



ISSUE PAPER

Subject: Mortgage Fraud Perpetrated Against Residential Lenders

Issue: Mortgage fraud perpetrated against residential mortgage bankers has grown exponentially over the past several years with significant consequences to lenders and, depending on how the fraud is perpetrated, to taxpayers, consumers and communities. Mortgage fraud is particularly costly to mortgage lenders due to the fact that, when fraud is discovered, lenders are generally held fully accountable for the costs of such fraud through repurchase requests from investors or other actions.

Background: Mortgage fraud is defined as material misrepresentation - intentionally providing false information to deceive or mislead a lender into extending credit beyond the limits of what would normally be extended if the facts were known. Information or documentation is considered false if there is clear and convincing data that the information or documentation lacks truth or accuracy. Mortgage fraud against lenders differs from predatory lending, which involves unscrupulous lending to an unsophisticated borrower.

Mortgage fraud can be divided into two broad categories: “fraud for property” and “fraud for profit.” Fraud for property occurs, typically, when fraud is committed so that a homebuyer can purchase a house for personal use. Such fraud usually carries a lower financial risk to lenders because the fraud is a one-time occurrence on a loan the buyer intends to repay. Fraud-for-profit schemes, on the other hand, typically involve a person or a group of people that abuse the system for financial gain. These persons are often industry insiders who know how to exploit the complex residential finance system at the expense of lenders, taxpayers, consumers and communities.

No authoritative statistics are available on the extent or the cost of the mortgage fraud problem. The Federal Bureau of Investigation (FBI) recently estimated industry losses resulting from mortgage fraud in 2006 to be between \$946 million and \$4.2 billion. Additionally, investigations by law enforcement and Suspicious Activity Report (SAR) filings by depository institutions are two indicators that are often used to gauge the extent of the problem. , The Federal Financial Crimes Enforcement Network (FinCEN) reported that over 37,000 SARs related to mortgage fraud were filed in 2006, an increase of almost 400 percent since 2003. However, these reports do not represent the entire mortgage industry, as only one-third of mortgage institutions are required to submit SARs. The FBI has seen its mortgage fraud caseload increase significantly. In September of 2002, the FBI had 436 mortgage fraud investigations. In 2006, that

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number grew to well over 1,000, an increase of more than 237 percent in less than five years.

Unlike credit and economic risk, the responsibility for mortgage fraud is borne fully by mortgage lenders. Secondary market investors generally require the repurchase of loans where fraud is discovered. Lenders, in turn, often have no practical recourse against those who perpetrate fraud, as these persons are either out of business, have little capital that a lender can draw on to compensate itself, or cannot be easily tracked down. Though the lender is the direct victim of mortgage fraud, fraud harms honest homeowners and homebuyers as well, through increased housing costs. Schemes that involve artificially inflated appraisals, for example, drive up property tax assessments for homeowners and prices for prospective homebuyers. Foreclosures resulting from fraud can depress surrounding home prices and contribute to the deterioration of a neighborhood.

In response to this rapidly growing problem, legislators on both the state and federal levels introduced a number of proposals that seek to curb mortgage fraud and appropriately punish those who commit it. MBA played a leading role in advising legislators on potential solutions that effectively address mortgage fraud without curtailing consumers' ability to access credit.

On October 7, 2004, MBA testified at a U.S. House of Representatives hearing about the need for increasing the investigation and prosecution of mortgage fraud by law enforcement agencies, improving the communication between mortgage lenders and the state and federal agencies that investigate and prosecute mortgage fraud, and developing better industry tools and intra-industry communication to combat fraud.

