



Financial Crimes Enforcement Network

**Regulatory Policy and
Programs Division**

Mortgage Loan Fraud

An Industry
Assessment based
upon Suspicious
Activity Report
Analysis

November 2006

**Office of
Regulatory Analysis**

TABLE OF CONTENTS

INTRODUCTION	1
EXECUTIVE SUMMARY	1
OVERVIEW	4
VULNERABILITIES IDENTIFIED IN SAR NARRATIVES.....	5
<i>Automated loan processing</i>	<i>5</i>
<i>Sub-prime loans associated with suspected fraud</i>	<i>5</i>
<i>Mortgage broker originated loans.....</i>	<i>6</i>
<i>Identity Theft</i>	<i>7</i>
<i>Fixed income and elder exploitation</i>	<i>8</i>
MORTGAGE LOAN FRAUD SUSPICIOUS ACTIVITY REPORT FINDINGS.....	8
<i>Characterizations of Suspicious Activity</i>	<i>8</i>
<i>Primary Federal Regulators</i>	<i>9</i>
<i>Fraud Locations</i>	<i>9</i>
REPORTED SUSPICIOUS ACTIVITIES IN SAMPLED NARRATIVES	11
<i>Loan Types</i>	<i>11</i>
<i>Material Misrepresentation/False Statements</i>	<i>11</i>
<i>Misrepresentation of Loan Purpose</i>	<i>12</i>
<i>Appraisal Fraud and Property Flipping</i>	<i>12</i>
<i>Straw buyers.....</i>	<i>14</i>
<i>Forged Documents</i>	<i>15</i>
<i>Other Fraudulent Activity</i>	<i>15</i>
EMERGING MORTGAGE FRAUD SCHEMES	17
<i>Asset Rental Fraud</i>	<i>17</i>

<i>Debt Elimination Fraud</i>	17
CONCLUSION	18

Introduction

In recent years federal and state law enforcement and regulatory agencies have devoted considerable effort to the prevention, investigation and prosecution of mortgage loan fraud. The United States has experienced substantial growth in mortgage lending markets and of innovative loan products that have expanded consumer access to home finance. At the same time there has been a significant increase in filings of Suspicious Activity Reports (SARs) pertaining to suspected mortgage loan fraud.¹

FinCEN's Office of Regulatory Analysis conducted this assessment to identify any trends or patterns that may be ascertained from an analysis of SARs regarding suspected mortgage loan fraud. Analysts searched the Bank Secrecy Act database for SARs² from depository institutions filed between April 1, 1996 and March 31, 2006 that contained "Mortgage Loan Fraud" as a characterization of suspicious activity. The search retrieved 82,851 reports, which were examined to discern the trends and patterns revealed in this assessment. A random sample of 1,054 narratives was reviewed for additional analysis. The parameters for the sample size were set to provide a 95 percent confidence level with a plus or minus three (+/-3) confidence interval. The analysis revealed - among other trends addressed in this report - a sharp increase in the number of SARs reporting mortgage loan fraud beginning in 2002. This trend is depicted in Figure 1 below.

Executive Summary

SARs pertaining to mortgage loan fraud increased by 1,411 percent between 1997 and 2005. This report filing trend continues apace in 2006, with 7,093 reports filed on suspected mortgage loan fraud during the first quarter, an increase of 35 percent over the SAR filings in the first quarter of 2005. One explanation for the increase in SARs reporting mortgage loan fraud is increased awareness of the potential for fraud in a dynamic real estate market. Many areas in the United States saw double-digit growth in real estate values during 2003 and 2004. At the same time, mortgage loan interest rates were at a historic low. Although growth in the housing industry appears to be slowing in the first quarter of 2006, opportunities for fraud are still present.

Reports of mortgage loan fraud rose significantly in 2003. The Federal Financial Institutions Examination Council reported an increase in the number of mortgage loans beginning in 2003: "The 2003 data include a total of 42 million reported loans and

¹ The information contained in this report is the complete mortgage loan fraud study findings as promised in *The SAR Activity Review Trends, Tips & Issues, Highlighted Trend: Mortgage Loan Fraud*, Issue 10, May 2006. See <http://www.fincen.gov/sarreviewissue10.pdf>, page 13-16.

² See Form FR 2230 (Board of Governors of the Federal Reserve System); Form 6710/06 (Federal Deposit Insurance Corporation); Form 8010-9,8010-1 (Office of the Comptroller of the Currency); Form 1601 (Office of Thrift Supervision); Form 2362 (National Credit Union Administration); Form TD F 90-22.47 (U.S. Department of the Treasury).

applications, which is an increase of about 33 percent from 2002, primarily due to a significant increase in refinancing activity (approximately 41 percent).”³ SARs on mortgage loan fraud increased over 92 percent between 2003 and 2004. The increase in filings may be attributed to an increase in overall mortgage lending concurrent with the decline in interest rates in the 2002 – 2005 timeframe and a broader awareness of this fraudulent activity. Figure 1 depicts the filing trend between 1997 and 2005.

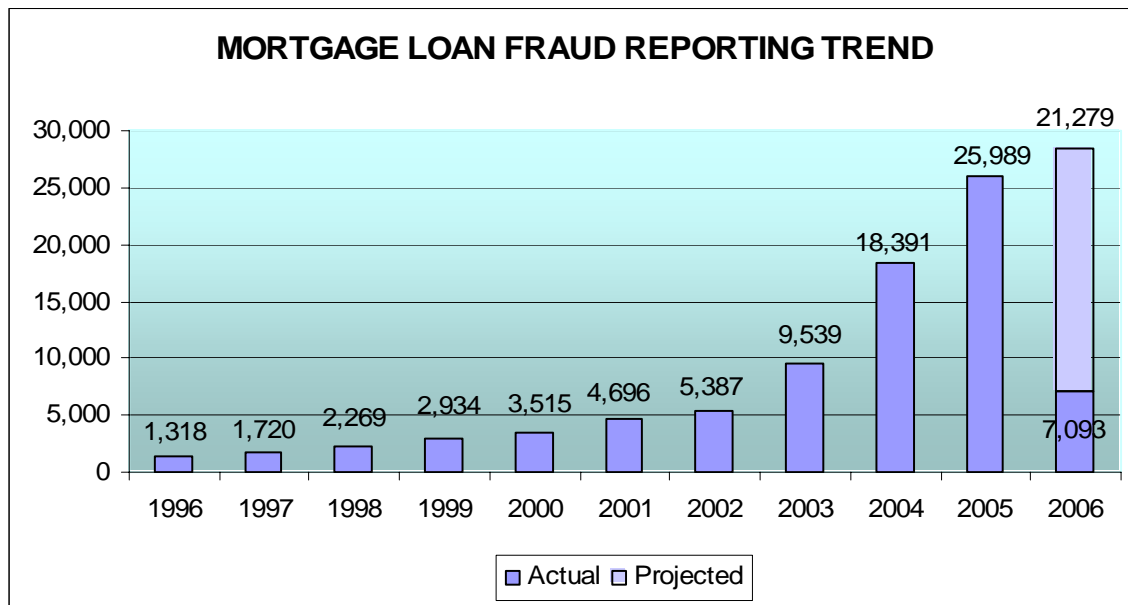


Figure 1

Mortgage loan fraud represents a growing percentage of total depository institution SARs. In 1997, reports of mortgage loan fraud comprised 2.12 percent of total depository institution SAR filings. In 2005, reports of mortgage loan fraud had increased to 4.94 percent of total depository institution filings. Figure 2 provides a comparison of the percentage of change in the number of total depository institution SAR filings to the change in the number of SARs reporting mortgage loan fraud.

