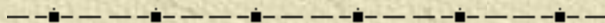
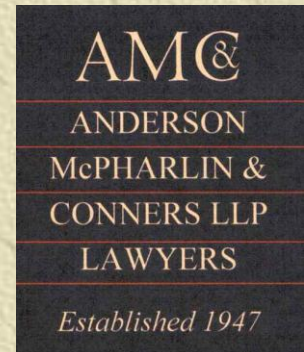




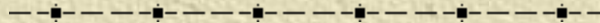
IDENTIFYING AND ADDRESSING FRAUD POST CLOSING

Gail Andrich Steve Dailey [redacted], Esq. Vanessa Widener, Esq.






Overview of Mortgage Fraud



What is Mortgage Fraud?



- ✦ Mortgage fraud is investigated by the FBI and is punishable by up to 30 years in prison or \$1,000,000 fine or both.



✦ Mortgage Fraud is defined as the intentional misstatement, misrepresentation, or omission by an applicant or other interested parties, relied on by a lender or underwriter to provide funding for, to purchase, or to insure a mortgage loan.

U. S. Department of Justice
Federal Bureau of Investigation

FINANCIAL CRIMES SECTION
CRIMINAL INVESTIGATIVE DIVISION

FINANCIAL CRIMES REPORT TO THE PUBLIC
FISCAL YEAR 2006



U. S. Department of Justice
Federal Bureau of Investigation

MORTGAGE FRAUD

New Partnership to Combat Problem

03/09/07

There are two kinds mortgage fraud: fraud for property and fraud for profit. In general, fraud for property is when a home buyer lies about income, debt, or other information in order to buy a home. This type of fraud accounts for about 20 percent of mortgage fraud cases.

Then there's fraud for profit. These crimes involve industry insiders, and generally include multiple loan transactions with several financial institutions.

U. S. Department of Justice
Federal Bureau of Investigation

SUBPRIME LOANS AND MORE

It's a Bull Market for Financial Fraud

1/31/08

Traditional mortgage fraud:

- **FBI has more than 1,200 cases open today (up about 40 percent from last year), mostly involving fraud for profit, where groups of straw buyers, realtors, etc. rig schemes to buy properties that are flipped or allowed to go into foreclosure.**
- **Suspicious activity reports that the FBI reviews for potential mortgage fraud have grown from 3,000 in fiscal year 2003 to 48,000 in fiscal year 2007. This year, they are on pace to receive more than 60,000 such reports.**

U. S. Department of Justice
Federal Bureau of Investigation

2006 Mortgage Fraud Report – May 2007

Top Areas for Mortgage Fraud

- Analysis of available law enforcement and industry resources indicates that the top ten mortgage fraud areas are California, Florida, Georgia, Illinois, Indiana, Michigan, New York, Ohio, Texas, and Utah.
- Other areas significantly affected by mortgage fraud include Arizona, Colorado, Maryland, Minnesota, Missouri, Nevada, North Carolina, Tennessee, and Virginia.
- There is a strong correlation between mortgage fraud and loans which result in default and foreclosure.

