

Connecticut Mortgage
Bankers Association, Inc.

Opening Doors

REPORT BY MARTHA CROOG

WHEN IS IT FRAUD?

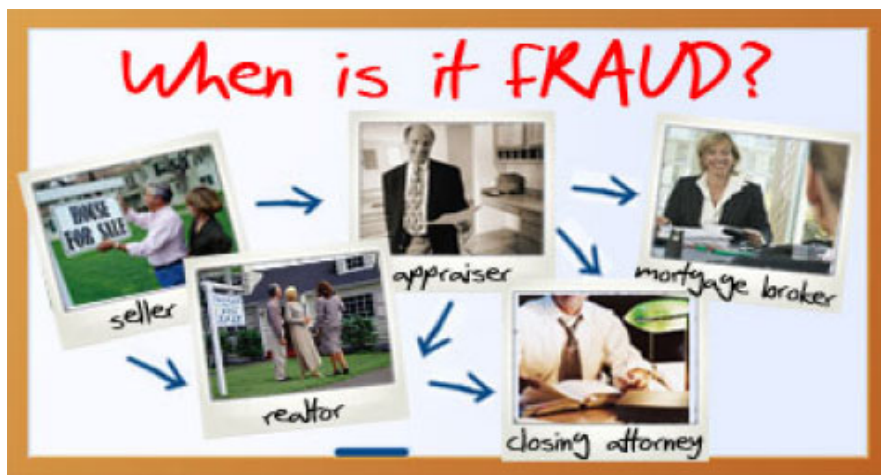
A SEMINAR

PRESENTED BY

JOINT TASK FORCE OF

Closing, Loss Mitigation, Production, Secondary Marketing & Underwriting

Committees of the Connecticut Mortgage Bankers Association



Graphic by Steve Donehue

Recent Market Conditions Facilitated Fraud

The challenges currently facing the mortgage banking industry are largely attributable to market conditions of prior years. Fueled by a combination of rapid and significant property appreciation and low interest rates, the mortgage banking community responded swiftly, introducing innovative and diverse loan products designed to maximize affordable, secured borrowing opportunities for homeowners as well as returns for investors. Independent brokers with inadequate supervision and education about the dangers of mortgage loan fraud, or who were otherwise unconcerned, submitted record numbers of loan applications to lender internet and call centers. These loans were processed and underwritten by overtaxed branch offices and corporate headquarters in a fiercely competitive pricing climate, operating at full capacity. This market landscape ultimately created a perfect storm which has, and in the near term, will continue to, cause major reforms and restructuring in the mortgage banking industry.

The Reach and the Grasp of Mortgage Fraud

One of the biggest challenges to emerge from past market conditions, is the significant increase in mortgage fraud. Afflicting lenders and borrowers alike, the rise in mortgage fraud has contributed to a rise in mortgage default by borrowers, with corresponding loan losses for lenders. For example, it has been reported that 70% of early payment defaults had fraud or misrepresentation. It has also been reported that loans with fraud or misrepresentation are five times more likely to

default.¹ For many borrowers, fraud has led to foreclosure, credit injury and “payment shock”. For many lenders, it has caused defaults in obligatory financial covenants, forcing loan repurchase demands by warehouse lenders and investors. The financial injury to lenders also includes mandatory earnings restatements due to unforeseen increases in nonperforming loans, regulatory intervention, forced business disruption, divestitures and bankruptcy. Since the effects of fraud are not immediately realized, the backlash will continue, even after the exigencies of recent years has faded.²

Mortgage fraud not only affects, but also implicates, diverse members of the mortgage banking community, long after the buyer and seller have walked away from the closing table. The affected participants include real estate brokers, loan brokers, appraisers, closing attorneys, title and mortgage insurance companies, and mortgage lenders, both federal and non-exempt mortgage and commercial banking institutions. The fraudulent mortgage loan transaction also affects a broad range of other stakeholders, such as servicers and warehouse lenders. Once the loan is packaged, securitized and sold to a mortgage loan pool, the beneficiaries, both individual and institutional, are at risk. Also vulnerable to losses from loan fraud

¹ In its March 7, 2007 Annual Report on Financial Crimes, the Federal Bureau of Investigations (FBI) reported that the “true level of mortgage fraud is largely unknown.” The FBI explained that a significant percentage of the mortgage industry does not have to report fraud cases, only federally-insured financial institutions, and that fraud is often concealed as mortgage products are packaged and sold in the secondary market.

