



The Market's Impact on Mortgage Fraud

MBA Residential Loan Production Conference

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Recent Economic News



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MBA's Economic Forecast Predicts:

- A 19.5 percent reduction in 2006 total residential mortgage production.
- Refinancings will drop by nearly 40 percent in 2006.
- Home price appreciation will moderate significantly in 2006, with median existing home prices increasing 6.6 percent this year.

Uncertain times

Feb. 13: Tech stocks fall amid renewed worries that a speech by new Fed Chairman Bernanke will pave the way for further rate increases. (Reuters)

Speaking before the House Financial Services Committee, Bernanke indicated that higher energy prices and an overheated economy could boost inflation. He did not say outright that the central bank would continue to hike the federal funds rate, but another quarter percentage point is expected at the next meeting. Bernanke also noted that home prices and residential construction could decline at a faster-than-anticipated rate. (Wall Street Journal)

Most economists expect home prices in bubble areas to flatten or decline modestly. But if home prices in those areas crash, will Bernanke intervene by aggressively lowering rates? Or will he let the market take its course? (NPR 1/31/06)

Uncertain times

Borrowers of subprime interest-only mortgages could be in for a payment shock, according to New York-based Fitch Ratings in the latest edition of 'Mortgage Principles and Interest.'

RealtyTrac reports that the number of foreclosures last year surged by 24.5 percent for all of 2005. (Realty Times)

The MBA reports that demand for home financing slumped 7 percent for the week ending Feb. 10. The index of loan applications fell to its lowest reading in more than two years. (Investor's Business Daily)

TPG Insured Loan Characteristics

For six months ending 1/31/06 vs. month of 1/06 alone:

- Average loan balance fell to \$159,039 from \$160,314
- Average FICO fell from 649 to 610
- Lenders report 10% drop in January over previous six months
- Top five states remain the same: CA, FL, TX, GA, NJ



What Does This Have to Do with Fraud?



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FRAUD STATISTICS AT A GLANCE

Approximately 10% of all applications contain at least one form of misrepresentation

FRAUD STATISTICS AT A GLANCE

Up to 45% of all Early Payment Default files are attributable to fraud or misrepresentation depending on geographic location.

FRAUD STATISTICS AT A GLANCE

Approximately 25% of all foreclosures
are due to fraud

FRAUD STATISTICS AT A GLANCE

On average, the severity of loss on a loan containing fraud or misrepresentation is 37%. (Ex: \$100,000 loan x .37 = \$37,000)



TPG CLAIMS OVERVIEW



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Claims Summary Data

- Average LTV 81.7%
- Average FICO 628
- Average Borrower Age 38
- Average Loan Amount \$185k
- Fixed Rate/ARM 32.0/68.0%
- Refinance/Purchase 12.1/87.9%
- Individual/Joint Borrower 91.0/9.0%
- Full-doc product 55.5%
- Reduced-Doc 45.5%

Update from TPG claims department

Types of fraud – Q4 2004 vs. all of 2005

Q4 2004

Employment/Income Fraud (34%)
Occupancy Fraud (22%)
Undisclosed Mortgage/Property (21%)
Straw Buyers/Borrowers (6%)
Funds Misrepresentation (6%)
Phony VOR/VOM/Lease Contract (4%)
Transaction Misrepresentation (3%)
Undisclosed Debt/Foreclosure (2%)
Phony SSN (2%)
ID Theft (1%)
Phony Credit Letters (0%)
Phony HUD-1 (0%)

2005 cumulative

Occupancy Fraud (31%)
Undisclosed Mortgage/Property (23%)
Employment /Income Fraud (22%)
Phony VOR/VOM/Lease Contract (7%)
Transaction Misrepresentation (5%)
Straw Buyers/Borrowers (4%)
Funds Misrepresentation (3%)
Undisclosed Debt/Foreclosure (2%)
Phony Credit Letters (0.8%)
Phony SSN (0.5%)
ID Theft (0.5%)
Phony HUD-1 (0.5%)

Update from TPG claims department

Fraud hot spots – Q4 2004 vs. all of 2005

Q4 2004

1. Chicago Metro Area
2. Detroit Metro Area
3. Atlanta Metro Area
4. Los Angeles Metro Area
5. Miami Metro Area
6. Tampa Metro Area

2005 cumulative

1. Atlanta Metro Area
2. Detroit Metro Area
3. Chicago Metro Area
4. Houston Metro Area
5. Dallas/Ft. Worth Metro Area
6. Miami Metro Area
7. Orlando Metro Area
8. Los Angeles Metro Area

OTHER “HOT SPOTS”

Las Vegas
Washington
Salt Lake City
Baltimore
Indianapolis
Brooklyn
Queens
Jacksonville
S. Florida

Raleigh
St. Louis
Cleveland
Denver
Cincinnati
Dayton
Birmingham
Charlotte
Houston



FRAUD TRENDS

Fraud Trends

- FBI states that in the last 2 years reports of mortgage fraud have tripled while the dollar value of the crimes has quadrupled to over \$1 billion.
- FBI also states that these numbers are understated as a large segment of the industry is not required to report.
- State and federal regulators stepping up fraud examinations, including sanctions and fines.

Lenders Are Reporting.....

- Harder loans - less qualified borrowers
- Increase in guideline exceptions being requested
- Increase in suspected misrepresentation - more referrals to prefunding QC
- In “down” markets, the motivation to commit fraud increases.

*Rising Rates = Fewer Loans.
Every Deal Counts*

Million Dollar Question

How do I maintain loan quality in a contracting market?

How do I maintain loan quality in a contracting market?

- Know Your Customer: Broker approval and monitoring, Retail Leads
- Account Executive and Loan Officer training: Sales and Fraud Awareness
- Exemplary Service
- Corporate Fraud Prevention Solution

Know Your Customer

- Broker approval and monitoring:
 - Vertical Integration?
 - Previous suspensions?
 - Strong broker contract and application
 - Re-brokering?
 - Staying within market area

Know Your Customer

- Retail Business Relationships:
 - Vertical Integration?
 - Staying within market area
 - Making sure YOU are dealing directly with the customer
 - If the deals sound too good to be true, they probably are

Corporate Fraud Prevention Solution

- Shift to technological solutions:
 - Assists in identification of potentially fraudulent transactions
 - Is not the entire solution
 - Lenders report that these tools stop less than 25% of the fraud

Corporate Fraud Prevention Solution

- Brick and Mortar Pre-funding:
 - Technology can not replace well trained staff
 - Closing/Funding issues typically unable to be addressed through application screening tools
 - Ex: Preliminary HUD-1 review with payoffs from Seller funds

Saleability is Only Half the Equation

Remember, there can be a difference between a "saleable" loan and a "quality loan"....

- Rep & Warrants for misrepresentation typically have no sunset clause
- Early Payment Defaults are often a clue to fraud incidence
- Protecting the company's bottom line is everyone's responsibility.



FINAL QUESTIONS?

