By Charles Wisniowski

Mortgage Fraud Expert Rachel Dollar—The MortgageFraud Blog

Rachel Dollar is a California attorney and recognized expert on fraud in the mortgage lending industry. She is the editor of the public-service industry Web site Mortgage Fraud Blog (www.mortgagefraudblog.com), which is committed to raising awareness of the growing problems associated with mortgage fraud against lenders.

Dollar is a partner in the law firm Lanahan & Reilley LLP, Santa Rosa, California, where she chairs the firm's Mortgage Banking Group. She handles mortgage fraud litigation for lenders on a nationwide basis. She has supervised successful complex mortgage fraud and Racketeer Influenced and Corrupt Organizations Act (RICO) litigation in the federal courts, as well as complex litigation involving secondary-market investors, mortgage insurers, loan servicers and other financial services companies. Dollar has also been involved in the discovery, investigation, resolution and litigation of large-scale fraud schemes nationwide.

A frequent industry speaker, Dollar also teaches in-house seminars on mortgage fraud issues to lending professionals. She frequently consults with licensing and local, state and national criminal agencies across the country on mortgage fraud matters, and is sought out regularly by the press to comment on mortgage fraud issues and cases.

Mortgage Banking recently interviewed Dollar about the current state of mortgage fraud against lenders.

Q: *Let's start by giving a working definition of "mortgage fraud" and explain its impact on the mortgage lending industry—both in terms of dollars and cents, and the way it has changed the way business is done.*

A: The definition of mortgage fraud is any misrepresentation made in the loan process in order to influence a lender's decision regarding credit. That causes the lender to extend credit beyond that which they would have otherwise have extended—which could be [in the form of] a higher loan amount or credit on different terms, including lower interest rates.

It's important to include that within the definition of mortgage fraud because it brings in the whole sphere of fraud for property. There are really two different types of mortgage fraud that we're concerned with: one of fraud for profit, which is the larger scheme. That results in really high dollar-amount losses and other ones that the statistics mostly track; versus fraud for property or fraud for housing, which usually only involve one loan to two loans at a time, lower dollar losses and a situation where a borrower is misrepresenting certain information in order to get into a larger house or a lower interest-rate product.

The difference is that in fraud for housing, the borrower intends to make the mortgage payments—while in fraud for profit, the ultimate intent of the parties taking out the loans is to default on the loans and allow them to go into foreclosure.

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The impact on the mortgage industry has really changed over the years, as mortgage fraud has become more of a significant issue. Initially, a lot of the fraud was viewed as a cost of doing business. But as fraud has impacted lenders at higher dollar amounts and has involved actual damage to consumers, lenders have taken a different look at it.

There are a lot of lenders now that are using fraud as one of their underwriting criteria. They are looking at fraud issues upfront in the loan process, and [they are] having that be a real focus of underwriting.

As far as dollars go, FBI [Federal Bureau of Investigation] statistics show that there was approximately $1 billion worth of mortgage fraud in 2005. That is estimated to be about one-third of the actual problem, so the losses are actually estimated between $1 billion and $3 billion—and that differential rests in the fact that the FBI measures fraud statistics by suspicious activity reports [SARs], and only one-third of lenders are required to file suspicious activity reports.

Also, a large percentage of fraud for property is never generally discovered and never reported, so losses concerning fraud for property will go through regular foreclosure channels.

Q: *How widespread is the problem of mortgage fraud within the industry?*

A: We see it throughout all aspects of the mortgage lending industry. For instance, in commercial lending there are significant dollar losses associated with mortgage fraud, but when you have mortgage fraud on the [commercial] mortgage side, your dollar losses are going to be much greater for that one scheme than they are going to be for a residential mortgage fraud.

[With] home-equity loans we see some [fraud], but we probably see less mortgage fraud on the home-equity side. We also see a significant amount of fraud for property in subprime or nonprime lending, but most large fraud-for-profit mortgage schemes that we see are A-paper.

Q: *Geographically speaking, is mortgage fraud just centered around the big metro areas with the big lending institutions, or is it all across the country at any lending institution, no matter the size?*

A: We see it all across the country at all sizes of lending institutions. There are some economic factors that contribute to increased fraud in certain areas, but we see fraud in rural areas. I've seen fraud-for-profit schemes where no one would expect to see it—in small towns that no one has heard of before.

Q: *What was the most pervasive or most reported method of mortgage fraud perpetrated against lenders in 2006—flipping, overvaluation, straw buying, air loans, etc.? Did you observe any sort of trend?*

A: Without appraisal fraud or valuation fraud, you don't have the significant losses. Overvaluation is always going to be an element of large-loss mortgage frauds. Property flipping has been a big issue for many years, and it continues to be.