² Companies often report fraud cases from one-to-four years after loan origination. It takes this time for fraudulent loans to go into default, for quality control departments to complete investigations and for SARs (Suspicious Activity Reports) to get prepared. It has been noted that many 2004 and 2005 SARS dealt with loans originated between early 2000 and late 2003. *Examining the Many Causes and Potential Progress of Fraud*, D. James Croft, Merle Sharck and Nick Larson, Servicing Management, 2006 Fraud Report Supplement, c. 2006

are hedge funds, mutual funds and investment banks, which provide and replenish the financial backing for these securitizations by selling or trading in them. Further, the respective investors in these entities, both individuals and other entities, as well as the shareholders of the mortgage companies, commercial banks and federal housing agencies themselves, suffer from the economic downturns in the mortgage lending business which fraud causes.³

A significant percentage of fraud losses involve collusion or collaboration by industry insiders.⁴ However, even where there is collusion among insiders, the industry's reach is so extensive that fraud's ripple effect triggers substantial economic loss for industry participants who are far removed from the original fraud scenario and its facilitators. Moreover, because the line between a fraudster and his victim are often blurred, apparent victims with some direct involvement may actually reap an economic benefit while an unapparent victim, involved only remotely as a passive investor, suffers the heaviest financial blow. Governmental agencies which operate in, or provide important ancillary services to, this sector, have, and will continue to, react to suspected and known violations with the passage of new laws, increased fines and penalties, both civil and criminal, and compliance mandates and revisions.⁵

³ More than 1 trillion in mortgage backed securities were sold during 2006 in the United States alone. Forbes Magazine, 3/13/07, *Big Banks May Be Chum*, Liz Moyer. "[I]n the process of buying the loans and packaging them up, investment banks retain some risk of loss, including accounting items like loans held for sale, loans held for investment, retained interests in the securitizations themselves, and so-called warehouse loans that keep the origination engines at the small mortgage lenders humming."

⁴ In its March 7, 2007 Report, the FBI stated that 80% of all fraud losses involve fraud for profit.

⁵ The FBI has reported that since September 2002, the number and types of mortgage fraud investigations have increased from 436 to 1,036. Of these current cases, 51% involved anticipated losses in excess of \$1

The reach of mortgage fraud does not end with some affiliation with the loan transaction. It also affects uninvolved property owners, and its grasp can cripple entire residential communities ---neighborhoods, cities and towns. Even where there is collusion or collaboration by industry insiders, a substantial percentage of fraud is initiated by consumers, as well as groups or “gangs” with criminal agendas unrelated to the lending process, which may infiltrate entire communities and perpetuate unrelated criminal enterprises. Other fraud scenarios involve appraisal fraud, such as flipping and purchase price inflation for cash back and concessions through the closing process, with and without appraiser coercion. In these cases, even if the fraud is discovered, the long term effects are not easily undone. Fraudulent values which have been placed in MLS are relied upon by legitimate appraisers, who may lack the means to discern a fraudulent MLS entry. This type of fraud leaves visible, long term economic consequences for unwitting neighbors who are forced to live in residential communities blighted by overvalued, abandoned and distressed properties .⁶

Fraud also impacts future borrowers. The consequences of increased regulatory intervention and a possible decrease in capacity and competitive pricing

million, and 57% involve federally insured financial institutions. The FBI acknowledges that its case load likely reflects only a small part of the problem.

⁶ On March 9, 2007, the Federal Reserve Board’s Consumer Advisory Council, including Federal Reserve Chairman Ben S Bernanke and three Fed Governors, took testimony about neighborhoods marked by abandoned homes due to foreclosures and received recommendations on ameliorating the devastating effect of the high rates of foreclosures. See also, Chicago Tribune series on mortgage fraud, “*Robbed at the point of a pen*”, David Jackson, Tribune staff reported, published November 5, 2005.

among mortgage lenders may reduce the future flow of mortgage lending capital and/or affordable loan products, with higher loan costs.⁷