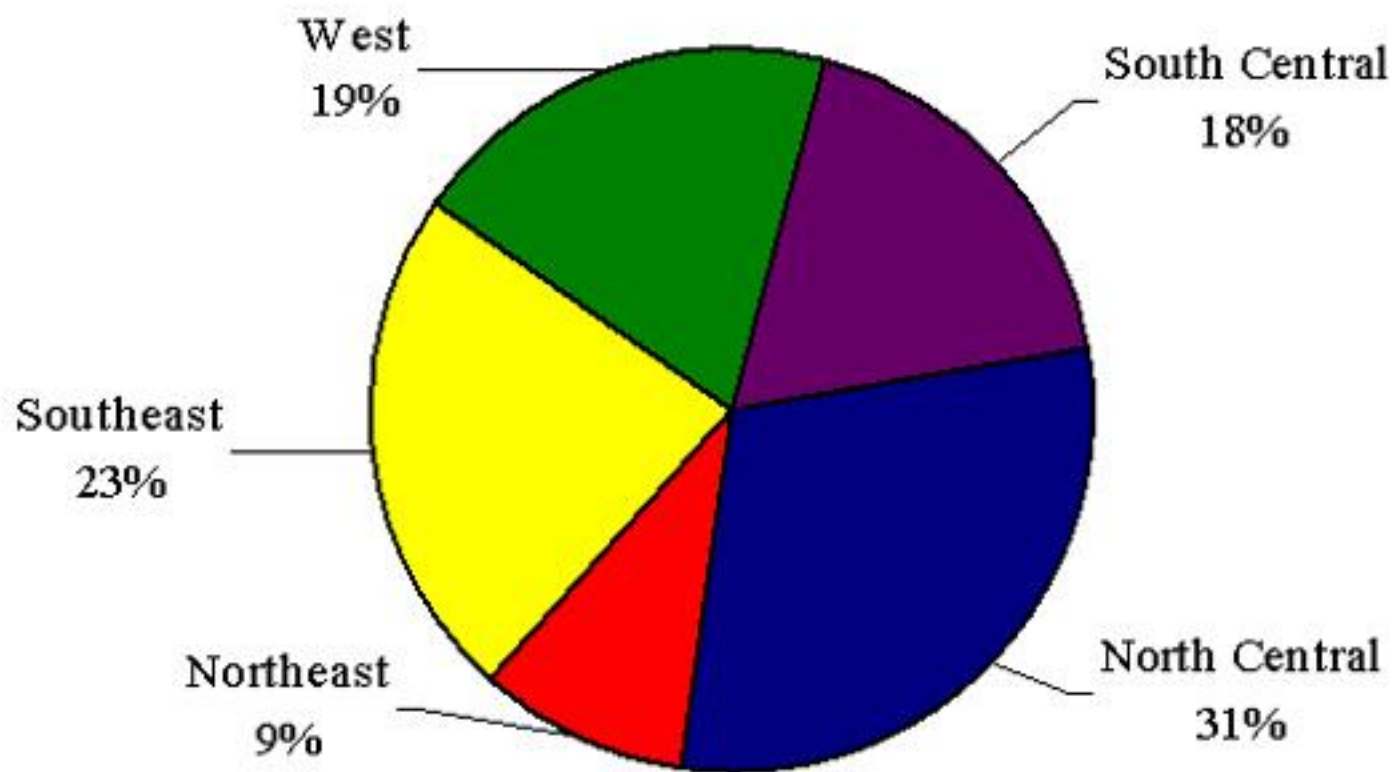
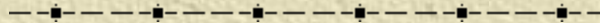


Figure 4: FY 2006 FBI Pending Mortgage Fraud Investigations by Region

Common Mortgage Fraud Scams





Property Flipping

- ✦ Property is purchased, falsely appraised at a higher value, and then quickly sold. What makes property illegal is that the appraisal information is fraudulent.
- ✦ The schemes typically involve one or more of the following: fraudulent appraisals, doctored loan documentation, inflating buyer income, etc. Kickbacks to buyers, investors, property/loan brokers, appraisers, and title company employees are common in this scheme.

Figure 1: Illegal Property Flipping Scheme



Silent Second

- ✦ The buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, when in fact, it is borrowed.
- ✦ The second mortgage may not be recorded to further conceal its status from the primary lender.

Nominee Loans/Straw Buyers

- ✦ The identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.

Fictitious/Stolen Identity

- ✦ A fictitious/stolen identity may be used on the loan application.
- ✦ The applicant may be involved in an identity theft scheme: the applicant's name, personal identifying information, and credit history are used without the true person's knowledge.

Inflated Appraisals

- ✦ An appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender.
- ✦ The report inaccurately states an inflated property value.

Foreclosure Schemes

- ✦ The perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure.
- ✦ Perpetrators mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees.
- ✦ The perpetrator profits from these schemes by remortgaging the property or pocketing fees paid by the homeowner.

Equity Skimming

- ✦ An investor may use a straw buyer, false income documents, and false credit reports, to obtain a mortgage loan in the straw buyer's name.
- ✦ Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title.
- ✦ The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.

Air Loans

- ✦ This is a non-existent property loan where there is usually no collateral.
- ✦ An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments, and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.



