SECONDARY MARKETING EXECUTIVE®

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A New Assault On Fraud

The mortgage fraudsters are still up to their tricks, and the industry needs to be extra cognizant of this threat.

By Greg Holmes

Mortgage fraud is alive and well. The Financial Crimes Enforcement Network reported that financial institutions filed 92,028 mortgage loan fraud complaints last year, up from 70,472 in 2010. Meanwhile, the Federal Bureau of Investigation (FBI) said pending mortgage loan fraud investigations in 2011 totaled 2,590, up 57% from 2008.

The FBI also reported that a whopping 62% of the top 10 mortgage fraud schemes identified in 2010 - the latest statistics available - involved loan origination schemes. These schemes involved falsifying a borrower's financial information - including income, assets, liabilities, employment, rent and occupancy status - to qualify a buyer who otherwise would be ineligible for a mortgage loan.


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While law enforcement is doing its best to track down perpetrators of mortgage loan fraud, it is clear from the stance taken by Fannie Mae through its Loan Quality Initiative (LQI) that the primary responsibility for detecting fraud remains with loan originators and underwriters. According to the most recent FAQ updates on the LQI on Fannie Mae's website, the lender's role as the loan originator and Fannie Mae's role as the investor will not change. In fact, the website says the lender's role in collecting and validating accurate data and then making sound underwriting decisions will become more important than ever.

The website also notes that a large portion of Fannie Mae's post-purchase file reviews still contains material differences between the loan data delivered to the agency and the actual facts of the loan. These differences, the site says, were caused by fraud, misrepresentation, data mismatch and calculation errors or other inaccuracies.

"We share the industry's commitment to getting back to the basics that served us well over many years," the agency's website says. "But in the face of increasingly sophisticated fraud schemes and the dual goals of efficiency and prudence … we are seeking a more sophisticated industry approach."

It's clear from this statement that the ball is squarely in the lender's side of the court. The responsibility for complete, accurate and verified loan data, as well as for the reduction or elimination of fraud, is on the shoulders of loan originators and underwriters.

Secondary market participants are now asking lenders for assurance that all necessary steps have been taken to prevent fraud. Lenders that fail to meet stricter requirements for data accuracy and verification can expect to see increased repurchase risk from Fannie Mae and other secondary market players.

As a result, lenders are taking a renewed interest in tools and technology designed to simplify data verification and warn of potentially fraudulent practices. These powerful technologies are providing lenders and underwriters with the weapons they need to contain the spread of fraud and misrepresentation while realizing cost-saving process efficiencies.

Income fraud is a prime example. It occurs when a borrower overstates his or her income in order to qualify for a mortgage or a larger loan amount. Income fraud was most often seen with stated-income loans (also known as "liar loans"), where income is presented without verification.

Because mortgage lenders have begun to tighten underwriting standards and stated-income loans are less available, income fraud is increasingly seen in traditional, full-documentation loans where the borrower forges or alters an employer-issued Form W-2, personal income tax returns or bank account records to provide support for inflated income. Verification of a borrower's income by the Internal Revenue Service (IRS) is the key to stopping this type of fraud. Lenders only need a signed authorization from the borrower to request a transcript of his or her income tax return.

Some service providers take this a step further by combining Social Security and tax return verification in one report. These reports can compare income-related lines of a borrower's tax return with the same lines on file at the IRS - and highlight any discrepancies. They can also verify that the applicant's information matches Social Security Administration and IRS files and provide a cashflow analysis that completes all calculations for the underwriter with IRS-validated data.

It's no surprise that identity discrepancies account for 60% of mortgage fraud. Fortunately, several automated tools are now available to halt this activity before it gets started. Identity validation tools are designed to check for common discrepancies involving the borrower's address, phone number, name (in correlation with an address or phone number), date of birth, presence on watch lists, and velocity (number of times an address or phone number has been seen recently).

Warning signs of potential fraud include addresses that come back as businesses or check-cashing stores; phone numbers reported to a different name and address; names not reported at an address; and an address or phone number that has been seen multiple times in recent succession. Automated tools can also check Social Security numbers for validity, issue date in correlation with date of birth, correct name and address, and whether the number belongs to someone who is deceased.

Employment fraud is another way to try to justify a fraudulent representation of income. It can occur when a borrower claims self-employment in a nonexistent company or claims a higher position in a real company. An employer ID report is designed to validate the borrower's employer information, including the company's name, address, phone number, year established, number of employees, key executives and website. The company's organizational structure can also be verified.

Concealment of debt obligations, such as undisclosed mortgage loans on the same or other properties, is also fraud because it can qualify a borrower for a bigger loan than would have been granted if the borrower's true debt had been disclosed. Lien reports include a search of more than 60 million lien records in the Mortgage Electronic Registration System to allow lenders to verify a borrower's property information. A search on the borrower's name, Social Security number or the property address can assist in the identification of undisclosed liens and multiple loans per borrower or property.

Red flags aloft

The "red flags" rules that went into effect in 2008 require mortgage professionals to detect and prevent instances of identity theft. All too often, thieves use the identity of an innocent consumer to obtain a mortgage without the knowledge or consent of the victim. Lenders need to be aware of the following red flags:

- alerts, notifications or warnings from consumer reporting agencies;
- suspicious documents or personally identifying information;
- unusual or suspicious activity on an account; and
- notices from consumers, victims of identity theft or law enforcement authorities.

Reports that gather all relevant alerts and summarize them in a convenient format are available to lenders. These reports include fraud alerts, active-duty alerts, credit freeze alerts, Social Security alerts, address alerts and others.

The high-stakes game in the mortgage loan industry and the multitude of providers and participants continue to make it a tempting target for white-collar crime. The FBI points out on its website that mortgage fraud perpetrators include a full spectrum of participants from throughout the mortgage loan industry as well as various organized crime groups. The FBI also notes that mortgage fraud is so prevalent because it allows perpetrators to earn high profits with a relative low risk for discovery.

Because of this, mortgage fraud perpetrators are using their experience in the banking and mortgage-related industries - including construction, finance, appraisal, brokerage, sales, law and business - to exploit vulnerabilities in the mortgage and banking sectors to conduct multifaceted mortgage fraud schemes. The FBI says many perpetrators have high-level access to financial documents, systems, mortgage origination software, notary seals and professional licensure information necessary to commit mortgage fraud and have demonstrated their ability to adapt to changes in legislation and mortgage lending regulations to modify existing schemes or create new ones.

Perpetrators in these schemes often supply fictitious bank statements, W-2 forms and tax return documents, and may also employ the use of stolen identities. Specific schemes used to falsify information include asset rental ("dough for a day"), backwards application and credit enhancement schemes.

Law enforcement is stepping up its efforts to bring these criminals to justice, and industry efforts to contain fraud are starting to have an effect. However, the vast majority of participants in the secondary market will likely take the same position as Fannie Mae - that it is up to loan originators and underwriters to step up now and make the changes necessary to detect and prevent fraud.

Most lenders understand the importance of this effort. The higher the prevalence of fraud within mortgages originated, the higher the risk of default on these mortgages. This, in turn, lowers the value of the mortgage-backed commodities created and sold in the secondary markets. Or, in other words, the more fraud in the industry, the higher rates will go.

Advanced technology will continue to be an important weapon in the fight against fraud. It may require some effort on the part of lenders to implement these changes, but it will return real benefits to the lenders - and the industry - in the long run. SME

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