A Proactive and Insightful Approach for Reducing Mortgage Fraud

This seminar will first attempt to define fraud by describing the types of transactions in which they occur.⁸ It will also address the influence of certain market conditions on the frequency and forms of fraud. Predicted future regulatory trends and enforcement policies of federal, state and local regulators, such as the State Attorney General, the FBI and the Connecticut Department of Banking will be addressed. Representatives from federally insured financial and housing agencies, HUD, FannieMae and Freddie Mac, will offer guidance on the current industry challenges with recommendations and guidance to safeguard against the risk of mortgage fraud through product features and sound underwriting policies. The critical appraisal and closing processes will be emphasized. Minimizing financial exposure with other proactive measures, such as the adoption of exclusionary vendor policies, cooperative information sharing among lenders about suspected and known offenders through formal and informal networks, and reliance on title

⁷ Freddie Mac, in its March 2007 Report, anticipates that ample liquidity will remain in the prime mortgage lending market. On February 27, 2007, FreddieMac announced an initiative to accept only subprime adjustable rate mortgages that qualify borrowers at the “fully-indexed and fully-amortizing rate.” The intent is to discourage lenders from approving loans at start rates that may rise significantly when scheduled rate increases become effective within two to three years.

⁸ It is difficult for the average lender to quantify mortgage loan loss resulting from fraud. Of those financial institutions reporting, the FBI, in its March 7, 2007 Report, noted that SARs increased from 17,127 during fiscal year 2004 to 35,617 SARs during fiscal year 2006. From these incidents, the FBI estimates losses of \$946 million.

It is also significant to note that according to the Mortgage Bankers Association’s latest National Delinquency Survey, reporting generally on the delinquency on one-to-four-unit residential properties, the delinquency rate in the fourth quarter of 2006 was 4.95% of all residential loans outstanding during that quarter, a rate which is 28 basis points higher than the third quarter and 25 BPS higher than the level during the preceding year.

and mortgage insurance, as well as technological innovations for early fraud detection, will be explored.

Foreseeable regulatory changes and “stepped-up” enforcement of existing laws will shape future trends in the mortgage banking industry, just as the market conditions of recent years triggered current and future trends. Prevailing market forces such as sagging home prices, excess housing inventory and structural changes among subprime mortgage providers will continue to influence these trends,⁹ just as the drastic property appreciation and record loan originations shaped market conditions of recent years. This seminar is designed to aid the reduction of mortgage fraud through a proactive response to the challenges of anticipated regulatory and enforcement reforms, as well as voluntary and involuntary market responses. It is intended that the responses to fraud that are discussed during the seminar, will help bring the industry’s “market corrections” into closer alignment with regulatory and enforcement policies and modifications.¹⁰ However, the primary purpose of this seminar is to educate each attendee about the concrete ways in which he or she may recognize and prevent mortgage fraud in daily practice.

⁹ In the MBA’s most recent National Delinquency Survey, MBA Chief Economist Doug Duncan’s written statement reported that “[s]ubprime borrowers are more likely to be susceptible to the cumulative increases in interest rates that we have experienced and the resultant slowing of home price appreciation including outright declines in the market.”

¹⁰In February 2007, the Fed’s Senior Loan Officer reported that 15% of banks are tightening underwriting standards on all loans, the highest rate since the recession of the early 1990s.

Opening Remarks—Attorney General Richard Blumenthal

The Attorney General will address pending and anticipated legislation designed to curb mortgage fraud, such as HB5222, which is directed at high risk, hard money loans, in particular, foreclosure rescue/sale-leaseback transactions for distressed borrowers, including those in foreclosure.

The Attorney General will also discuss his observations on the growing problem from an enforcement perspective. In particular, he will address the presentation of specific factual scenarios that prompt him to pursue enforcement action.

**Existing State and Federal Regulatory Schemes, Definitions and Policies and
Predicting Future Trends and Policies
Mortgage Fraud Scenarios. Gangs and Flippers**

Fraud Transactions and Definitions

Fraud for Profit—usually committed by industry insiders

Fraud for Housing—action taken by borrowers to acquire a house under false pretenses

