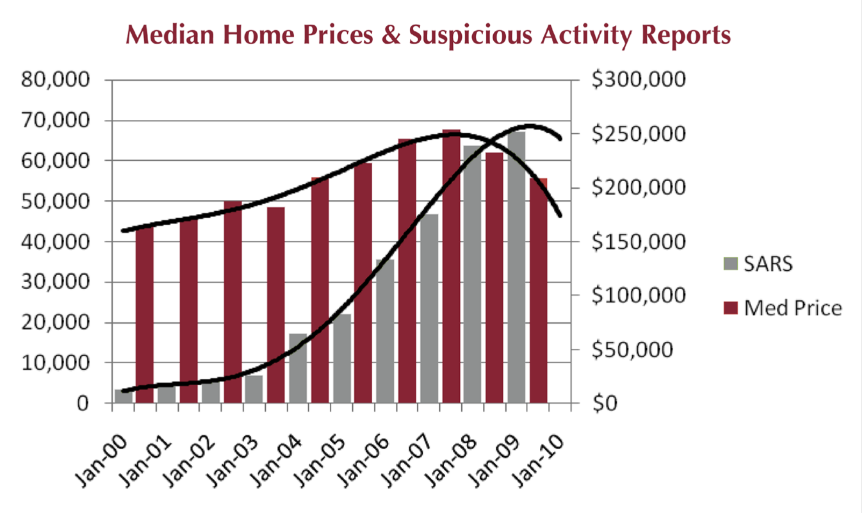
Appraisers who are willful in their participation in loan fraud by conceding to requests for predetermined valuations, and by deliberately hiding property defects are not likely to change their behavior voluntarily. Market changes have made the business of falsifying appraisal reports less lucrative than it was a few years ago. The evolution of scoring appraisal reports for completeness, compliance and risk (to be discussed in detail deeper into the report) will make it much more difficult for these reports to pass through the system, reducing the incidence of higher risk transactions slipping into conforming funding channels.

The Fraud Opportunity

The Mortgage Asset Research Institute MIDEX table of alleged fraud and misrepresentation shows how various types of reported fraud changed over the period from 2005 through 2009. This table reveals that application fraud and credit report fraud both rose from 2005 to 2006, and then declined steadily thereafter, while appraisal fraud declined from 2005 to 2006 and then rose steadily thereafter. It is Veros' belief that these areas are interrelated for several reasons:

a. From 2002 through most of 2006, property prices rose almost everywhere in the United States. Appraisal fraud was doubtlessly occurring, but because prices were rising, actual damages because of appraisal fraud were minimal, thus indentifying and reporting of such fraud was not a priority. Suspicious Activity Reports (SARs) collected by the Financial Crimes Enforcement Network (FinCEN) grew slowly at first and rose sharply and steadily after 2003. More importantly, because credit requirements were so relaxed (i.e. no-document, stated income loans) credit-related fraud was a cinch. Easy credit coupled with rising prices meant there simply wasn't much call for fraudulent valuations from 2002 through 2006.

Image 1



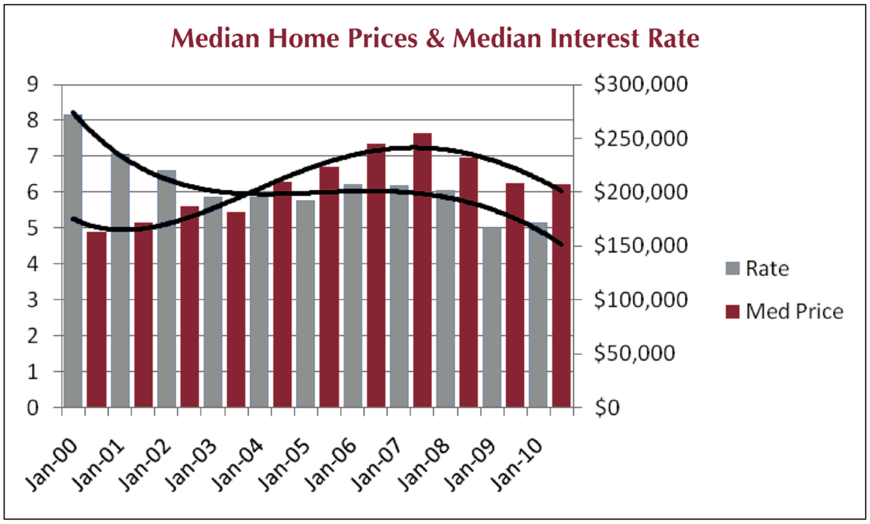
b. Once the credit frenzy ended (August 7, 2007) prices immediately stopped rising and there was a sudden increase in credit scrutiny. This created an increased requirement for fraudulent appraisals and over-valuation in order to keep pushing otherwise marginal borrowers through the pipe.