How to Salvage the Fraudulent Loan Identify Sources of Recovery

- ✦ Borrower
- ✦ Property Sellers
- ✦ Mortgage Brokers /
Correspondent Lenders
- ✦ Appraisers
- ✦ Closing Agents
- ✦ Realtors
- ✦ Title Insurers
- ✦ Escrow / Notary



Borrowers

1. Workouts (payment plans or modification)
2. Friendly foreclosure or deeds in lieu
3. Litigate to deficiency – as applicable per state law

Breach of Contract

(application fraud and nonpayment)

Mortgage 8

Borrower shall be in default if, during the Loan application process, Borrower . . . gave materially false, misleading, or inaccurate information or statements to Lender (or failed to provide Lender with material information) in connection with the Loan.

Fraudulent inducement and Negligent Misrepresentation

(Applications, HUD-1 Settlement Statements, Affidavits)

Borrower Affidavits

2. **ACKNOWLEDGMENT OF PAYMENT.** That the required down payment, settlement costs and prepaid expenses as required to legally settle this purchase of the Property were paid by me/us.

3. **SOURCE OF FUNDS.** That no portion of the down payment, closing costs and prepaid expenses were borrowed from any source and that I/we did not incur any debt in this transaction except the subject loan and no additional agreements or kickbacks with the seller or agent have been made that have not been disclosed to the Lender.

Claims against Borrowers

1. Conspiracy
2. Foreclosure
3. Rescission
4. Unjust Enrichment
5. Injunctive Relief
6. Constructive Trust
7. Breach of Contract
8. Fraudulent inducement and Negligent Misrepresentation



Property Seller

✦ Developer Sale

- Inflated Sale Price + Seller Concessions and/or Secondary Financing

✦ Resale

- Inflated Sale Price + Side Payment

✦ Legal Theories

- Fraudulent inducement
- Conspiracy
- Racketeering
- Unjust Enrichment
- Injunctive Relief
- Constructive Trust

Mortgage Brokers / Correspondent Lenders

- ✦ Lender-broker agreements generally create contractual duties and obligations for the benefit of the lender and its assignees (secondary market purchasers).
- ✦ Correspondent lenders transact loans via sale contracts generally containing representations and warranties imposing a duty to repurchase and/or indemnify if there is: (a) fraud; (b) an early payment default; (c) a failure to comply with applicable federal or state law, or applicable insurer guidelines.

Examples of Standard Representation and Warranties

- ✦ Broker has used its **best efforts** to ensure that nothing contained in any loan application package, whether obtained, derived or requested by the borrower, Broker or otherwise, is untrue, erroneous or misleading.

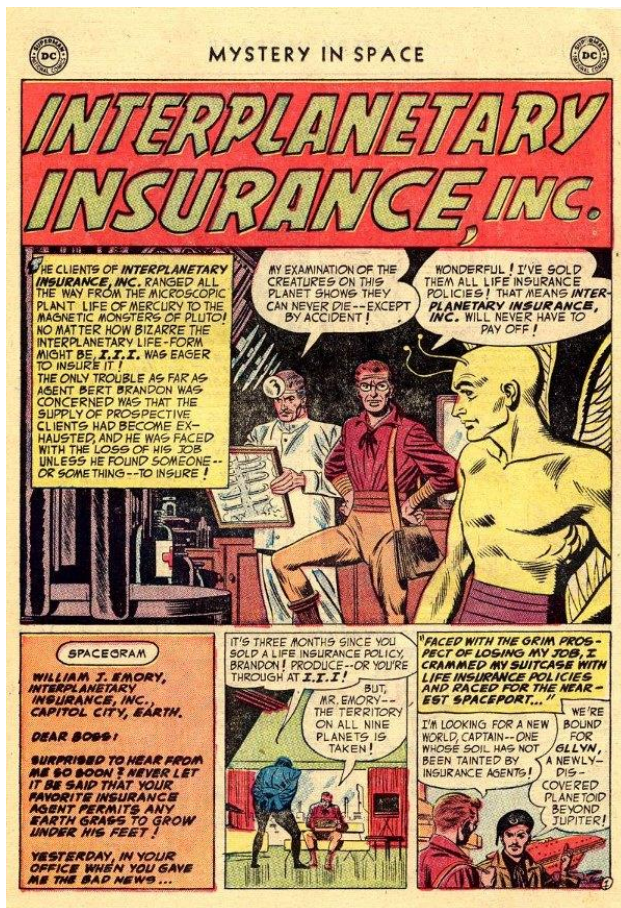
✦ Broker has **no knowledge nor any reason to know** of any of the following: . . . (vi) any circumstances or condition which might indicate that the appraisal is incomplete or inaccurate or that the value of the Property might not be at least the amount reported therein; or (vii) circumstances or conditions with respect to the Property, the borrower or the borrower's credit that could reasonably be expected to cause private institutional investors to regard the loan as an unacceptable investment or cause the loan to become delinquent, or adversely affect the value of marketability of the loan.

