



Fighting Mortgage Fraud

FIRST, THE BAD NEWS: MORTGAGE FRAUD is widespread in our industry today. The statistics tell a clear story. A *USA Today* article dated Oct. 4, 2005, stated that the Federal Bureau of Investigations (FBI) reported it has 642 cases of mortgage fraud in the first half of 2005 versus 534 in 2004. Banks, in their suspicious activity reports (SARs), documented 12,100 incidents for the first nine months of 2004 versus 4,220 for 2001. According to a Mortgage Bankers Association (MBA) press advisory dated June 30, 2005, Georgia Attorney General Thurbert Baker reported that mortgage fraud affects all types of homes—everything from tract houses to multimillion-dollar mansions. This degree of fraud is a wake-up call for our industry.

Now, let's look at the good news. As leaders of the mortgage banking industry, we have an opportunity to be proactive. We have the power and the will to fight this fraud. Having said that, we're aware that within the past year, the problem has been exacerbated by those few who have lowered credit and quality standards to make loans that would not have even been considered two or three years ago. It is time for us to shine a light on some of our own practices and fix what I call "irresponsible lending patterns."

The stated-income, stated-asset loan type has become very popular in today's marketplace. The majority of mortgage professionals are using responsible practices to make these loans, avoiding the risk of mortgage fraud. However, there are those who are not making these loans responsibly, and we have to be aware of them. Let's look at a hypothetical example. An auto mechanic applies for a stated-income, stated-asset loan. He states that his annual income is \$250,000. After all, it is stated income—so it must be true, right? Wrong! This is an opportunity for us to use best practices and eliminate this type of fraud.

Before I look at the ways we can stop

these unethical actions from damaging our industry's reputation, let's examine the types of mortgage fraud being utilized. "Fraud for profit" can involve real estate brokers, mortgage brokers and appraisers who are in collusion to defraud the consumer. Unfortunately, some cases have even included closing attorneys involved in real estate transactions who are supposed to uphold the integrity of the buying and selling process. The fraud often involves overvaluing multiple properties. Mortgage



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companies are then stuck with mortgages that are much higher than the true property value.

"Fraud for housing" involves a person who has been coached by an industry professional—a mortgage broker, a loan officer or a Realtor®—on how to submit incorrect information on a loan application. In fact, the aforementioned FBI report also states that 80 percent of the mortgage fraud cases involve industry insiders. One reason for difficulty in detection is that these crimes are carried out in some of the hottest housing markets, where rapid appreciation can make it difficult to spot "illegal profits," according to Rachel Dollar, editor of

Mortgage Fraud Blog (www.mortgage-fraudblog.com) and a mortgage fraud attorney.

Whatever kind of fraud is being perpetrated, it involves the loss of tens of millions of dollars a year, as mentioned by William Matthews in a recent report on mortgage fraud by the Mortgage Asset Research Institute Inc. (MARI), Reston, Virginia, detailed in an Oct. 4, 2005, *USA Today* article. Mortgage fraud is causing considerable harm to consumers, industry professionals and the reputation of the mortgage banking industry. Not only does it affect the lending institutions that have to deal with fraudulent loans, but also every citizen is subjected to higher property tax rates due to inflated property values. Homes involved in mortgage fraud are often abandoned or become foreclosures, devastating neighborhoods and communities.

A number of protective tools have been developed to combat fraud, including new computer software and electronic reviews of data using automated valuation models (AVMs). Numerous warnings are being included in the pre-funding quality-review process, where an explanation may be requested to better determine any possible mortgage fraud. These red flags include flip caution, high concentration of real estate-owned properties (REOs), seller on contract but not on title, an appraisal that pre-dates the loan application, a vacant investment property or one that was owned less than one year, multiple ownership in the last 36 months, and payoffs listed on the HUD-1 that are not shown on the preliminary title. Detecting any of these may stop mortgage fraud in action. These tools can be easily incorporated into company systems and processes, and enable better detection of what types of loans to avoid. This is a real alternative to paying the price for a fraudulent loan, which then must be repurchased from the investor or from Fannie Mae or Freddie Mac.

However, more needs to be done to combat mortgage fraud. We cannot do it alone. Passing laws that punish the crime of mortgage fraud and aggressively prosecuting these criminals may help slow or stop its growth. At the same time, our focus needs to be on implementing processes to catch individuals who are trying to defraud us.

There is also a movement toward requiring all lenders to file a similar report to those that financial institutions file. Referred to as the SMART (suspi-

cious mortgage activity report) form, it is being developed by the FBI and would be mandatory for everyone in the mortgage lending industry to report possible cases of mortgage fraud. The FBI is currently working with members of MBA's Quality Assurance Leadership Subcommittee to finalize the form. The SMART form would be submitted by a reporting source to the FBI and filed with the Financial Crimes Enforcement Network (FinCEN) for any necessary prosecution. To protect this tool from abuse or fraud,

only the reporting source and the FBI would have access to the information reported from the form.

More states might consider following Georgia's lead when it passed a bill to include mortgage fraud as a criminal act this past May. Each incident results in a one- to 10-year prison term with up to a \$10,000 fine. If the same person is involved in numerous cases of fraud, the prison term is increased to three to 20 years and up to a \$100,000 fine.

None of us should turn a blind eye to our own practices. Be alert to underwriting standards, quality-control processes and risk-management procedures. Do not pretend that stated income is always what a person really earns if it appears illogical and seems like a bad business practice. It comes

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down to making appropriate decisions, because doing the right thing is what our industry is all about.

It is time for us to start policing any bad practices that exist in our industry. It is time to ensure that we prohibit and prevent mortgage fraud. And it is time to apply common sense to current and future underwriting policies. After all, mortgage fraud can be construed as a violation of fair lending because borrowers are being put at risk with loans and houses they cannot afford.

For those unwilling to fight mortgage fraud, the vast majority of professional mortgage bankers are going to make sure it is prevented with or without their support. This is about our reputation and the strength of our industry.

John M. Robbins Jr., CMB, is chairman and chief executive officer of AmNet Mortgage Inc. and American Mortgage Network (AmNet), San Diego. Marta McCall, senior vice president of American Mortgage Network, responsible for risk management (broker monitoring, fraud detection, mitigation and resolution), also contributed to this column.