- **Appraisal Fraud**—failure to accurately evaluate fair market value (gross negligence) or deliberate participation in a scheme to defraud
 - **Flipping** – A property is over-or under valued, often due to pressure from loan originators and real estate agents to alter appraisal reports. Pressure can appear positive (gifts, referral fees or kickbacks) or negative (yelling or threatening). Flippers often use identity theft, straw borrowers or industry insiders to effect the flip. In the end, the loan amount exceeds the value of the property and the lender sustains a loss when the loan defaults.¹¹
- **Deceptive Purchase Contracts with Purchase Price Inflation for Cash Back at Closing and Hidden Seller Concessions**
 - **Designed to create illusion of rising property value where price is prima facie evidence of fair market value¹²**
 - **Scenario** – Borrower submits \$200,000 contract to seller with no cash down. Lender's loan to value ratio is 80%, so seller and buyer, with advice of real estate or loan broker, agree to increase purchase price to \$250,000. Buyer finances \$40,000 through the seller in a second mortgage that seller agrees to tear up after the closing.

¹¹ Approximately 64% of Suspicious Activity Reports described collusion by sellers, appraisers and mortgage brokers in flip transactions, while approximately 14% of the sampled narratives described the use of straw buyers. *Mortgage Loan Fraud-An Industry Assessment based upon Suspicious Activity Report Analysis*, Financial Crimes Enforcement Network, Office of Regulatory Analysis, November 2006.

¹²In an earlier report, The Appraisal Institute, in its Forum Report, stated that 98% of the time the purchase price is hit by the appraiser. *Detection and Prevention of Mortgage Loan Fraud*, Vernon Martin, The RMA Journal, September 2004.

Seller agrees to refund the remaining \$10,000 cash down payment, which agreement will also be destroyed. Buyer gets house with “no money down”, seller gets full asking price, real estate and loan brokers get commissions based on inflated purchase price and loan amount

- **Debt Elimination Fraud/Forgery**
 - **Double Sales**
 - ❖ **During period between deed delivery and recording, a fraudster records a deed, arranges a loan, and before the transactions appear in the land records, files another deed and arranges another loan**
 - **Fraudster advises borrower to file a document stating that the loan was released, and persuades borrower to apply for one or more new loans. Once approved, the fraudster takes the greater part of the proceeds, leaving the borrower with the unpaid liens and exposure to criminal conspiracy charges**

- **Home Improvement Cons**
 - **A contractor persuades a homeowner into making costly or unnecessary repairs, loaning the homeowner money for the job or arranging a mortgage loan, with the proceeds sent directly to the contractor. At foreclosure, the contractor either redeems the loan and takes back the house, or pockets the excess foreclosure sale proceeds**

- **Hard Money Loans and Foreclosure Rescue Scams**
 - **Delinquent mortgagor is offered a “loan to get caught up” on the payments. In exchange for the “rescue”, the homeowner conveys title to the fraudster, who promises that the homeowner may remain in home while paying rent and may repurchase with rent payments applied to “re-purchase price”. Fraudster evicts homeowner for nonpayment of rent, cancelling “sale/leaseback contract” or sells to someone else**

- **Fraudster persuades mortgagor in foreclosure that he will resolve the foreclosure for him. Mortgagor sends several thousand dollars and never hears from fraudster again**
- **Misrepresentations (with/without Forgery or Cash Payments)**
 - **Of Identity**
 - **Straw Buyers**
 - ❖ **A person or entity pays another person for the use of his/its name and credit history to purchase a property**
 - **Of Owner Occupancy, Loan Purpose or Intended Holding Period**
 - ❖ **Possible motivation to purchase investment property at more favorable loan rates than would be available if the property was not owner occupied or to launder money from illegal activity¹³**
 - ❖ **Stated intent for property renovations with proceeds used for acquisition of luxury items**
 - ❖ **Reliance on fraudulent appraisal to induce lender to loan more that is adequately secured by the property, with intent to repay only if property value increases, but to default if property performance and value decrease**
 - **Air loans**
 - ❖ **A fraudster invents borrowers and buildings to obtain loans, perhaps setting up phones and posing as borrower, employer, appraiser and credit agency to lender's underwriter**
 - **Chunking**
 - ❖ **Fraudster holds a seminar promising groups of prospective investors to get rich buying property with no money down. Using the investors'**

¹³ See fn. 13, *supra*. Occupancy fraud was reported in 80.62% of SARs.

information, the fraudster submits multiple mortgage loan applications, keeping the loan proceeds