³ Federal Financial Institutions Examination Council, Press Release, July 26, 2004, <http://www.ffiec.gov/hmcpr/hm072604.htm>. Accessed October 3, 2005.

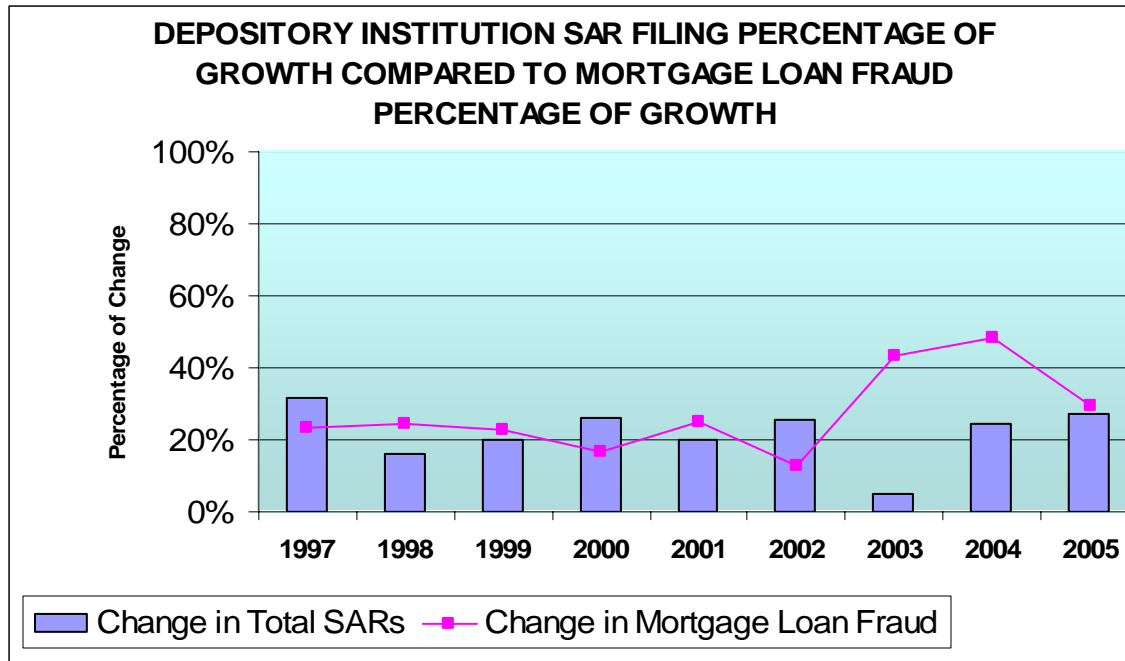


Figure 2

Mortgage loan fraud can be divided into two broad categories: fraud for property and fraud for profit. Fraud for property generally involves material misrepresentation or omission of information with the intent to deceive or mislead a lender into extending credit that would likely not be offered if the true facts were known. The fraudulent activities observed in the SAR narratives describing fraud for property include: asset fraud; occupancy fraud; employment and income fraud; debt elimination fraud; identity theft; and straw buyers.⁴ Fraud for property is generally committed by home buyers attempting to purchase homes for their personal use. In contrast, the motivation behind fraud for profit is money. Fraud for profit is often committed with the complicity of industry insiders such as mortgage brokers, real estate agents, property appraisers, and settlement agents (attorneys and title examiners). Typical fraudulent activities associated with this category in the SAR filing sampling are: appraisal fraud; fraudulent flipping;⁵ straw buyers; and identity theft.

Identity theft was frequently reported in conjunction with the commission of suspected mortgage loan fraud. Reports of identity theft increased nearly 102 percent between 2004 and 2005. The depository institution SAR form began collecting data on identity theft in July 2003. *The SAR Activity Review – By the Numbers*, Issue 6 (May 2006) reported that identity theft was observed in nearly two percent of the total depository institution SARs. Identity theft was characterized as a suspicious activity on over two percent of the total mortgage loan fraud SAR reports. This is significant given

⁴ A straw buyer is someone who purchases property for another person in order to conceal the identity of the true purchaser.

⁵ Property flipping generally involves the buying and selling of the same property within a short period of time with the intention of making a quick profit.

the relatively brief amount of time specific data on identity theft has been collected in SARs.

Overview

Real estate mortgage loan fraud poses a growing risk to financial institutions. The Federal Financial Institutions Examination Council reported: “Mortgage loan fraud is growing because it can be very lucrative and relatively easy to perpetrate, particularly in geographic areas experiencing rapid appreciation.”⁶ Although the true level of mortgage loan fraud is unknown, the growing awareness of mortgage loan fraud is confirmed by the year to year increase in the number of SARs describing this activity. (See Figure 1, Mortgage Loan Reporting Trend.) Depository institutions filed 82,851 SARs describing suspected mortgage loan fraud between April 1, 1996 and March 31, 2006. This represents 3.57 percent of all depository institution SAR filings submitted during that time period.

Over the past 30 years (1975 – 2005), house prices at the national level have grown at about a six percent annual rate.⁷ However, in the first quarter of 2005, the national average percentage increase was 12.5 percent. Many U.S. coastal states saw housing prices increase by as much as 20 percent or more during 2004. By contrast, growth rates in many states in the South and Midwest fell below the national average.⁸ Interest rates for 30-year mortgages declined throughout the period from 1997 through 2004, with the exception of the first three quarters of 2000.⁹ The number of residential loans increased steadily by 153 percent between 1997 and 2003, according to the Federal Financial Institutions Examination Council.¹⁰ “Adjusted 2003 data show that low and moderate-income census tracts taken together experienced the largest increase, 16 percent, in home purchase lending. Such lending for middle and upper-income census tracts increased by 9 percent, respectively, from 2002 to 2003, according to the adjusted 2003 data.”¹¹ The only year experiencing a decrease in the number of home loans was 2000, possibly due to concern over fluctuating interest rates during the first three quarters of 2000. The rapid growth in mortgage lending activity that resulted from the boom in the real estate industry could result in an increased risk in the mortgage loan industry.

⁶ Federal Financial Institutions Examination Council, *The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper*, Produced by the October 27 – November 7, 2003 FFIEC Fraud Investigations Symposium, Issued February 2005. <http://www.ffiec.gov>. Accessed August 30, 2005.