Repurchase and Indemnity Issues

- Standard broker contracts require repurchase and/or indemnity following breach of representations and warranties.

Legal Theories Against Brokers/Lenders

- ✦ Breach of contract
- ✦ Breach of fiduciary duty
- ✦ Fraudulent inducement
- ✦ Negligent misrepresentation
- ✦ Negligence
- ✦ Constructive Trust
- ✦ Negligent hiring, retention and supervision
- ✦ Racketeering
- ✦ Unjust enrichment
- ✦ Injunctive Relief
- ✦ Coverage Consideration
- ✦ Economic versus non-economic losses



Closing Agent

✦ Closing protection letters generally state:

[Title Insurer] . . . agrees to reimburse you [the lender] for actual loss incurred by you in connection with such closings . . . when such loss arises out of:

1. Failure of . . . Issuing Agent . . . to comply with [the lender's] written closing instructions to the extent that they relate to (a) the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land . . . or (b) the obtaining of any other document specifically required by [the lender], but not to the extent that said instructions require a determination of the validity, enforceability or effectiveness of such other document, or (c) the collection and payment of funds due you, or
2. Fraud or dishonesty of said Issuing Agent . . . in handling your funds or documents in connection with such closings.

✦ Look for breaches of closing instructions, including:

- inaccurate HUDS;
- misstating (a) borrower contribution to cash due at closing; (b) seller concessions; and (c) borrower's identity;
- closing prior transactions for same borrower; within XX days without disclosing to lender;
- silent seconds

Causes of Action Against Closing Agent

- ✦ Breach of contract
- ✦ Breach of fiduciary duty
- ✦ Fraudulent inducement
- ✦ Negligent misrepresentation
- ✦ Negligence
- ✦ Constructive Trust
- ✦ Negligent hiring, retention and supervision
- ✦ Racketeering
- ✦ Unjust enrichment
- ✦ Injunctive Relief
- ✦ Coverage Consideration
- ✦ Economic versus non-economic losses

Title Insurance



- Insurable events
- Defense vs. Indemnification
- *Buss v. Superior Court (1997) 16 Cal.4th 35*
- Title Insurance Does Not Insure the Value of Collateral
- Title Insurer Often Requires Express Indemnity

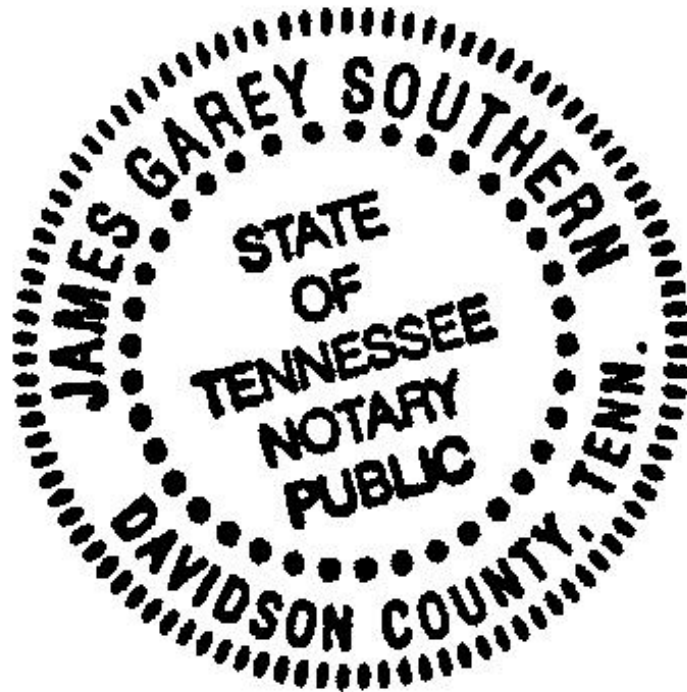
Title Insurance

- ✦ Timing of claim
- ✦ “Actual Loss”
- ✦ Cooperation versus Adversity
- ✦ Claims Against Title Insurers on CPLs
- ✦ Breach of contract
- ✦ Breach of fiduciary duty