c. By mid-2008 prices were declining in almost every market in the United States. Shrinking equity coupled with tighter credit requirements brought even more pressure on valuation providers to "make the deal" lest all lending come to a halt. In 2009, the National Association of Realtors published statements blaming appraisers for the decline in home prices, adding to the pressure appraisers were already experiencing from loan originators.

In looking back farther and examining a few key trends, the findings above are put in even more clear perspective:

d. From 2000 through 2007 national median home prices rose (with one exception—2003 showed a very slight drop from 2002) and for the majority of that time, interest rates fell. One result of this was that millions of people either purchased homes or refinanced existing mortgages.

Image 2



The extended period of rising prices, falling interest rates and relaxed credit policies created an environment conducive to loan churning, and one in which home purchase decisions became speculative rather than shelter-based. Whether for purchase or refinance, each of those transactions required a property valuation. As noted previously, little attention was paid to valuation because prices were rising and therefore risk was perceived as low.

Veros is dedicated to eliminating appraisal fraud. The expertly-performed collateral valuation is among the most important documents in the loan file, and its integrity is vital. Although equity may be the most telling predictor of default, it cannot be determined without accurate valuations both primary and supplemental. In order to survive, the industry must do everything possible to ensure appraisal accuracy against fraud and other threats, whether intended or the result of inadequate expertise.

Solutions

The real risk takers in mortgage finance are the end investors. Historically, loan level data (credit and collateral) has only been made available at the investor level long after the loan had gone bad. Discovering for the first time at this point that there were misrepresentations in the valuation is of no help to the investor—the damage is done. Regardless of the severity of loan loss, preventative measures cannot be implemented by investors because they are only dealing with completed, funded loans. Therefore it is all the more critical that loan level data be available to investors before they purchase a loan pool in order to properly understand the level of risk they may be taking.

Electronic Appraisal Data Delivery

Fannie Mae is launching its Collateral Data Delivery (CDD) initiative this summer in an effort to combat fraud, increase accuracy and bring transparency to its loan purchase process. Veros was pleased to be selected as Fannie Mae's technology provider in this groundbreaking program, tasked with building and operating the CDD platform.

With the implementation of CDD, Fannie Mae requires that appraisals be delivered in MISMO-compliant electronic format at least 24 hours prior to loan purchase. This system allows the agency to check, analyze and evaluate appraisals electronically before it buys, effectively using technology to find and interdict appraisal-related repurchase candidates before they are purchased in the first place. This practice is likely to become standard operating procedure for investors in the future. They are realizing, as Fannie Mae and Veros recognized and as MARI has documented, that incorrect comparables, missing or incorrect data elements and unjustifiably inflated values are an increasing problem. The additional scrutiny to which loans have been subjected over the last several years have not corrected appraisal fraud and inaccuracies in valuations.

Appraisal Scoring

Appraisal scoring is another safeguard in the fight against fraud and deficient valuations. Scoring provides an automated, immediate review and evaluation of the data elements comprising each appraisal and offers a readily useable numerical reference to assess risk quickly. Veros' approach uses three key components in its developing its appraisal score: completeness, compliance and risk, detailed later in this supplement. The resultant appraisal score, easily implemented by lenders, provides the ability to instantly determine whether an appraisal may be automatically accepted, requires manual review, or the outright rejection for further diligence or support. This functionality allows better collateral decisions, improved vendor management and benchmarking, and reduces the financial risks of buybacks. Veros' Appraisal Scoring also ensures that loans enter the most appropriate funding stream reducing the risk of buy-backs and mortgage insurance problems.

