



## **When and How Can Mortgage Fraud Be Brought Under Control?**

**By Dennis M. Lormel**

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The financial crisis has exposed a plethora of frauds. While business scandals like Enron and Ponzi schemes such as Madoff and Stanford have garnered considerably more visible attention and notoriety, mortgage fraud has consistently grown at an alarming annual pace. The Financial Crimes Enforcement Network (FinCEN) reported on February 25, 2009, that for the year ended June 30, 2008, 62,084 suspicious activity reports (SARs) of mortgage loan fraud were filed. This was an increase of 44% from the prior year. On July 7, 2009, the FBI issued its 2008 Mortgage Fraud Report (MFR). For fiscal year (FY) 2008, the FBI received 63,713 mortgage fraud SARs. This was an increase of 36% from the prior year. While the dollar loss attributed to mortgage fraud is unknown, financial institutions reported losses of at least \$1.4 billion in FY 2008, an increase of 83.4% over FY 2007.

There has been a steady increase in the number of SARs filed for mortgage fraud since 2004, and likewise, there has been a steady, if not substantial, increase in the number of mortgage fraud investigations undertaken by the FBI. The number of open FBI mortgage fraud investigations in FY 2008 was 1,644. For the first half of FY 2009, the FBI had 2,346 open mortgage fraud cases. In addition, although specific statistics are not available, the number of mortgage fraud cases investigated by other federal, state and local agencies has continued to increase.

### **When can mortgage fraud be brought under control?**

This is a perplexing question. The answer is contingent on a number of factors. However, there are two basic elements to consider...opportunity and responsiveness. First is the opportunity to commit mortgage fraud. Industry and government must work in tandem to limit this opportunity. They must share information about fraud schemes, emerging trends and coordinate strategies that enable them to both collectively, and individually, address the crime problem. Second is the responsiveness from the industry and government in developing and implementing methodologies that deter and diminish mortgage fraud. Industry must do a better job of recognizing institutional vulnerability to mortgage fraud and then develop measures to limit exploitation of such vulnerabilities. Government must do a better job of developing and implementing innovative and progressive investigative methodologies that will more effectively result in timely prosecutions.

Mortgage fraud is defined as a material misstatement, misrepresentation, or omissions relied upon by an underwriter or lender to fund, purchase, or insure a loan. Mortgage loan fraud is divided into two categories: fraud for property and fraud for profit. Fraud for



property or housing entails misrepresentations by the applicant for purposes of purchasing a property for a primary residence. Fraud for profit, however, often involves multiple loans and elaborate schemes perpetrated to gain illicit proceeds from property schemes.

According to the 2008 FBI MFR, “the schemes most directly associated with the escalating mortgage fraud problem continue to be those defined as fraud for profit. Fraud for profit schemes often employ the use of a variety of loan products in addition to a standard conventional loan, such as sub-prime loans, Alt-A loans, Home Equity Lines of Credit, option-adjustable rate mortgage loans, and Home Equity Conversion Mortgage loans. Prominent schemes include builder bail-out, short sale, foreclosure rescue, credit enhancement, loan modification, illegal property flipping, seller assistance, bust-out, debt elimination, mortgage backed securities, real estate investment, multiple loan, assignment fee, air loan, asset rental, backward application, reverse mortgage fraud, and equity skimming. Many of these schemes employ various techniques such as the use of straw buyers, identity theft, silent seconds, quit claims, land trusts, shell companies, fraudulent loan documents (to include forged loan applications, settlement statements, and verification of employment, rental, occupancy, income, and deposit), double sold loans to secondary investors, leasebacks, and inflated appraisals.” For specific details and descriptions concerning the numerous schemes mentioned above, refer to mortgage fraud on the FBI’s website and review the 2008 FBI MFR, and other publications. FinCEN issued an Advisory on April 6, 2009, highlighting the increase in loan modification and foreclosure rescue schemes resulting from the current economic environment.

The answer to the question “when can mortgage fraud be brought under control?” is contingent to a great degree on the response and commitment by industry and government to the question “how can mortgage fraud be brought under control?”. There must be a true understanding for the scope and cause of the problem. In turn, there must be a more comprehensive response and commitment by industry and government to adequately address and reduce the problem to a controllable level.

Quite frankly, to date, industry and government have not demonstrated the capacity to adequately control the mortgage fraud problem. Businesses dealing in all aspects of mortgages have allowed profits to trumpet compliance and thereby facilitate fraud. Government has not dedicated the resources necessary to adequately investigate, prosecute and deter mortgage fraud. The combination of these two factors has enabled mortgage fraud to reach epidemic proportions. In the past year, industry and government have made an encouraging commitment to fight and reduce mortgage fraud, in part, driven by Congressional oversight.