Escrow

- Escrow Company—*Lee v. Escrow Consultants* (1989) 210 Cal.App.3d 915; *Summit Financial Holdings, Ltd v. Continental Lawyers Title Co.*, (2002) 27 Cal.4th 705.
- Breach of Contract

➤ Claims Against Notary Notary Bond



Realtors

- ✦ Realtors may induce financing by using MLS to inflate property value (*e.g.*, property sits for \$500k for 1 year without any sales, de-listed, then re-listed at \$700k and sells within a week without any improvements)
- ✦ Realtors may act as fraud ringleader, particularly in condominium scams. They may recruit straw borrowers who are paid a fee for allowing use of their credit.

Claims against Realtors

- ✦ Fraudulent inducement
- ✦ Negligent misrepresentation
- ✦ Negligence
- ✦ Constructive Trust
- ✦ Conspiracy
- ✦ Consumer protection funds
- ✦ Negligent hiring, retention and supervision
- ✦ Racketeering
- ✦ Unjust enrichment
- ✦ Injunctive Relief
- ✦ Coverage Consideration



APPRAISERS

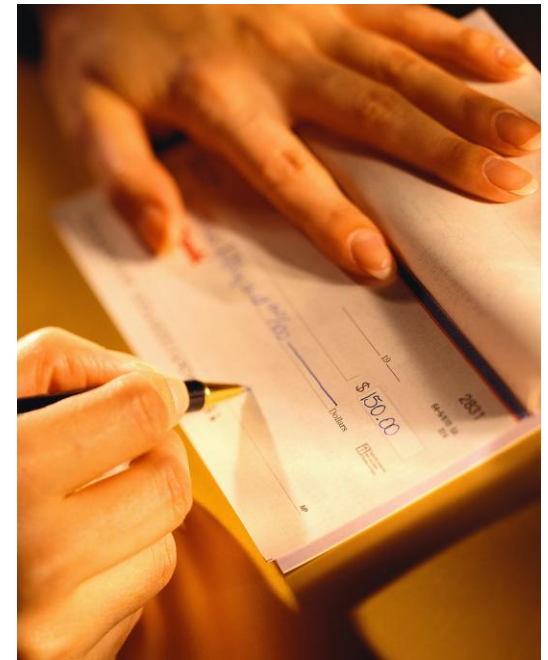
- ✦ Objective flaws
- ✦ Subjective flaws
- ✦ Intended User Defense
 - Issue
 - Purpose of Appraisal
 - Applicable version of USPAP
 - Key definition in USPAP
 - Statement on Appraisal **Standards No. 9 (SMT-9)**
 - The important of communication
 - Impartiality of the appraiser

Claims against Appraisers

- ✦ Breach of contract
- ✦ Breach of fiduciary duty
- ✦ Fraudulent inducement
- ✦ Negligent misrepresentation
- ✦ Negligence
- ✦ Constructive Trust
- ✦ Conspiracy
- ✦ Negligent hiring, retention and supervision
- ✦ Racketeering
- ✦ Unjust enrichment
- ✦ Injunctive Relief
- ✦ Coverage
- ✦ Consideration

Settlement Solutions

- ✦ Payment Plans
- ✦ Stipulated judgments
- ✦ Doing business again/renewing relationship



Mitigation

- ✦ BPO
- ✦ Actively list property on the market—MLS
- ✦ Vacancy issues/vandalism
- ✦ Prompt review appraisal where the property is still in substantially similar condition
- ✦ Document status of property and secure the property
- ✦ Issues regarding servicing the loan between foreclosure and liquidation



Litigation Cost

- ✦ Business decision
- ✦ Market perception
- ✦ Collectibility



Questions



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