⁷ Mortgage Bankers Association, *Housing and Mortgage Market: An Analysis*, September 6, 2005. http://www.mortgagebankers.org/files/News/InternalResource/29899_HousingandMortgageMarkets-AnAnalysis.pdf. Accessed October 11, 2005.

⁸ Ibid.

⁹ Federal Reserve Internet site, <http://www.federalreserve.gov/releases/h15/data/wf/cm.txt>. Accessed October 3, 2005.

¹⁰ Federal Financial Institutions Examination Council, Press Release July 26, 2004. <http://www.ffiec.gov/hmcpr/hm072604.htm>. Accessed October 3, 2005.

¹¹ Ibid.

Vulnerabilities Identified in SAR Narratives

Automated loan processing

The use of the Internet and related technology to receive and process loan applications is increasing. The growing faceless nature of these transactions increases the opportunities for fraud (especially identity fraud) and, coupled with “low-document” or “no-document” loans, creates a condition vulnerable to fraudulent activity.

Using the Internet or telephone to receive and process mortgage loans means that lenders may never meet borrowers, even during the loan closing process. In some cases, lenders forward the loan documents to borrowers by courier service and the documents are returned to lenders in the same manner.

Filers reported use of the telephone or Internet in origination of mortgage loans on 106 reports of mortgage loan fraud (less than one percent). Figure 3 depicts the reports of suspected fraudulent loans originated via telephone or Internet since 1998. (Note that the filings for 2006 occurred during the first three months.)

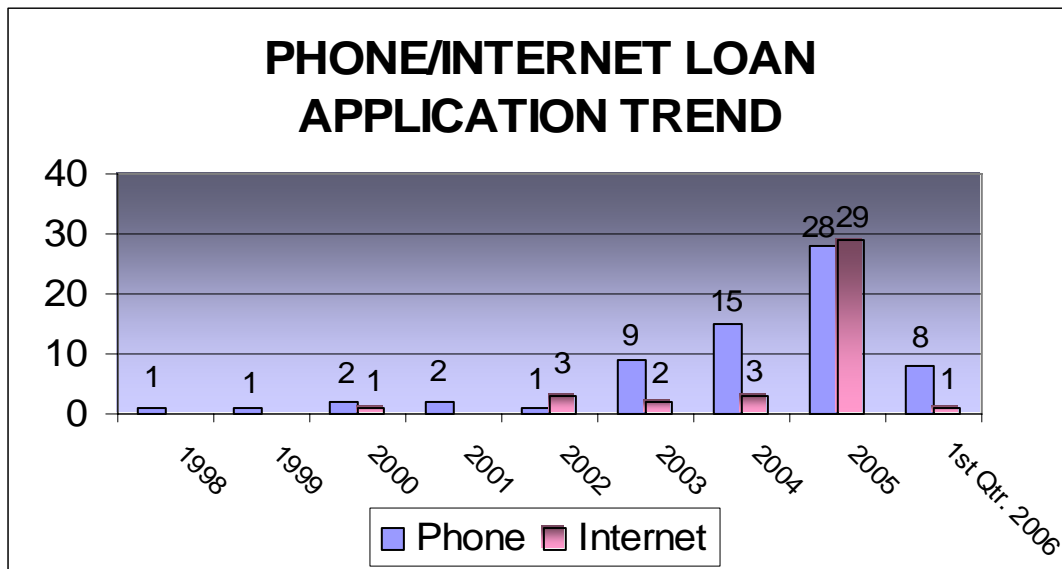


Figure 3

Sub-prime loans associated with suspected fraud

Sub-prime lending involves higher-interest loans extended to consumers with impaired or non-existent credit histories stemming from modest incomes or excessive debts. The mortgage industry designed innovative loan packages to allow more low-to-moderate income borrowers to qualify for loans. Filers reported a pattern of the use of exaggerated or fabricated income information associated with sub-prime loans. Such

activity may be part of added efforts by some lenders to qualify borrowers in the sub-prime market.

Loans specifically identified as sub-prime appeared in 68 (less than one percent) of the total reports of mortgage loan fraud. Figure 4 depicts the number of report narratives that describe sub-prime loans in SARs reporting suspected mortgage loan fraud.

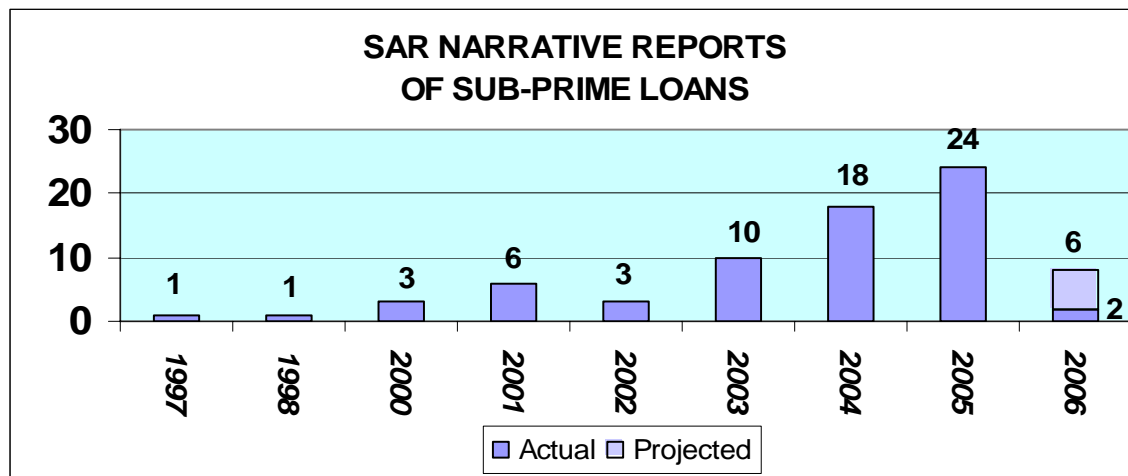


Figure 4

Mortgage broker originated loans

The National Association of Mortgage Brokers reports that as many as two-thirds of mortgage loans are now originated by mortgage brokers. Currently there are no national standards for licensing and oversight of mortgage brokers. Some states license mortgage brokerage offices, but not individuals; 24 states have no specific educational or experience requirements for mortgage brokers; and only a few states require criminal background checks on mortgage brokers making it possible for unethical individuals to move from one mortgage brokerage firm to another.

Figure 5 depicts the number of sampled report narratives regarding mortgage broker-originated loans that involved suspected loan fraud. Note that the number of reports filed during the first quarter of 2006 equals the total number of reports filed in all of 2004.