In April 2008, FinCEN published an Updated MFR. The report stated “data analysis for the most recent studied time period indicates a 50 percent increase in the number of SARs that reported intercepting the suspected fraud prior to funding a mortgage. This indicates



growing vigilance and awareness in the financial community.” The FBI’s 2008 MFR advised that in December 2008, the FBI created the National Mortgage Fraud Team to assist field offices in addressing mortgage fraud. The report noted that the FBI has formed 18 mortgage fraud task forces and 53 working groups to investigate mortgage fraud with other federal, state and local law enforcement partners. It also discussed liaison partnerships with industry and developing new and innovative investigative techniques to detect and combat mortgage fraud. If industry and government continue to build capacity, as outlined above, they can reduce the crime problem significantly in a two to four year period.

In early 2009, the Senate passed two pieces of legislation that, in time, should have a positive impact in reducing mortgage fraud. S.331 – Supplemental Anti-Fraud Enforcement (SAFE) Market Act increased the number of federal law enforcement officials investigating financial fraud, to include 500 new FBI Agents, 50 new Assistant United States Attorneys and 100 new SEC Enforcement Division employees. S.386 – Fraud Enforcement and Recovery Act of 2009 provides the federal government with more tools to investigate and prosecute financial fraud in the mortgage industry. The bill broadened the definition of a financial institution to include mortgage lending businesses not previously required to establish and maintain an anti-money laundering (AML) program and report suspicious activity. On July 15, 2009, FinCEN issued an advance notice of proposed rulemaking concerning possible application of AML program and SAR regulations on non-bank residential mortgage lenders and originators.

Over time, three to four years out, the above legislation should have a positive impact and contribute to reducing mortgage fraud. However, there will probably be little impact in the coming year or perhaps two. It will take a good two years for the allocated law enforcement resources to become functional and effective. In the interim, the FBI and other agencies dealing with mortgage fraud and the financial crisis should consider outsourcing with consultants experienced and specializing in dealing with such crimes. There is precedence for outsourcing. The FBI has retained consulting firms to provide asset forfeiture specialists. In addition, in the post 9/11 environment, when the FBI began building capacity for intelligence analysts, they relied on consultants to provide a short term solution. When FinCEN moves forward in either late 2009 or 2010, and mandates that non-bank residential mortgage lenders and originators establish AML programs and report suspicious activity, there should be a spike in SAR reporting. FinCEN and law enforcement must think forward and be prepared to address the potential surge in SARs.

As the financial crisis worsened during the past year, many thousands of bank employees lost their jobs. In addition to the alarming number of layoffs, financial institutions slashed budgets dramatically. These overwhelming resource reductions are placing financial institutions at greater risk for falling prey to a variety of frauds, including mortgage fraud. The idea of compliance departments having to do more with less is contrary to the type of capacity building necessary to deal with the current and emerging fraud problem.



Like other frauds, the current financial crisis has intensified the mortgage fraud crime problem. The fraud opportunities created by the financial crisis, coupled with the lack of accountability and transparency associated with the Troubled Asset Relief Program (TARP) and the Stimulus Package will soon result in a wave of economic crimes that will overwhelm law enforcement. The House Committee on Oversight and Government Reform chastised the U. S. Treasury Department for the lack of transparency at a hearing on July 21, 2009, based on a report from TARP Special Inspector General Neil Barofsky. Like the FBI and other agencies, Mr. Barofsky's office lacks the resources to adequately address the emerging wave of frauds on the horizon. Again, this is a situation where the government should consider outsourcing with experienced financial crimes consultants. There is a large cadre of retired federal law enforcement agents who would be capable of assisting the government and augment resource shortfalls.

If law enforcement and financial institutions continue to lack resource capacity to adequately deal with the escalating fraud problem and a new wave of frauds hits as anticipated, it will likely take five to eight years to reduce the scope of frauds confronting us.