We see more off-record flips these days where you have assignments of contracts. Because lenders have become more and more aware of property flipping and refuse to lend in a lot of those circumstances or give increased scrutiny to those types of transactions where you have quick, on-record transfers, they have started to do it by assignment of deed, where the intermediate ownership is never recorded.

Q: *Is there anything in particular—any new fraud strategies or scams—that lenders need to be aware of in 2007?*

A: Well, we're seeing an increase in some schemes that [lenders] are aware of. I'd say there's almost a reverse on the fraud-for-property scheme, where people are making misrepresentations to get *out* of loans at this point in time rather than get into them. So we've seen an increase in investors transferring their properties to straw buyers in order to get out of burdensome loan situations.

Q: *How has the mortgage lending industry responded to the problem of mortgage fraud? What steps does it need to take to get in front of this issue?*

A: Well, . . . one thing is just an increase in awareness and education. Underwriters are being trained more to spot fraud and to be aware of fraudulent issues.

I think that company management and the executives within the companies are getting more and more aware of this issue, and they are changing the focus. For a number of years, the focus was really on production. Risk has really become an issue, and lenders have recognized that originating a bad loan is not making money.

Q: *You've emphasized the role of quality assurance/quality control in reducing fraud—control, awareness and detection. Have quality assurance and quality control received enough attention?*

A: Quality control is receiving a lot more attention these days. I think that it's very important that quality control actually be seen as a profit center rather than just something that lenders are forced to do by regulation or by their investors. It's very important to stay in front of these schemes and to know who it is that is perpetrating them and to catch them quickly.

It's one thing to fund one bad loan in a bad scheme. It's another thing to fund 500 of them, because those are the issues that put companies out of business. Focusing on quality control as a company goal or a company focus can really save companies, especially as the economy changes.

Q: *Have the roles of government and law enforcement in combating mortgage fraud been adequate so far, in your opinion? What has been done right, and where is there room for improvement?*

A: There's really kind of a pull on that one, and there's a balance on it. There's never enough enforcement, because there are always people out there [committing mortgage fraud], and there are always those out there that we just wish would get indicted.

We watch them for a very long time and don't understand why they're not indicted. But when you look at what else happens in this country and the competing interest for the law-enforcement dollars—if you have gang shootings in a neighborhood versus a real-estate flipping scheme, I think most people would agree that law-enforcement dollars should be spent on the violent crime.

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But mortgage fraud brings violent crime into areas—so it's a chicken-or-the-egg philosophy as well. So I think that law enforcement does what they can with the dollars that they have.

I think that increased education in law enforcement would go a long way if we focus more on educating law enforcement about the loan process, and the roles of the various different parties and the documents that are involved.

It would make the job of law enforcement much easier and much less expensive. I think it would be very beneficial for the lenders to do that, because the education really avoids a lot of potential pitfalls within the investigation and prosecution of those cases.

Also, lenders putting together the information themselves and cooperating with law enforcement is just really important. We have a lot of complaints with law enforcement about the inability to obtain some information that they need to continue their prosecution. So it really has to be a joint effort and cooperation between the government and the lending institutions.

Q: *At the state level, as you know, the Georgia Residential Mortgage Fraud Act was signed into law in May 2005. Having had a couple of years to watch it in action now, how effective has it been?*

A: I think it was a great thing for the mortgage industry to get that passed in Georgia, and it really assists with the ability of local authorities to prosecute these cases. The problem was—and the problem is in many, many states—that mortgage fraud doesn't fit neatly within the boxes of crimes that exist on the books.

For instance, they may have to indict [an accused mortgage fraud suspect] on a forgery charge, and in order to indict on forgery, you have to have somebody signing the signature of another person. That's not always something that occurs in a mortgage fraud case.

Or in order to indict under grand-theft statutes, you have certain elements that you may have to meet, and it may not always fit neatly within those elements. So mortgage fraud as a crime [in and of] itself gives the state a very specific statute under which to prosecute these crimes, and that's very helpful for them.

In a lot of states, they really can't indict under their own statutes or they have to wait for federal prosecutors to come in, because federal prosecutors do have the tools to go after participants in these schemes.