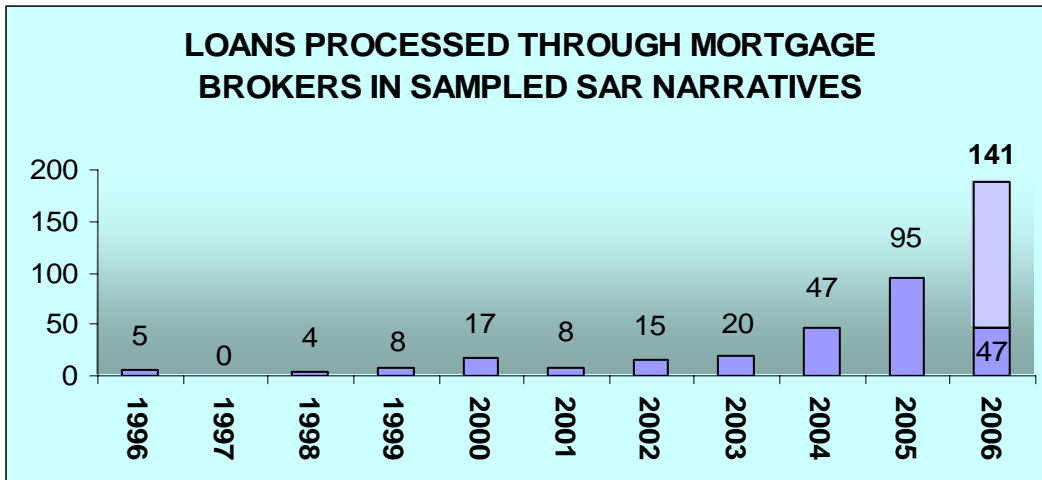


Figure 5

Identity Theft

Identity theft has been associated with both fraud for property and fraud for profit, and is recognized as one of the fastest growing crimes in the United States. Recent news reports of personal information theft from commercial data brokers, corporate databases, and credit report companies demonstrate the potential for large-scale identity theft. Identity theft was characterized as a suspicious activity on 1,761 (2.13%) of the reports of mortgage loan fraud filed from January 1, 2003 to March 31, 2006. Figure 6 shows the increasing incidence of identity theft in conjunction with mortgage loan fraud in the SARs reviewed for this study.

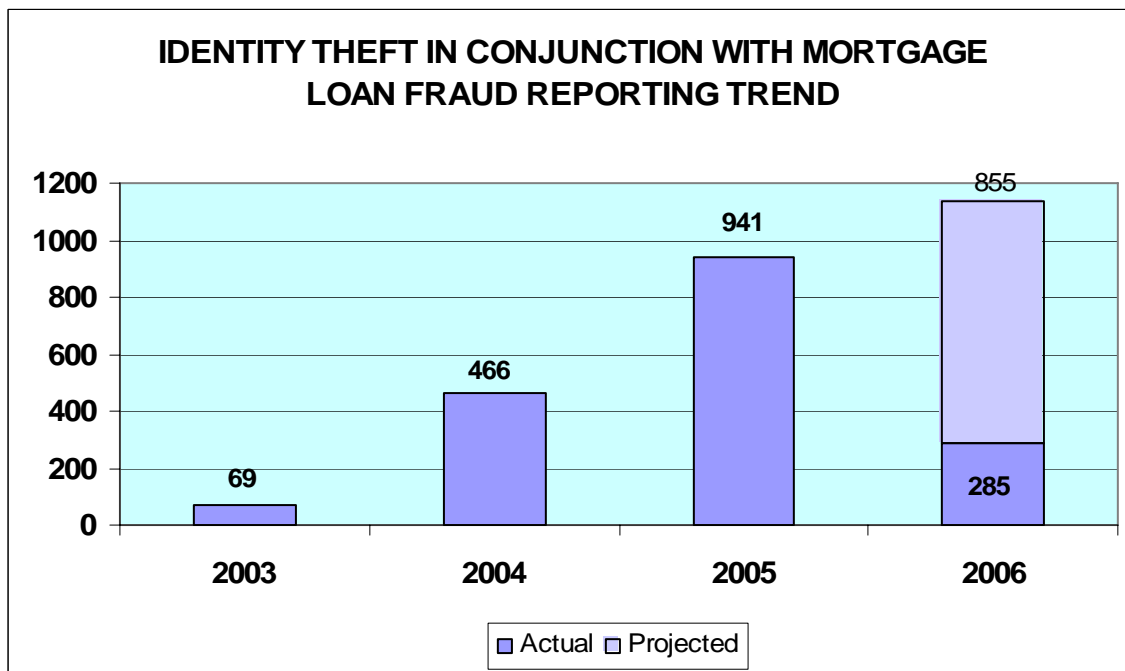


Figure 6

Fixed income and elder exploitation

Retired persons were identified as subjects in 769 (1%) of the SARs reporting mortgage loan fraud filed between April 1, 1996 and March 31, 2006. Additionally, 25 filers suspected exploitation of older subjects in association with mortgage loan fraud. Low- or fixed-income retired persons are often targeted for fraudulent schemes. The growing number of retired and elderly citizens could provide a burgeoning target for mortgage loan fraud. Figure 7 displays the reporting trend for SARs involving this subject group.

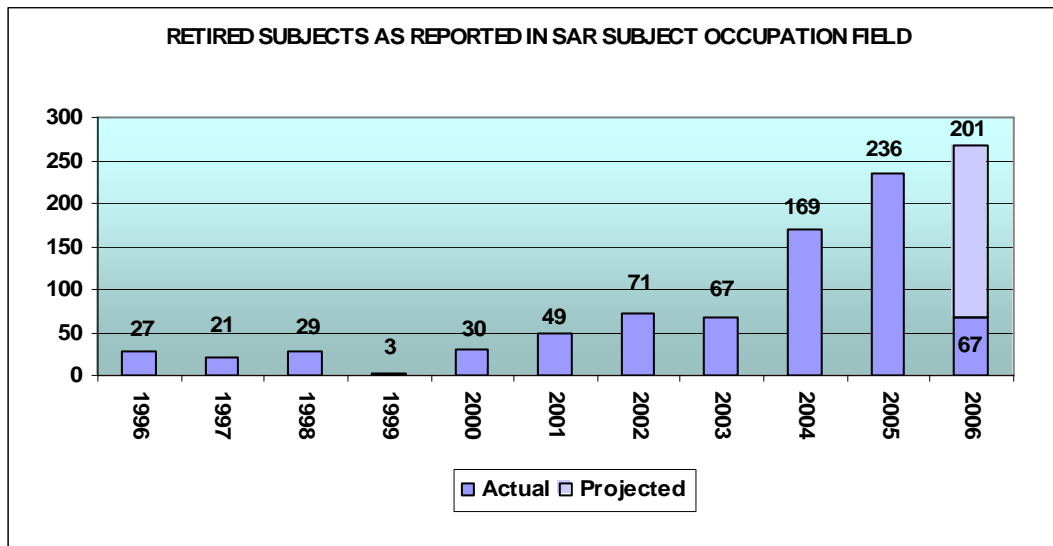


Figure 7

Mortgage Loan Fraud Suspicious Activity Report Findings

Characterizations of Suspicious Activity

Many reports included more than one characterization of suspicious activity in addition to “mortgage fraud.” False statement was the most reported suspicious activity in conjunction with mortgage loan fraud. Identity theft represented the fastest growing secondary characterization reported, more than two percent in less than two years. Figure 8 reveals secondary characterizations of suspicious activities reported in conjunction with Mortgage Loan Fraud.