- ❖ **Variation- Fraudster promises prospective investors to get rich buying property with no money down, guaranteeing that tenants or third parties will make loan payments. Fraudster submits loan application using investor information, pockets loan proceeds, loan defaults and investors lose property and credit standing.**

- **Of Credit**

- **Borrower with low credit scores is added to the credit card of a person with perfect credit. Borrower has no access to card but enjoys the benefit of strong credit to obtain mortgage loans**
- **Fraudster solicits persons with perfect credit are solicited by on-line marketers who promise to earn the person thousands of dollars each month. Credit information is obtained by fraudster to obtain mortgage loans**

- **Of Tenant occupancy or rental income¹⁴**

- **Of Earnings**

- **Of Assets**

- ❖ **Asset Rental Fraud**

- **Of Bank statements**

- **Of Liabilities**

- **Of Down-Payment**

- **Of Employment**

- **Fabricated Gift Letters**

- **Of social security number**

Statement of State and Federal Regulatory Schemes—DOB, FBI

¹⁴ See, Department of Housing and Urban Development, Section 8 Initiative.

Highlight of fraud scenarios from recent cases

Correlation between Market Conditions and Regulatory Responses

- **Record increase in origination volume**
- **High Risk Products with low and no documentation**
- **Financial Incentives for High Priced, High Risk Products for Broker, Buyer, Seller, Lender**
- **Broker ordering of appraisals**
- **Low Interest Rates**
- **Off the Shelf software/products with unrestricted potential use and misuse**
- **Phantom loan brokers**
 - **Independent contractors**
 - **No broker (or ASC appraiser) loyalty**
 - **Easy industry re-hire if terminated due to lax registration requirements invites marginal players from real estate and financial services sectors**
 - **Short term involvement in loan process, with limited economic incentive for detailed fact checking**
- **Overtaxed front-end quality control procedures**
- **Stated interest rate increases after “teaser” rate change**
- **Rapidly escalating property values may conceal actual fraud**
- **Inadequate regulation of fraudsters**

Regulatory Responses

- **Mandatory Underwriting Guidelines**

- **Increased Enforcement and Penalties**
- **Market Interest Rate Reductions to facilitate refinances**
- **Imposition of Suitability Requirements**
- **Regulations Prohibiting the Influence of Appraisal Process**
- **Expansion of Broker Registration Processes (Nationalized Registration)¹⁵**
- **Mandatory Broker Education**
- **Warehouse Lender Regulation**
- **Increased Issuance of Cease and Desist Orders**
- **Referral Fee (kickback) broker regulation**
- **Foreclosure Rescue and Hard Money Lending Regulation**

The “Flip” sides of Fraud

Shifting Perpetrators and Victims—Will Suitability Rules in the Securities Industry Work in the Mortgage Loan Industry? Is the “universal” dream of home ownership the same for stock ownership?¹⁶

- **Understanding Motive (Intent)—Often the perpetrator and the victim share a motive---to mitigate risk and minimize equity investment. How the motive is acted on reveals when it is fraud. In certain cases, the “victim” of fraud may also be the “economic beneficiary” or “facilitator” of the fraud.**
- **Is it Fraud where SISA or no income loans are written, or where there are repeated refis and high points and fees are charged each time but where there is no other opportunity for borrowers?¹⁷**

¹⁵ Twenty-eight states have signed a letter of intent to participate by the end of 2008 in a nationalized, internet based central mortgage licensing system, sponsored as a joint project of the American Association of Residential Mortgage Regulators (AARMR) and the Conference of State Banking Supervisors (CSBS). This initiative is opposed by the National Association of Mortgage Brokers (NAMB), which claims that the resulting exemption from registration for 60% of mortgage companies will create “a false sense of security” for consumers. The opposition appears to presume that only consumers will benefit from the initiative.

¹⁶ “... [A]s surely as there will always be borrowers with sketchy credit histories, there will be lenders to take them on. “Whatever form it takes, subprime mortgage lending will continue,” said the report from Standard & Poor's research. “Subprime operations of these investment banks and other entities will be well positioned to handle this demand, especially if bank regulators further limit traditional banks' ability to serve this marketplace.” *New Century's Trials are an Opportunity*, Forbes Magazine, Liz Moyer, March 9, 2007.