Q: *The Conference of State Bank Supervisors, along with the American Association of Residential Mortgage Regulators, are in the midst of creating a standardized licensing system between the states. The National Association of Mortgage Brokers has said it unfairly singles them out, and the system should include all mortgage loan originators. What are your thoughts?*

A: I think that project is a great idea. There is some merit to the argument that all loan originators should be treated equally, as they all have that ultimate relationship with the consumer—and I think that's where the focus should be, rather than on whether somebody works for a federal- or state-licensed institution. But the database is a great idea. A large amount of mortgage fraud is perpetrated by repeat offenders, so we'll have mortgage loan originators being disbarred in one state and going into another.

In fact, there's one [case] that we posted on MortgageFraudBlog within the last day or two, out of Alaska, where the originator actually lost his license in Wisconsin and he was just indicted in Alaska for mortgage fraud.

Q: *The 2005 FBI report on mortgage fraud noted that the mortgage industry is void of any mandatory fraud reporting, while fraud in the secondary market is often underreported. Should there be mandatory fraud-reporting within the industry?*

A: Yes. The problem is that there's no safe harbor for fraud reporting. There definitely should be one, and there should be for information-sharing for lenders as well—or the information should be a two-way street.

The biggest problem that we have with mortgage fraud is that lenders don't have any safe way of sharing information. So the criminals out there who are perpetrating these schemes attempt to find a loan at one institution, and when they are discovered, they just go next door and reapply after having patched the holes in whatever their documentation was.

And the two lenders have no way of communicating to one another who these people are or what they're trying to do. So eventually, in a lot of cases, the loans end up being funded.

Q: *If it were up to you, how would you structure such a mandatory mortgage fraud-reporting requirement—what should it include and not include?*

A: It's a difficult question, because you have to very specifically define fraud. There's also an issue with becoming over-inclusive, or with the burdening of lenders with vague requirements. So you have to be very specific about what needs to be reported. Definitely [some requirements should be] a safe harbor and some manner of having your reports referred back to the appropriate agencies—either the state or local, or federal level—for investigation and prosecution.

It already entails significant resources to deal with the SARs reports and the FACT Act [The Fair and Accurate Credit Transaction Act of 2003], but it's only a part of the big story and it allows these perpetrators to continue to operate just by the fact that we don't have the mandatory reporting. For instance, if a mortgage fraud scheme is perpetrated through an institution that is not federally regulated, then there's no reporting.

So there may be, for instance, a mortgage fraud scheme that involves $2 million worth of losses. But because only $200,000 of it was run through a federally regulated financial institution, that's the only portion of the scheme that the authorities are aware of. Then it won't trigger the federal threshold for an investigation, and that case would never be instituted.

Q: *In the past there has been, or at least there appeared to have been, an emphasis on mortgage fraud for profit while fraud for housing—applicants tweaking their data to qualify for the loan—seemed to be a lesser priority. Do you detect a change as the housing market slows and lenders start looking after every cent?*

A: I don't know if it's so much a change as it is a loss position. In most of those situations, you had borrowers who intended to make the mortgage payments, and you had borrowers who did make the mortgage payments. So you didn't have large losses to lenders, and most of them just weren't discovered. As quality control has increased and as underwriting has become more focused on these issues, more of it is being discovered.

With the economic slowdown you have more borrowers who, despite all their good intentions, are not able to make their payments—so you have higher default rates and higher loss rates coming out of the fraud-for-housing sector.

Q: *So then, should the industry really tighten up on fraud for housing?*

A: A lot of times it's harder to discover fraud for housing, either on the front end or on the back end, just because you don't have the same types of patterns coming out [as with] fraud for profit. I think that fraud for housing is a concern, because the underwriting criteria are in place for a reason. One of those reasons is to make sure that the borrower getting into the loan can afford it.

Although that [would be of] assistance to the lender, it's also in favor of the borrower. If the borrower can't make the payment or struggles to make the payment every time the mortgage payment comes due, then they are less likely to be able to keep their house.

When borrowers have put in substantial savings and the down payment, that's a huge concern to try to keep their home, whereas maybe if they would have been denied for that loan application and maybe if they had gotten something smaller and more affordable, they would have been able to keep their home.

Q: *For 2007, do you see the problem of mortgage fraud getting better, getting worse or remaining the same for the industry?*

A: I actually expect that it will go up over 2007. Based on a lot of the economic conditions, I expect losses to increase because of falling housing prices. I can see a lot of desperation, and a lot of the schemes we're seeing—we've started seeing cash back at closing, we've started seeing builder bailout—[show] there's desperation in the people that are doing it in order to get out of properties where they're overextended, and that just adds to the fraud that's already out there.

Charles Wisniowski is a correspondent for *Mortgage Banking*.