CHARACTERIZATION OF SUSPICIOUS ACTIVITY	NUMBER OF SARs	% OF TOTAL SARs
P - MORTGAGE LOAN FRAUD	82,851	100.00%
N - FALSE STATEMENT	15,390	18.58%
S - OTHER	3,149	3.80%
U - IDENTITY THEFT	1,761	2.13%
O - MISUSE OF POSITION OR SELF DEALING	1,219	1.47%

CHARACTERIZATION OF SUSPICIOUS ACTIVITY	NUMBER OF SARs	% OF TOTAL SARs
G - CONSUMER LOAN FRAUD	699	Less than 1%
E - COMMERCIAL LOAN FRAUD	409	Less than 1%
M - DEFALCATION/EMBEZZLEMENT	373	Less than 1%
C - CHECK FRAUD	290	Less than 1%
A - BSA/STRUCTURING/MONEY LAUNDERING	256	Less than 1%
J - COUNTERFEIT INSTRUMENT (OTHER)	217	Less than 1%
R - WIRE TRANSFER FRAUD	169	Less than 1%
H - COUNTERFEIT CHECK	69	Less than 1%
B - BRIBERY/GRATUITY	68	Less than 1%
D - CHECK KITING	62	Less than 1%
Q - MYSTERIOUS DISAPPEARANCE	60	Less than 1%
K - CREDIT CARD FRAUD	57	Less than 1%
F - COMPUTER INTRUSION	33	Less than 1%
L - DEBIT CARD FRAUD	25	Less than 1%
T - TERRORISM	9	Less than 1%
I - COUNTERFEIT CREDIT/DEBIT CARD	5	Less than 1%

Figure 8

Primary Federal Regulators

Figure 9 displays the primary federal regulators identified in the reports of mortgage loan fraud. National banks with offices located throughout the country made up the largest group of lenders reporting mortgage loan fraud. The Office of the Comptroller of the Currency (OCC) is the primary regulator for national banks. National banks filed nearly 41 percent of the total reports.

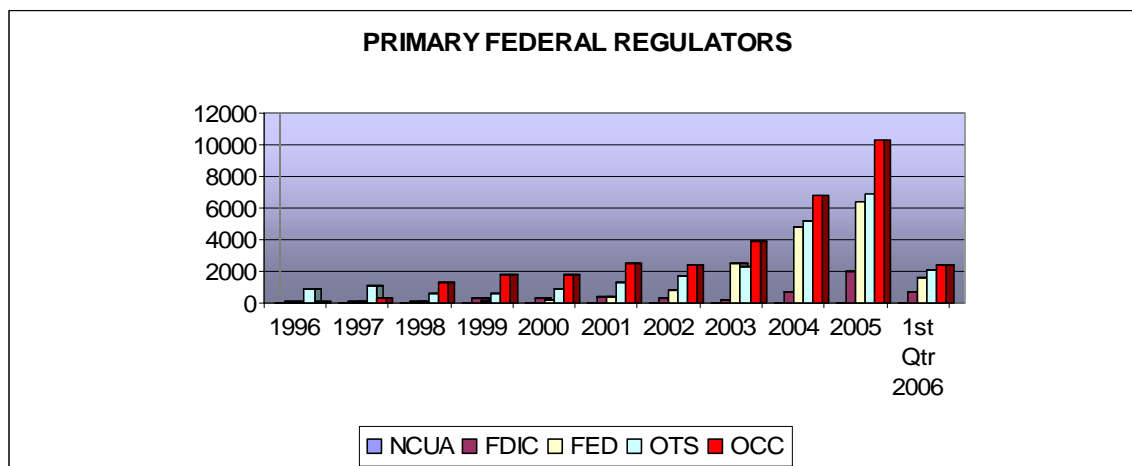


Figure 9

Fraud Locations

SARs contain data fields for subject addresses, the filer's main office address, and the branch address where the suspicious activity was discovered. In the SARs reviewed

in this study, suspicious activity occurred in - or was otherwise associated with - all 50 states, the District of Columbia, Puerto Rico, Guam, and American Samoa.

The subject address provides the best source for identifying the geographic location of real estate involved in mortgage loan fraud because most residential mortgage loan applicants intend to reside on the property used to secure the loan. Figure 10 provides a comparison of the address states for the filer and branch offices, and reported subjects, as provided on depository institution SARs filed on mortgage loan fraud between April 1, 1996 and March 31, 2006.

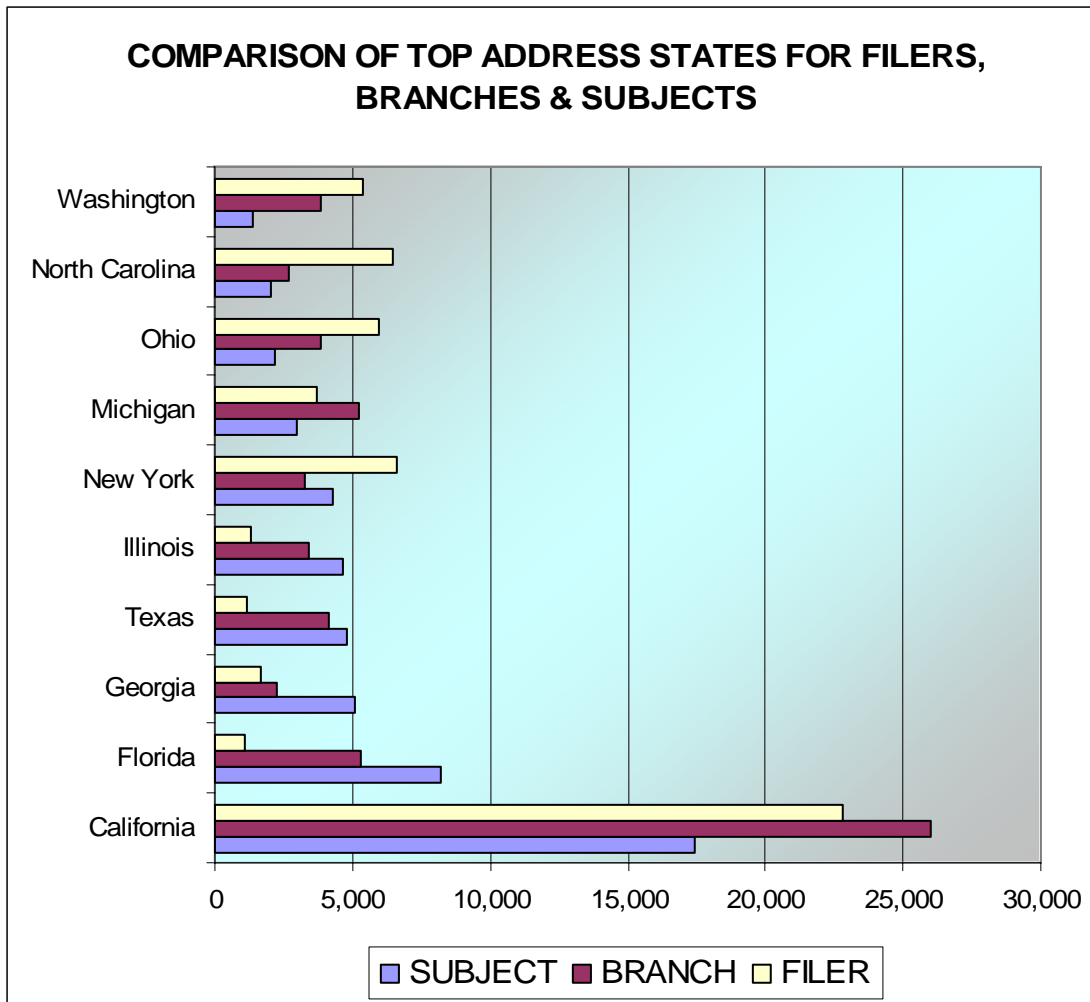


Figure 10

During 2005, the top five reported subject address states were California, Florida, Illinois, Texas, and Georgia.