### **How can mortgage fraud be brought under control?**

The first step in answering this question is to truly understand and identify the root causes of the problem and to develop methodologies to mitigate them. The overall scope of the problem expanded significantly to include all aspects of the subprime mortgage crisis. A variety of causes can be cited. However, mortgage brokers are at the center of the issue. According to the April 8, 2008, FinCEN MFR an analysis of SARs determined that "Mortgage brokers initiated the loans reported in 58% of the SARs sampled. SAR reports included examples of brokers acting both as active participants in the reported fraudulent activity and as the intermediaries that did not verify information submitted on loan application." An example of how industry and government can take proactive steps to deal with opportunity and responsiveness is to identify and focus on areas of systemic vulnerability most susceptible to mortgage fraud. As noted above, mortgage brokers present significant risk. Industry and government should come together, share information and ideas concerning mortgage brokers and work together to develop and implement strategies to leverage more effective use of limited resources. Collectively, they should rely on technology through analytics to identify questionable patterns of activity involving mortgage brokers. From there, mechanisms to criminally and/or civilly pursue cases should be coordinated. Individually, industry should conduct more comprehensive due diligence concerning mortgage brokers, while law enforcement orchestrates national investigative takedowns of mortgage brokers to heighten media attention, promote awareness and create a significant deterrent.

Technology is another area the government should consider relying on consultants to assist. There are numerous government contractors possessing robust analytic capabilities who



regularly deal with the government in other areas. The FBI has developed some impressive analytic tools to assist in identifying patterns of mortgage fraud activity. However, they would greatly benefit from the more robust support government contractors can offer.

Training is an important element of understanding. Both industry and government should devote more time to training, especially through case typologies. Training should be collective and individual in the sense joint business/government training could bridge the differences in perspectives of financial institutions and law enforcement and lead to more meaningful strategies. Individually, business should conduct training to focus on internal mechanisms to identify mortgage fraud. Likewise, law enforcement should conduct training to understand the mortgage process in order to better develop evidence to support prosecutions.

Industry and government should continuously assess adequacy of resources to address the problem both in terms of numbers and experience or competence. This should include honest assessments of experience and level of competence needed to investigate more serious and complex frauds.

Industry and government should continuously assess risk, identify emerging trends and develop and refine innovative methodologies and technologies to more readily identify mortgage fraud schemes. Information sharing would facilitate such efforts and serve to leverage effective resource utilization.

One of the most essential tools available to fight mortgage fraud is suspicious activity reporting. This is where the financial services industry and law enforcement should work in unison at the national and local levels to articulate the mortgage fraud crime problem. What is needed is better communication, coordination and cooperation in identifying the information to include in SARs that is important to law enforcement. This dialogue should take place at the national level through initiatives like the National Mortgage Fraud Team and Bank Fraud Working Group. At the locality level, SAR working groups and FBI mortgage fraud task forces or working groups should work closely with the financial community to delineate the information required by law enforcement in SARs.

SARs make an important difference to law enforcement. Bankers more often than not do not realize the benefits derived by law enforcement from SARs. This is an area where law enforcement needs to do a better job of communicating with bankers. SARs should be comprehensive, thorough and coherent. The narrative is the most important part of a SAR. However, the supporting information to include name, address, phone number, date of birth and social security number is also vital to law enforcement. With the data mining and analytical capabilities law enforcement possesses, it is more likely to link different SARs and criminal activity together than it was in the past. The identifying information is critical to that process.



The narrative needs to stress the “who, what, when, where, why and how” the activity was suspicious. There are no magic “buzz” words that consistently draw the attention of law enforcement to a SAR. The why generates the appropriate “buzz” word. Why the activity is suspicious is what law enforcement wants to know. In addition to including the five w’s and the how, the SAR need s to tell the story and emphasize why the activity is suspicious. Although there are no specific “buzz” words, FinCEN has periodically issued guidance concerning specific crime problems. With respect to mortgage fraud, on April 6, 2009, FinCEN issued guidance on foreclosure rescue frauds and suggested foreclosure rescue schemes be listed in the related SAR. In mortgage fraud cases, the FBI would like to see all of the professionals involved in the mortgage listed in the SAR.

During an ABA Mortgage Fraud teleconference on April 2, 2009, Sharon Ormsby, Chief of the FBI’s Financial Crimes Program stated “the information contained in a SAR provides law enforcement with a wealth of information used to identify emerging crime trends, examine the depth of crime problems, and to perform link analysis on various criminal organizations which are committing financial crimes which otherwise would go undetected.” This is especially true for mortgage fraud.

Mortgage fraud has reached an epidemic level. Much like the flu pandemics we periodically deal with, most recently swine flu, we must identify the vaccine to counter the threat. In the case of mortgage fraud, the flu is opportunity and the vaccine is the strength of responsiveness. The key to success is the response. If industry and government make a committed and appropriate response, the mortgage fraud epidemic will be brought under control in two to four years. If not, the epidemic will continue for up to eight years.