**Detection, Mitigation and Prevention in the Underwriting Process.
Underwriting Guidelines, Identity Theft.
Challenges in the Broker and Appraisal Process.**

Underwriting Guideline Responses and Revisions

- **Promote lender cooperation and information reciprocity on known or suspected fraudsters**
 - ❖ **Mortgage Asset Research Institute, Inc.’s Mortgage Industry Data Exchange relies on contributory (non-public) information from subscribers to assist lenders in identifying mortgage and real estate professionals that have been associated with fraudulent activity or serious misrepresentation in the past**
- **Changing Products to account for “weakened” real estate markets and “Payment Shock”¹⁸**
 - **Tighten Credit Standards and Eliminate or phase down products reliant on reduced credit scrutiny**
 - **Shorten Prepay Penalty period**
 - **Promoting Refinances for Payment Shocked Borrowers after Teaser Rate Change**
 - **Mandatory Escrows for Taxes and Insurance**
 - **Mandatory Downpayments**
- **Increased Scrutiny of loan relationships**
 - **Are there multiple transactions with same borrowers, brokers and/or appraisers?**

¹⁷ See Freddie Mac Seminar presentation for discussion whether actual rate of fraud increases for unconventional loans that are offered to appropriate borrowers in accordance with sound underwriting principles.

¹⁸ See, e.g., Joint Release: Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency and Office of Thrift Supervision Proposed Statement on Subprime Mortgage Lending, Notice and Request for Comment, March 2007.

- **Are there predominate appraiser relationships with a single broker and/or closing attorney?**
 - **Did a loan originator or broker associated with known or suspected fraud submit the pending loan?**
- **Heighten protection of appraisal process**
 - **Enact ineligibility standards for transactions involving flipped properties¹⁹**
 - **Brokers v chief appraiser ordering using AMCs or ASC appraisers**
 - **Secondary reliance on AVMs**
 - **Accept appraisals only from approved appraisers²⁰**
 - **Examine date of appraisal report, date of inspection and date of appraisal order to insure authenticity for requested purpose**
 - **Supply appraisers with title searches for examination of liens and assessments that materially affect value**
 - **Compare contract rents with market rents for rental income verification**
- **Utilize Fraud Warning Notices²¹**
- **Safeguard mortgage release process**
 - **Implement safeguards against erroneous recording of mortgage releases—cross checks in release preparation**
- **Implement incident response plan for security breaches**

¹⁹ HUD’s regulation “Prohibition of Property Flipping in HUD’s Single Family Mortgage Insurance Programs; Final Rule”, 24 C.F.R. part 2003 makes certain flipped properties ineligible for FHA mortgage insurance.

²⁰ HUD, FannieMae and Freddie Mac have all undertaken initiatives for exclusionary lists and debarments for fraudulent conduct involving both appraisers and closing attorneys.

²¹ On March 7, 2007 the FBI and the Mortgage Bankers Association entered into an agreement to make available a Mortgage Fraud Warning Notice as a proactive means of educating consumers and mortgage-lending professionals of the penalties and consequences of this criminal activity. *FBI, Lenders Warn Fraud is Illegal*, Press Release, FraudBlogger.com, March 7, 2007.

- **Monitor the security of nonpublic consumer and financial information and guidelines for determining detected breaches to the consumer**
- **Examine purchase contract for red flags**
 - **Scrutinize allowances for repairs—cross check with appraiser**
 - **Examine seller financing for possible “forgiveness”**
- **Enact Anti-Flip policies**
 - **Require advance notice of any “flips” that occurred within several years of the closing**
 - **Require disclosure or certification from closing attorney that no flips occurred within several years of closing**
- **Explore Technology Solutions for Accelerated Fraud Detection and Mitigation**
- **Improve Supervision with regionalized operations**
 - **multiple branch office elimination in favor of regionalized structure**
- **Lender Exit Strategies²²**
 - **Divestitures²³**
 - **Bankruptcy Reorganization with intent to sell**

²² Credit Sight Analyst David Hendler calls Wall Street a bunch of enablers for allowing the situation to progress to such a crisis. Lenders... "have been enabled by fast money (namely warehouse lending lines from brokers eager to securitize their product) and are now being somewhat butchered by the same brokers/banks that gave them the keys to the subprime loan writing castle in good times," Hendler wrote. *Forbes Magazine*, 3/13/07, *Big Banks May Be Chum*, Liz Moyer.