Reported Suspicious Activities in Sampled Narratives

Loan Types

In the sampled narratives, purchase of residential property was the most frequently reported loan purpose, followed by refinance, home equity, and second trust loans. New construction loans made up a relatively small percentage of the sampled narratives:

- Residential real estate purchase loans – 880 (83.65%);
- Residential refinance loans (76), home equity/lines of credit (28), FHA Title One loans (20), second Trust loans (4) – (12.17%); and
- New construction loans – 16 (1.52%).

Material Misrepresentation/False Statements

Material misrepresentation and false statements were reported on 692 (65.78%) of the sampled narratives.¹² Identity fraud was reported on 160 (23.12%) of the narratives and identity theft was reported on 27 (3.9%) of the narratives.¹³ Mortgage brokers or correspondent lenders initiated the loans in 254 (36.71%) of these reports. Following are the types of loan falsifications reported in the sampled narratives.

- Altered bank statements;
- Altered or fraudulent earnings documentation such as W-2s and income tax returns;
- Fraudulent letters of credit;
- Fabricated letters of gift;
- Misrepresentation of employment;
- Altered credit scores;
- Invalid social security numbers;

¹² Material misrepresentation relating to straw buyers, appraisal fraud, or property flipping are addressed in subsequent paragraphs.

¹³ For the purpose of this report, identity fraud is differentiated from identity theft. Identity fraud as used here refers to the loan applicant's use of a non-existent social security number or a number taken from the social security death index, along with the use of the borrower's true personal identifiers (name, date of birth, address). The loan applicant intends to use the Social Security number to qualify for a loan, either because the borrower does not have a number or because the borrower's credit rating associated with their true number is inadequate for approval. Identity theft, on the other hand, is an attempt to obtain credit in another person's name.

- Silent second trust;¹⁴
- Failure to fully disclose the borrower's debts or assets; or
- Mortgage brokers using the identities of prior customers to obtain loans for customers who were otherwise unable to qualify.

Misrepresentation of Loan Purpose

Misrepresentation of loan purpose or misuse of loan proceeds was described in 129 (12.26%) of the sampled narratives. Mortgage brokers or correspondent lenders originated the loans described on 37 (28.68%) of the reports of misrepresentation or misuse of loan funds.

Misuse of FHA Title One loans was reported in 20 (15.5%) of these narratives. FHA Title One loans may be used to finance permanent home improvements that protect or improve the basic livability or utility of the property. The funds cannot be used for debt consolidation, cash-out, or any non-home related expenses, or for luxury items such as swimming pools or hot tubs.

The most commonly reported misrepresentation was occupancy fraud, which occurs when the borrower fails to occupy the property, although the loan application specified the property was the borrower's primary residence. Occupancy fraud was reported in 104 (80.62%) of these reports. Possible motivations for misrepresentation of the loan purpose are to purchase investment property with more favorable loan rates than would be available if a lender knew the property was intended for use other than as a primary residence, or to launder funds from illicit activity.

Appraisal Fraud and Property Flipping

Appraisal fraud and fraudulent property flipping were described in 111 of the sampled reports (10.55%). Appraisal fraud is frequently associated with fraudulent property flipping. Filers indicated on 48 (42.34%) of these reports that they suspected the fraudulent activity was perpetrated with the collusion of mortgage brokers, appraisers, borrowers, and/or real estate agents/brokers.

Lenders rely on accurate appraisals to ensure that loans are fully secured. Appraisal fraud occurs when appraisers fail to accurately evaluate the property, or when the appraiser deliberately becomes party to a scheme to defraud the lender, the borrower, or both. The Appraisal Institute and the American Society of Appraisers testified that "...it is common for mortgage brokers, lenders, realty agents and others with a vested

¹⁴ A silent second trust occurs when the seller takes back a second trust from the buyer in lieu of a cash down payment. The lender is not aware of the second trust.

interest to seek out inflated appraisals to facilitate transactions because it pays them to do so.”¹⁵ Higher sales prices typically generate higher fees for brokers, lenders, real estate agents, and loan settlement offices, and higher earnings for real estate investors. Appraisal fraud has a snowball effect on inflating real estate values, with fraudulent values being entered into real estate multiple listing systems and then used by legitimate appraisers as comparable values for determining market values for neighborhood properties. Some commonly reported types of appraisal fraud found in the sampled narratives are:

- Appraisers failed to use comparable properties to establish property values;
- Appraisers failed to physically visit the property and based the appraisal solely on comparable properties, *i.e.*, the actual condition of the property was not factored into the appraisal;
- Appraisers participated in a fraud scheme such as flipping; or
- A licensed appraiser’s name and seal were used by unauthorized persons.

Fraudulent property flipping is purchasing property and artificially inflating its value. The fraud perpetrators frequently use identity theft, straw borrowers and industry insiders to effect property flipping schemes. Ultimately, the property is resold for 50 to 100 percent of its original cost. In the end, the loan amount exceeds the value of the property and the lender sustains a loss when the loan defaults. The following fraudulent activities were reported in the sampled narratives that described property flipping.

- Nearly 64 percent of sampled narratives described collusion by sellers, appraisers, and mortgage brokers in connection with property flipping.
- Nearly 14 percent of the sampled narratives described the use of straw buyers.

The number of sampled narratives that specified fraudulent property flipping activity remained steady over the past four years. A significant spike in reports describing appraisal fraud was seen in 2004, but there was a slight decrease in the trend in 2005. This does not necessarily indicate appraisal fraud and fraudulent property flipping are decreasing, especially since activities associated with flipping (straw buyers and false statements) are increasing. Figure 11 depicts the reporting trend for appraisal fraud and fraudulent property flipping as described in the sampled narratives.

¹⁵ Testimony presented on behalf of the Appraisal Institute, the American Society of Appraisers, and the American Society of Farm Managers and Rural Appraisers before the House Committee on Financial Services Subcommittee on Housing and Community Opportunity and the Subcommittee on Financial Institutions and Consumer Credit on Legislative Solutions to Abusive Mortgage Lending Practices, May 24, 2005.

