

---

# Current Hot Topics

Andrew L. Sandler

Skadden

MBA

Regulatory Compliance Conference

September 2006

# Key Risk Areas

---

- I. Fair Lending - HMDA
- II. Mortgage Fraud
- III. Privacy/Information Security
- IV. Anti-Money Laundering

Skadden

## **I. FAIR LENDING - HMDA**

# Fair Lending - HMDA

---

## Home Mortgage Disclosure Act (“HMDA”) (12 U.S.C. §§ 2801-2809)

- Requires certain financial institutions to collect and disseminate data about mortgage loans and applications for such loans.
- Through its implementing Regulation C (12 C.F.R. Part 203), HMDA is intended to provide information on whether financial institutions serve the housing credit needs of the communities in which they are located.

Skadden

# Fair Lending - HMDA

---

## Fed HMDA Report

- Reports on 2004 HMDA data for 8,853 lenders, which account for approximately 80% of all home loans.
- Approximately 2% of lenders have statistically significant disparities between Minority and White Non-Hispanic trigger rates.
- “Minority” is defined as Black and Hispanic combined.
- Fed Report is partially based on data that is not publicly available (date of application) but otherwise can be replicated by the public.

Skadden

# Fair Lending - HMDA

---

## Fed HMDA Report

- Fed acknowledges that:
  - “[T]he data are not sufficient by themselves for drawing conclusions about the fairness of the lending process or the activities of any individual lender.”
  - “For example, credit history scores and other factors not included in the HMDA data can be critical in determining loan prices.”

Skadden

# Fair Lending - HMDA

---

## Fed HMDA Report

- Only 2% of lenders identified as having statistically significant pricing disparities, once Minority and White customers are matched based on loan amount, income and other variables included in the HMDA data.
  - Many large lenders were on the 2% List.
  - The 25 largest lenders accounted for 55% of the data.
  - The 500 lenders that made at least 100 higher-priced loans accounted for 96% of all higher-priced loans.

Skadden

# Fair Lending - HMDA

---

## Fed HMDA Report

- Many exclusively “prime” lenders reported significant numbers of triggered loans while many “nonprime” lenders reported far less than 100% triggered loans.
- Disparities in denial rates continue to exist. On an unadjusted basis the denial rate for conventional first liens is:
  - Black – 24.7%
  - Hispanic – 18.4%
- While only 2% of lenders had a statistically significant difference in trigger rates, 11% of lenders had statistically significant differences in denial rates.

Skadden

# Fair Lending - HMDA

---

## Fed HMDA Report

- 2005 HMDA data showing greater percentage of loans hitting HMDA triggers.
- Further analyses expected by Fall 2006.

Skadden

# Fair Lending - HMDA

---

## Government Use of Fed HMDA Report

- The Fed has referred data from lenders with statistically significant disparities in trigger rates to primary regulators.
- Referrals have been split between HUD and other financial institution regulatory agencies:
  - OCC
  - FRB
  - OTS
  - FDIC
  - NCUA

Skadden

# Fair Lending - HMDA

---

## Government Use of Fed HMDA Report

- DOJ economist studying data for investigation targeting.
  - Redlining/reverse redlining focus.
  - Pricing discretion.
- FTC reorganization and refocus on lending.
- State Attorneys Generals.
- State Human Relations Commissions (*e.g.*, Maryland, Ohio).
- State Banking Departments (*e.g.*, New York)

Skadden

# Fair Lending - HMDA

---

## Examination/Investigation Focus

- Origination Compensation
  - Broker points and fees
  - Discretionary pricing parameters
- Management of pricing discretion
- Proactive self-monitoring and action

Skadden

## **II. MORTGAGE FRAUD**

# Mortgage Fraud

---

## Evidence of Increasing Fraud

- According to the FBI, the number of complaints of fraud has doubled since 2001 and the number of Suspicious Activity Reports has doubled since 2003.
- The number of open FBI investigations into mortgage fraud has increased by 400% in the past three years.
- An estimated 10 to 15% of all mortgage applications have some indicia of fraud or misrepresentation.

Skadden

# Mortgage Fraud

---

## Property-Related Fraud

- Approximately 80% of instances of mortgage fraud involve either inflated property appraisals or nonexistent properties.
- Fraud plays a role in an estimated 20% of loans that enter foreclosure.
- Nonprime lenders account for 10 to 15% of the lending market, but 60% of all foreclosures.
- Appraisal fraud plays a major role in complex property “flipping” schemes, which frequently also involve closing agents and other co-conspirators.