²³ "We expect the shakeout in the sector to continue, with investment banks and possibly hedge funds and private equity firms purchasing distressed subprime lenders or their discounted assets," said a report Friday by Standard & Poor's research. "The advantages these firms will have in vertically integrating a newly purchased origination platform within their existing distribution capabilities (including significant pricing power over the marketplace) will make it difficult for standalone subprime originators to survive." *New Century's Trials are an Opportunity*, *Forbes Magazine*, Liz Moyer, March 9, 2007.

- **Implement Accounting Reforms for loan loss reserves**

Challenges in the Broker Process

- **Identity Theft**
- **Improved Broker Education**
- **Increased Supervisory Force**

Challenges in the Appraisal Process

Recommended Measures for Preventing Appraisal Fraud

- **Supply Appraisers with title searches to examine liens and assessments that materially affect value**
- **Resist coercion to appraise to a predetermined value**
- **Practical issues with reporting coercion or suspected fraud**
 - **Misappropriation of Appraiser's identity using packaged appraisal forms**
 - **Reported Connecticut Cases where appraiser reported fraud**
- **Scrutinize for phantom renovations—check appliances, carpets, whether permits were obtained to support claimed renovations**
- **Verify whether claimed improvements were illegally erected**
- **Scrutinize for misrepresented or undisclosed property conditions**
- **Examine listings in addition to comparable sales**
- **Avoid bias in borrower provided comparable sales information**
- **Examine unusual changes in occupancy**
- **Give appropriate discounts for location and visibility**

- **Advantages and Disadvantages of AVMs and AMCs**
- **Overcoming the Snowball effect of appraisal fraud on long term property values**

**The Closing Phase.
Title Fraud, Identity Issues.
Communicating Underwriting Deviations prior to and at Closing.**

The Closing Phase

Proactive Measures for Preventing Fraud during the Closing Phase²⁴

CLOSING ATTORNEY WATCH LIST FOR REQUESTS TO:

- **Back date HUDs to show prior purchase of the property to obtain refinancing under less scrutiny than original loan**
- **“Launder” sales proceeds by issuing settlement checks to shell companies controlled by the fraudster or to pay for luxury items which do not serve to clear title**
- **Record false satisfaction, cancellation and assignments of mortgages on a number of properties to eliminate the security interest of legitimate lenders, either by fraudulent transfer to a co-conspirator’s company or showing the property to be free of all liens before obtaining additional mortgage loans**
- **Quitclaim property back to seller or to another coconspirator without notice to or permission of the lender. This could trigger an unofficial loan assumption without the knowledge of the lender, or indicate that a straw buyer was used to obtain the loan, with title being transferred to the actual owner after the loan disbursement**
- **Submit to lender closing packages which were signed outside your presence**
- **Conduct closing by someone other than you signing the HUD**
- **Record mortgage in favor of the fraudster’s shell companies or third parties before you record the mortgage**
- **Close a loan and/or issue a title policy where the seller did not yet own the property sold to the borrower, i.e., where seller intends to pay for property with proceeds of borrower’s loan**

²⁴ See, Mortgage Fraud-The Consequences and Our Commitment to Fight Back, a paper by Assistant United States District Attorney Gale McKenzie, United States Attorney’s Office, Atlanta, GA 30303, posted October 4, 2005 on The Mortgage Fraud Blog, supported and funded by The Prieston Group.

- **Close a loan where the borrower knows and fails to disclose that a third party owns an interest in the property**
- **Close a loan without written permission of lender where property has been “flipped” within the past week, month or year**
- **Advance borrower down payment funds from closing attorney’s escrow account or to accept such funds from any other source without a pre-approved gift letter or written permission from lender**
- **Accept copies of POAs or drivers licenses from any party to the closing**
- **Conduct “staggered” closings and back date HUD to original closing date**
- **Ignore obvious red flags for misrepresentations on no document loans**
- **Disburse closing proceeds other than to the seller and prior lienholders and other closing costs listed on HUD**
- **Disburse funds (launder) by making other payments on behalf of another party even if disclosed on the HUD**
- **Quitclaim the property just closed or otherwise change title without advance permission of the lender**