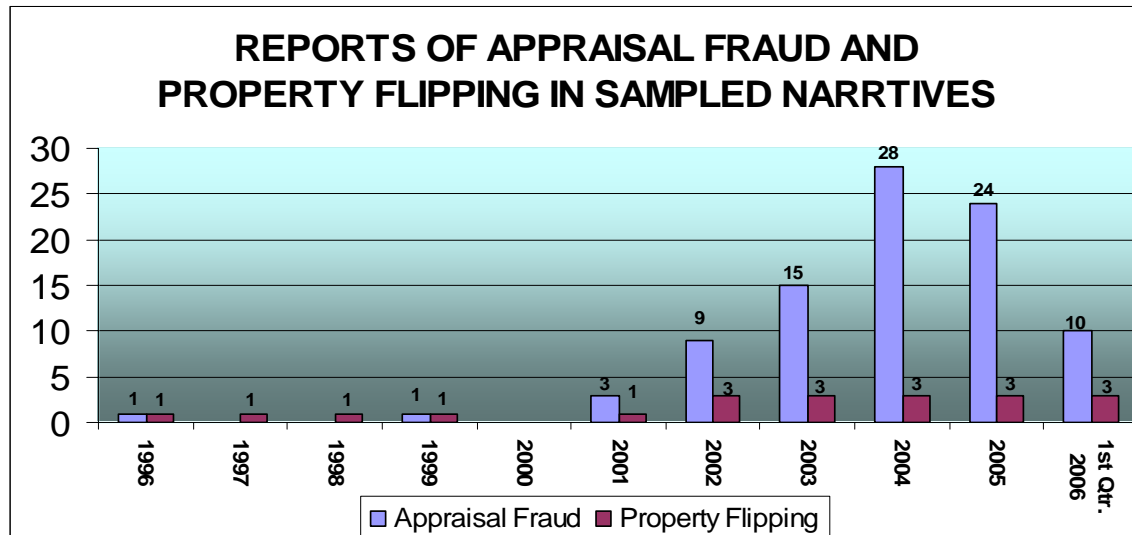


Figure 11

Property flipping and appraisal fraud have received a lot of attention from the media, real estate professionals, and lawmakers. Some actions taken to combat fraudulent property flipping are:

- The Housing and Urban Development regulation “Prohibition of Property Flipping in HUD’s Single Family Mortgage Insurance Programs; Final Rule” (codified in 24 C.F.R. part 203) makes certain frequently flipped properties ineligible for Federal Housing Administration mortgage insurance. The regulation, which became effective in June 2003, may have impeded some flipping schemes;
- Some home builders include clauses in their sales contracts that prohibit buyers from placing their houses back on the market for a period of time after closing – usually one year.¹⁶ There is a question whether this type of contract clause is legally enforceable under applicable state law; and
- Some states have adopted new or enhanced appraisal standards and appraisal licensing requirements.

Straw buyers

The use of straw buyers to obtain mortgage loans was specifically described in 27 (2.57%) of the sampled narratives. Mortgage brokers or correspondent lenders processed loans in 21 (77.78%) of these sampled narratives.

¹⁶ REAL ESTATE JOURNAL.COM, The Wall Street Journal – Guide to Property, October 3, 2005. <http://www.realestatejournal.com/buysell/tactics/20050927-sichelman.html>, accessed October 5, 2005.

Straw buyers are reported in the narratives of 2,566 SARs (3.1% of the total of 82,851) reports. Figure 12 displays the total number of mortgage loan fraud SARs that revealed the use of straw buyers.

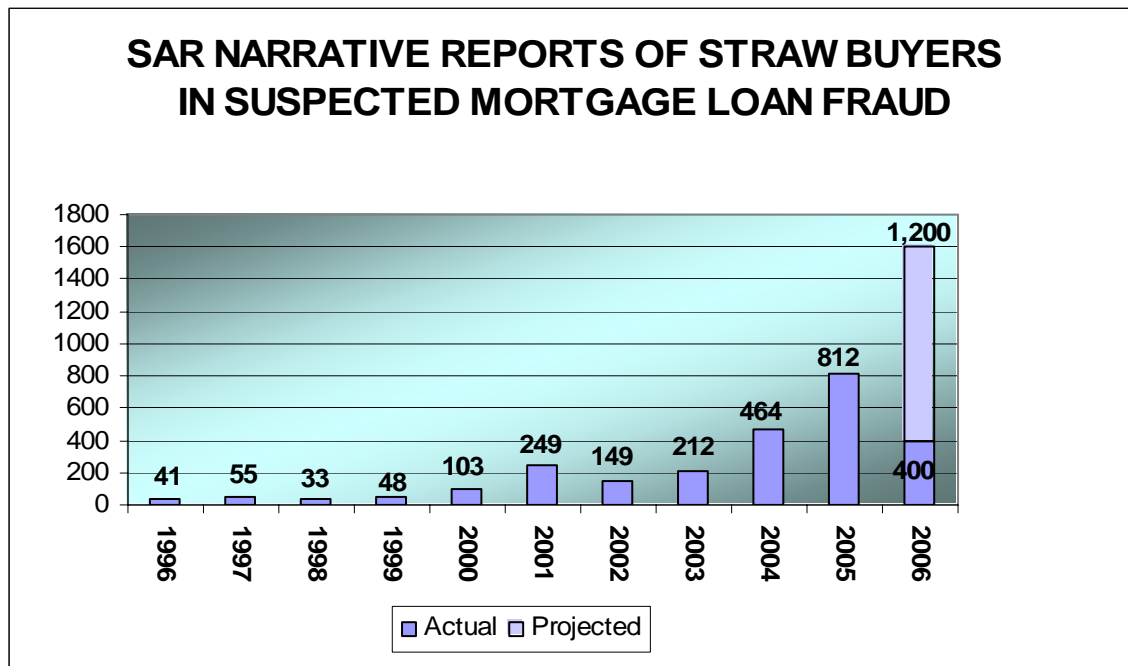


Figure 12

Forged Documents

Use of forged documents was reported on 20 (1.9%) of the sampled narratives, with correspondent lenders or mortgage brokers processing the loans described in five of those reports. The types of activity reported include the following:

- Borrowers forged co-owners' signatures to loan documents (most often one spouse forging the other spouse's signature without prior knowledge or permission);
- Loan closing services forged applicants' signatures on loan documents (possibly to expedite the loan process); or
- Builders forged borrowers' names on loan draw documents.