Skadden

# Mortgage Fraud

---

## Types of Fraud

- Falsification of identity documents.
- Misrepresentations regarding employment and income (*e.g.*, falsified W2s).
- Identity theft.
- False down payments.
- Home improvement-related schemes.

Skadden

# Mortgage Fraud

---

## Enforcement Actions/Settlements

- Even though lenders are frequently themselves the victims of fraud, they are the focus of enforcement agencies and regulators. Examples of recent enforcement actions and settlements include:
  - Cease and Desist Order with Georgia's Department of Banking and Finance;
  - Joint Agreement with the U.S. Attorney for the Eastern District of Pennsylvania; and
  - Settlement with the U.S. Attorney for the Eastern District of Pennsylvania.

Skadden

# Mortgage Fraud

---

## Compliance Self-Analysis

- In anticipation of litigation, conduct self-analysis pursuant to the attorney-client privilege.
- Benchmark against industry best practices.
- Adjust for special circumstances (*e.g.*, geography, product mix).

Skadden

# Mortgage Fraud

---

## Elements of Effective Compliance Program

- Corporate commitment and structure.
- Broker approval process.
- Broker scorecard, watch list, and suspension.
- Prefunding and post funding reviews.
- Robust investigative process.
- Focus on appraisals, closing, and seasoning of loans.

Skadden

### **III. PRIVACY/INFORMATION SECURITY**

# Privacy/Information Security

---

## Gramm-Leach-Bliley Act and Federal Regulation

- Require banks to establish a comprehensive written information security program to:
  - Ensure security and confidentiality of customer information;
  - Protect against threats to integrity of customer information; and
  - Protect against unauthorized access that could result in harm to customers.

Skadden

# Privacy/Information Security

---

## Data Security Breaches

- Written response program required to address any unauthorized access to customer information.
- Must notify all affected customers if:
  - Sensitive customer information is accessed; and
  - Misuse has occurred or is likely to occur.
- Customer notice governed by federal regulation and laws in 23 different states.

Skadden

# Privacy/Information Security

---

## Multi-factor Authentication

- Must authenticate identity of customers using bank's online products and services.
- Three basic factors of authentication:
  - Something customer KNOWS
  - Something customer HAS
  - Something customer IS
- Compliance required by year-end 2006.

Skadden

---

## **IV. ANTI-MONEY LAUNDERING**

Skadden

# Anti-Money Laundering

---

## New Challenge For Mortgage Bankers

- Money laundering activities are a mounting concern in the mortgage industry.
- Internal systems to monitor AML activities in mortgage companies are not as sophisticated as in depository institutions.
- Vendors have not kept up.

Skadden

# Anti-Money Laundering

---

## New Challenge For Mortgage Bankers

- Real estate transactions, including mortgage loans, are vulnerable at all three stages of money laundering.
  - Placement: funds from illegal activity are introduced into financial system (e.g., payment for real estate with a large cash down payment).
  - Layering: funds are separated from their illegal origins using multiple transactions (e.g., real estate being bought and resold, making it more difficult to trace the true origin of funds).
  - Integration: illegal proceeds reenter economy and are converted into apparently legitimate business earnings (e.g., money launderer sells a piece of real estate and proceeds appear to be from a legitimate business transaction).

Skadden

# Anti-Money Laundering

---

## Money Laundering Risks in Mortgage Transactions

- Some of the factors that make mortgage transactions vulnerable to abuse by money launders include:
  - High value transactions (layering and integration stages);
  - Involvement of multiple parties (brokers, agents, appraisers); and
  - Vibrant real estate market has been accompanied by an increase in mortgage fraud. According to the IRS, in mortgage fraud cases, money laundering is often the mechanism used by the perpetrators to hide their income from the government.

Skadden

# For further information contact:

---

**Andrew L. Sandler, Esq.**

Skadden, Arps, Slate, Meagher & Flom LLP

1440 New York Avenue, N.W.

Washington, DC 20005

(202) 371-7400

[ASandler@Skadden.com](mailto:ASandler@Skadden.com)

**[Skadden.com/consumerfinancialservices](http://Skadden.com/consumerfinancialservices)**

Skadden