There are many reasons for bad appraisals as discussed earlier. HVCC was adopted by the industry to keep mortgage brokers and other originators from influencing valuations in order to obtain the largest possible loan for their customers. Many argue that there have been unintended consequences of HVCC, as some appraisal management companies have been accused of utilizing low-cost appraisers in order to protect profit margins. This is not permitted under the FHA's version of HVCC, but the perception is there for conventional loans, which represents over 60% of the market. Whatever the cause, inaccurate appraisals represent a tremendous threat to lenders and investors, and greater transparency is required to adequately assess risk on every transaction.

Valuation Risks Beyond Fraud

Collateral valuations are subject to other dangers apart from fraud and poor execution in appraisals. Lenders and investors must be conscious of the risk associated with the collateral itself. The cascading effects of the nation's weak markets make valuations a moving target, even when primary appraisals are done in exemplary fashion.

Real estate forecasts have become essential. Gaining insights into poorly performing markets enable lenders to more accurately assess risk in their valuations and tailor their lending strategies more appropriately. The best forecasts utilize many factors beyond raw data to form their conclusions, and granularity in data sources combines with predictive analytics to create more useful reports.

Foreclosure activity continues to be an important influence on valuation risk, and one often not predictable with traditional valuation products. Trends among neighborhoods can be predicted, however, using a combination of the right data and the most robust predictive analytics and technology. Timeliness is critical in assessing valuation risks as a result of foreclosure activity, as vacant properties frequently become targets for squatters, criminal activities and vandalism. Devastating impact on property values can occur very rapidly, making nearby foreclosures a risk concern for every lender and investor.

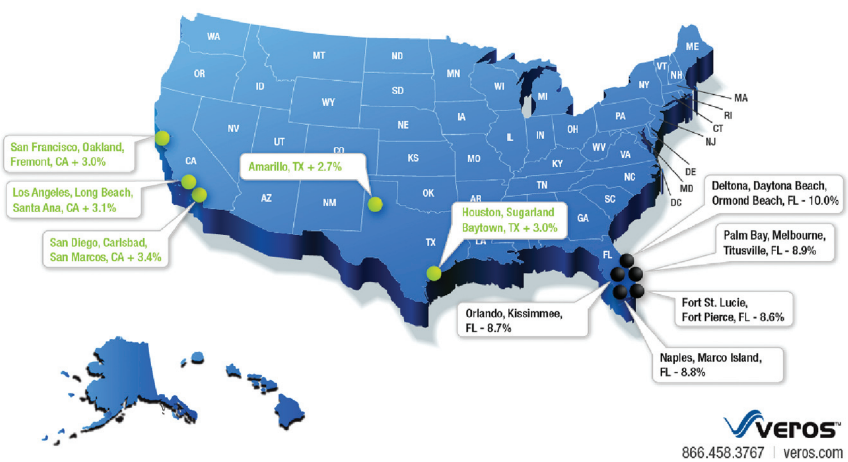
Forecasting To Assess Collateral Risk

As an example of real estate forecasting tools, Veros' VeroFORECAST presents a 12- and 18-month forecast of the market trends, updated quarterly as conditions shift. Most recently, the report showed these markets as among the nation's weakest for residential real estate in major metropolitan areas (typically greater than 500,000 residents) among single-family homes in the median price tier:

Projected Five Weakest Markets (shown in Image 3)

1. **Deltona / Daytona Beach / Ormond Beach, FL -10.0%**
2. **Palm Bay / Melbourne / Titusville, FL -8.9%**
3. **Naples / Marco Island, FL -8.8%**
4. **Orlando / Kissimmee, FL -8.7%%**
5. **Port St. Lucie / Fort Pierce, FL -8.6%**

Image 3



Florida, Nevada and Michigan have led the list of weak markets for the last several quarters, though Florida is currently in sole possession of the bottom five rankings. Of the ten weakest markets in the country, seven are in Florida, two are in Nevada and one is in Michigan.