Other Fraudulent Activity

Other types of fraudulent activity reported in the sampled narratives included:

- Loan closing services failed to properly disburse loan proceeds or pay off underlying property liens, including prior mortgage trusts. Loan settlement

offices were also reported for failure to pay insurance premiums from funds collected at settlement;

- Borrowers signed multiple mortgages on the same property from multiple lenders. The mortgage settlements were held within a short period of time to prevent the lenders from discovering the fraud;
- Loan closing services failed to record the mortgage in property land records;
- Prior lenders failed to release home equity loans in land record offices 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 exceeded the property value;
- Violations of the Mortgage Broker Practices Act by mortgage brokers who abused the terms of a power of attorney;
- Mortgage brokers or correspondent lenders failed to ensure all loan documentation was properly signed;
- Real Estate Settlement Procedures Act (RESPA) violations by lenders accepting kickbacks from mortgage brokers;
- Non-arm's-length sales occurred when parties to the real estate transaction failed to disclose relationships between the buyers and sellers. Knowledge of a non-arm's-length sale would alert lenders to scrutinize loan packages more carefully;
- Elder exploitation where older individuals were persuaded to sign loan documents without understanding borrower rights and responsibilities under applicable federal and state law;
- Unofficial loan assumption occurred when property ownership was transferred without the knowledge of lenders. This could indicate that a straw buyer was used to obtain the loan, with the property title being transferred to the actual owner after the loan disbursement;
- Theft of debit card or convenience checks associated with home equity lines of credit;
- Fraudulent bankruptcy filings to stall or prevent foreclosure; and
- Suspected use of real estate purchases to launder criminal proceeds.

Emerging Mortgage Fraud Schemes

Asset Rental Fraud

Nine (less than one percent) of the sampled SAR narratives reported asset rental fraud. Mortgage brokers or correspondent lenders processed the loans in six of those reports. This is a fraudulent scheme designed to exaggerate or inflate the stated value of a borrower's assets. Filers reported that funds were temporarily deposited into the loan applicant's bank account for the time required to qualify for a loan. The funds came from friends or family, or even from mortgage brokers attempting to qualify an ineligible borrower. The temporary funds were withdrawn from the bank account after the loans were approved.

One elaborate asset rental fraud scheme reported in a news article involved deposits of funds into bank accounts established in a prospective borrower's name, with the deposited funds being temporarily "rented" for a fee. The customary fee charged for this "service" was reportedly approximately five percent of the deposited funds. The service also may include verification of employment and income in any amount for an additional fee of one percent of the claimed annual income.¹⁷

Debt Elimination Fraud

Debt elimination schemes were reported in ten (less than one percent) of the sampled narratives. Filers described borrowers attempting to pay off their mortgages with non-negotiable checks, or fake instruments such as bills of exchange or subrogation and security bonds. Filers described specious arguments in which the borrowers claimed the mortgage was invalid and the debt never existed.¹⁸ The arguments relied on an unreasonable interpretation of Section 1-207 of the Uniform Commercial Code that has never been affirmed or supported by any court or governmental authority.

Other types of debt elimination schemes reported in the SARs were attempts to fraudulently release mortgage liens from municipal land records. Once the land title appeared clear of all mortgage debt, the homeowner could theoretically obtain another mortgage loan based on what appeared to be a clear title. The threat this fraud scheme presents is that a subsequent lender could believe it had a first priority lien on property when in reality there could be little or no equity to secure the loan.

Reports of debt elimination schemes were described in 430 SARs (less than one percent of the SARs reporting mortgage loan fraud) filed between April 1, 1996 and

¹⁷ Kenneth Harney, "Now You Can Rent Assets To Qualify For A Loan," *The Baltimore Sun*, August 28, 2005.

¹⁸ Borrowers who presented these specious arguments are believed to belong to groups that believe U.S. laws and regulations, along with banking regulations, do not apply to them. A typical debt elimination fraud scheme involved the presentation of numerous documents containing frivolous arguments that the subject mortgage was invalid. The arguments presented in the documents avowed that funds were never loaned, despite the fact that the borrower received the proceeds. Successful culmination of this scheme would result in the filing of a fraudulent mortgage discharge.

March 31, 2006. Figure 13 depicts the filing trend for debt elimination fraud through March 31, 2006.

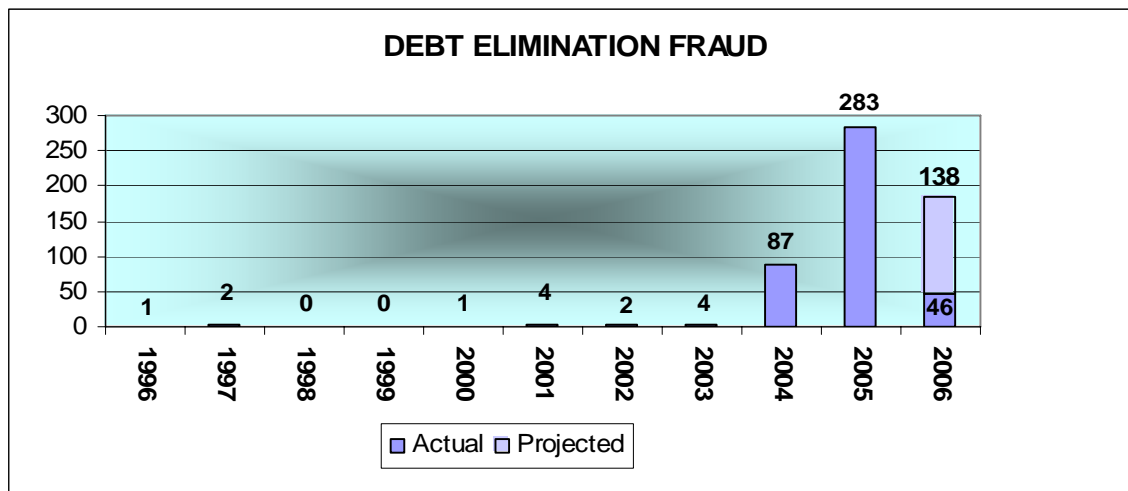


Figure 13

Conclusion

The study of the depository institution SARs describing mortgage loan fraud confirms reports of fraud associated with mortgage loans continues to grow – although it is unclear if this is primarily due to an increase in the number of fraudulent loans or an increase in awareness of this suspected fraudulent activity. It is apparent from the number of pending fraud cases reported by the Federal Bureau of Investigation (721 in 2005, up from 534 in 2004) that the awareness of mortgage loan fraud is increasing.¹⁹ See Figure 2 for a comparison of the percentage of growth in total depository institution SARs filings to the growth in reports of mortgage loan fraud.

High home prices coupled with rising mortgage rates result in a reduction in housing affordability. In response to this trend, the housing industry is expecting a slow down in mortgage loan originations, a decrease in housing sales, and a slowing in housing price gains. The slow down in the growth of housing prices could result in the housing industry becoming less attractive to investors, which in turn could result in a reduction in the reports of fraud for profit. The current housing trend could also lead to an increase in fraud for housing as the increased costs of housing decreases the number of persons who qualify for mortgage loans. The current trend of rising interest rates and slowing housing equity growth could result in an increase in debt elimination fraud schemes, especially for homeowners with adjustable rate mortgages and interest only loans.

¹⁹ Federal Bureau of Investigation, Press Release, “Mortgage Fraud operation “Quick Flip”, December 14, 2005. <http://www.fbi.gov/pressrel/pressrel05/quickflip121405.htm>. Accessed May 16, 2006.