On May 5, 2005, Georgia became the first state to criminalize mortgage fraud when the **Georgia Residential Mortgage Fraud Act** ("the Act") was signed into law. The Act provides a definition of residential mortgage fraud, outlines the terms of punishment for violation of the law, and amends the Georgia Racketeer Influenced and Corrupt Organizations Act to include residential mortgage fraud within the definition of racketeering activity. In 2007, seventeen states introduced some variation of mortgage fraud legislation. Arizona, Florida, Michigan, Minnesota, Mississippi, Missouri, New Jersey, Nevada, and Texas are among those states currently considering bills that most closely resemble the Georgia law. On April 25, 2007, Senator Barack Obama (D-IL) reintroduced the **"Stopping Transactions which Operate to Promote Fraud, Risk, and Underdevelopment Act, or the "STOP FRAUD Act,"** S. 1222. The bill would criminalize mortgage fraud, expand the definition under the Bank Secrecy Act of who is required to report incidences of "suspicious activity," establish a database of censured and debarred mortgage professionals and provide funding for various enforcement activities. This bill, however, also contains a number of provisions that seek to address predatory lending. MBA will work to ensure that any legislation is balanced and workable.

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MBA has again sent letters to the Chairs and Ranking Members of the House and Senate Appropriations Committees, requesting \$6.25 million per year, over a five-year period, of dedicated funding for the FBI's efforts in tracking down and prosecuting mortgage fraud. The funding would provide for new FBI field investigators; additional prosecutors dedicated to mortgage fraud; and support for the operations of FBI Interagency Task Forces in the areas with the 15 highest concentrations of mortgage fraud.

MBA has provided a number of resources to lenders in support of their efforts to protect themselves from mortgage fraud. On April 1, 2005, MBA launched ***the Mortgage Fraud Against Lenders Resource Center Web site*** (<http://MBAFightsFraud.MortgageBankers.org>). The Web site serves as a one-stop resource with comprehensive information on mortgage fraud, including: fraud alerts, legislative and regulatory updates, industry news, and fraud detection and prevention resources.

In January, 2007 MBA's Residential Board of Governors (RESBOG) created a Mortgage Fraud Task Force. The purpose of this Task Force was to develop additional policy recommendations for RESBOG's consideration on industry efforts to combat mortgage fraud. Focusing on efforts to improve fraud detection and deterrence, the task force recommended that MBA support efforts to establish a national fraud database. On June 8, MBA, through Lender Technologies, issued a request for information (RFI) as the first steps towards creating such a database.

MBA held its second annual National Fraud Issues Conference March 8-9, 2007. The conference brought together over 400 participants who learned how to protect themselves and their institutions from being victimized by fraud, by gaining insight into how to move beyond learning about schemes and red flags, and look at issues that cut across departments and industries.

At the Conference, MBA Chairman John Robbins and FBI Financial Crimes Section Chief Karen Spangenberg introduced a new FBI Mortgage Fraud Warning Notice. This notice can be used by lenders to ensure that all participants in the mortgage lending process are fully aware that mortgage fraud is a serious crime and that significant penalties exist for those who commit mortgage fraud. The Warning Notice, along with information regarding its use, can be found at:
<http://www.mortgagebankers.org/FBIMortgageFraudWarning.htm>.

MBA Position: Regardless of the lack of authoritative statistics, MBA's members continue to report that mortgage fraud is a growing problem that is becoming more expensive. MBA believes that increased enforcement, better communication and further innovation is required in order to adequately protect the industry, as well as consumers, taxpayers and communities, from the costs of mortgage fraud. In addition, MBA strongly encourages lenders to consider any steps necessary to defend themselves from fraudulent schemes, such as integrating the FBI Mortgage Fraud Warning Notice into their loan processes.

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Status: MBA continues to work with the House and Senate Appropriations Committees to have language included in both the House and Senate appropriations committee reports that expresses the committees' concern about mortgage fraud and urges the FBI to increase resources committed to this problem. Specifically, MBA has requested that Congress appropriate \$6.25 million per year, over a five-year period, of dedicated funding for the FBI's efforts in tracking down and prosecuting mortgage fraud. The funding would provide for new FBI field investigators, dedicated prosecutors and support for the operations of FBI Interagency Task Forces in the areas with the 15 highest concentrations of mortgage fraud.

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Date: **July 2007**