Veros' forecast numbers for the bottom 20 markets relate directly to MARI's Fraud Index by state on the top fraud markets in 2009, found on page four, specifically Florida, California, Michigan and Virginia. There is a demonstrable correlation between the incidence of fraud and declining values in markets, the former all too frequently contributing to the latter.

Arriving at these forecasts with accuracy is a complex process. However, use of probabilistic models, analytics and other predictive technology methods, combined with relevant market data help to produce extremely useful information.

Automated tools are available to deal with foreclosure and other risk trend factors provide a series of predictive information that correlate to the likelihood of poor loan performance due to collateral fraud, early payment default and similar risks that threaten lenders.

Veros' version of this tool, the Collateral Integrity Analysis (CIA) report, looks at local foreclosures, NODs, trustee sales, historic price trends, forecasting analyses, area comparable sales (a key factor among MARI's appraisal fraud indicators), and other complexities of fraudulent borrower behavior; as well as providing suggested due diligence steps to remediate collateral risk exceptions.

Conclusion

The Mortgage Asset Research Institute Twelfth Periodic Mortgage Fraud Case Report surfaces some very sobering facts for the mortgage industry to digest:

- From 2007 through 2009, Suspicious Activity Reports (SARs) increased from 46,717 to 67,190 a frightening number of new cases by any standard.
- In Florida, mortgage fraud exceeded anticipated levels by three times, correlating to Veros' read on the state's negative real estate value forecast.
- The most noticeable increase in reported fraud type for 2009 is in appraisal fraud and misrepresentations, appearing in 33% of the cases.

Given the supreme importance of the valuation in the loan decision and in the security of the loan once the loan decision has been made, these figures indicate a situation that can only be considered dire. If left unchecked, this trend will bankrupt the nation's lending industry and keep investors from ever returning to the mortgage sector, restricting mortgage availability to a privileged few.

Fortunately for the industry and American home ownership, there are a variety of technology-driven tools that equip lenders and investors to understand and control fraud to a great degree. There is probably no feasible way to put an end to all mortgage fraud, but there are ways and means to prevent most appraisal-related deceptions. There is power in data when it is teamed with powerful and innovative analytics, sufficient power to beat the perpetrators of appraisal fraud at their own game. If they use false comparables to justify inflated values, we will expose them with predictive technology and initiatives like Fannie Mae's CDD. If they use invalid adjustments to authentic comps, we will flag them and ask for human intervention and review. If they omit or misstate information that overvalues the property for the neighborhood, we will find the foreclosure properties in the vicinity. And we will analyze the trends down to the most granular levels to give lenders a fighting chance, even when lending nationally and in great volume.

The information contained in the Mortgage Asset Research Institute's 2009 Report serves as a wakeup call for the industry that mortgage fraud is worsening, not improving. It falls to the valuation analytics and technology sector to provide an effective line of defense against appraisal fraud and collateral risk, and we are up to the task. We are having significant success at finding predictive, effective solutions to address this challenge.

It is an effort that will continue to refine, improve and add great value to the mortgage community as a whole, from Main Street to Wall Street, and for everyone in between. Based on the progress we have already made and the dynamic results we are currently seeing, mortgage fraudsters will have their work cut out for them in making crime continue to pay.

About Veros Real Estate Solutions

Veros Real Estate Solutions, a proven leader in enterprise risk management and collateral valuation services, uniquely combines the power of predictive technology, data analytics and industry expertise to deliver advanced automated decisioning solutions. Veros products and services are optimizing millions of profitable decisions throughout the mortgage industry, from loan origination through servicing and securitization. Veros provides solutions to control risk and increase profits including automated valuations, fraud and risk detection, portfolio analysis, forecasting, and next-generation collateral risk management platforms. Veros is headquartered in Santa Ana, California. For additional information on Veros, visit www.veros.com or call (866) 458-3767.

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