RECOMMENDED MANDATORY CLOSING PROCEDURES

- **Make a clear copy of the drivers license of both borrower and seller**
- **Require borrower to resign the loan application in your presence after reviewing the qualifying information; examine signatures on loan app and HUD**
- **Orally verify borrower’s primary residence**
- **Verify all releases where any prior lien has been released by calling 411 for number of prior lender rather than relying solely on release**
- **Verify all quitclaim deeds to borrower**
- **Have closing participants sign their names and list positions to increase risk of identification of straw sellers**

- **Promptly record mortgage**
- **Maintain record of method by which lender and third parties received funds and make copies of negotiated disbursement checks**
- **Send transmittal letters with disbursement checks for proof of delivery**
- **Identify and disclose referral fees and suspected broker kickbacks to avoid potential RESPA violations**
- **Refer to sales contract**
- **Report mortgage fraud**

ETHICAL RULES THAT BIND CLOSING ATTORNEYS

Duty to prevent, cure or report fraud or a conflict of interest, execute duties with reasonable diligence and promptness and avoid aiding the unauthorized practice of law

Indemnification.
Mortgage - Title Insurance Coverage.
Technology Solutions.
Lawsuits and Disciplinary Proceedings.

Indemnification—Coverages and Exclusions

- ***Fraud Insurance***
 - **product in developmental phase according to Triad Guaranty.**
- ***Title Insurance***
 - **What types of mortgage fraud trigger bona fide title claims and what does not? Exclusionary rules.**
 - **Mortgage Release Transactions**
 - **Example—Prior lender failed to release home equity loan in land records after receiving mortgage pay-off, causing the new lender’s loans to have a subordinate position. Homeowners continued to use the prior lines of credit in addition to the new loan to obtain an extension of credit that exceeds property value.**
 - **What are the considerations that influence the lender when to undertake litigation to enforce lender title claims to fulfill indemnification obligation?**
 - **Proof and Damages Considerations in cases filed by title insurance carriers where mortgage fraud is involved**
 - **Fraud claims filed in reliance on the closing protection letter**
 - **Landmark Cases**
- ***Mortgage Insurance***
- ***Technology Solutions***

- **Technology solutions to detect risk where credit score risk assessment is ineffective due to misrepresentation of loan qualifying data is intended to revolutionize the mortgage risk management process for lenders and securitizations. These solutions are designed to address fraud prevention, mortgage prepayment forecasting, regulatory compliance, collateral risk assessment and due diligence reviews.**
- **Some of the providers of these technological advances include Interthinx™, CoreLogic Systems, Inc.²⁵ and BasePoint Analytic. These companies employ predictive models in analyzing loan originations to detect risk when fraud is present.²⁶**

Disciplinary Proceedings and Criminal Enforcement

- **Consequences**
 - ❖ **Industry participants-financial losses, injury to professional reputation**
 - ❖ **Consumer-higher interest rates and fees, stolen identifies, impaired credit**
 - ❖ **Neighborhoods—higher property taxes, increased criminal activity, abandoned properties, lower fmvs**
- **Categories of Disciplinary Proceedings**
 - **Civil**
 - ❖ **License Suspensions**
 - ❖ **License Revocations**
 - **Criminal Penalties and Sentencing**
 - **Fines**

²⁵ In the first quarter of 2007, the Real Estate Solutions Division of the First American Corporation's subsidiary, FARES LLC joint venture with Experian Group Limited, merged with CoreLogic. FARES is a also a minority shareholder of Base Point.

²⁶ BasePoint Analytic claims that its FraudMark™ technology outperforms traditional credit scores by over 200% in determining early payment default where the loan application contains fraudulent misrepresentations, and that its technology correctly identifies approximately 40% of a lender's loans pre-funding that would stop paying within the first six months, if the loan had been booked. News Release, BasePoint Analytics, February 12, 2007.

- **Connecticut Enforcement Actions**

- ❖ **Against Attorneys—mail, wire, bank, HUD and bankruptcy fraud, use of false identification documents and false social security numbers, launder of scheme proceeds and conspiracy to commit these offenses**
- ❖ **Against Brokers----**
- ❖ **Against Appraisers---**
- ❖ **Against Lenders----**

Law Office of Martha Croog, LLC
740 North Main Street, Suite N
West Hartford, CT 06117
860-236-9661
860-233-9927 (fax)
Martha.Croog@Mcroogllc.com