



March 13, 2008

Dear MBA Member:

Mortgage fraud continues to pose a significant and growing threat not only to lenders, but to homeowners and communities throughout America. Through education and research, the Mortgage Bankers Association (MBA) strives to provide its members with the knowledge and tools necessary to catch and avoid fraud in their operations. Through advocacy, we are seeking to improve law enforcement resources to combat mortgage fraud.

One tool is the cooperative databases of the Mortgage Asset Research Institute, Inc. (MARI), a ChoicePoint Company. The most prominent of these is the Mortgage Industry Data Exchange (MIDEX), which is a database system where lenders, insurers and agencies exchange information about companies and parties that have originated loans containing fraud.

Enclosed you will find the *Tenth Periodic Case Report to the Mortgage Bankers Association*, produced by MARI. MARI provides MBA members these annual reports as well as discounted fees to participate in MARI's database.

Mortgage fraud is a burgeoning crime that is affecting more and more companies and communities. As the *Case Report* indicates, recent statistics from the Federal Bureau of Investigation (FBI) and Financial Crimes Enforcement Network (FinCEN) illustrate just how quickly the problem is growing; Suspicious Activity Reports (SARs) related to mortgage fraud, for example, have risen from over 3,515 in FY 2000 to over 46,700 in FY 2007, a 139 percent increase that represents approximately \$1 billion in losses. It is important to note that this likely does not tell the whole story, as SARs are only filed by federally-regulated institutions.

MBA continues to be at the forefront of efforts to help lenders detect, investigate and prevent mortgage fraud.

Last October, MBA released a paper that took a comprehensive look at the policy discussion surrounding fraud against lenders. The paper, *Mortgage Fraud: Strengthening Federal and State Mortgage Fraud Prevention Efforts*, separates the issue of mortgage fraud from predatory lending and provides policymakers with a roadmap to effectively combat the growing incidence of mortgage fraud. In the paper, MBA discourages adding to or modifying the already comprehensive list of federal fraud statutes and instead recommends that Congress increase resources available to law enforcement and help facilitate the coordination of federal and state law enforcement of financial crimes.

That is why MBA's 2008 Advocacy Agenda again includes a request for additional resources in the fight against fraud: \$31.25 million over a five-year period in dedicated funding for the FBI and the Department of Justice to combat mortgage fraud. MBA believes this funding could provide 30 new FBI field investigators, two new prosecutors at the Department of Justice to coordinate prosecution efforts of mortgage fraud cases and \$750,000 to support the operations of Interagency Task Forces in targeted areas with concentrations of mortgage fraud.

MBA is also involved in collaborative efforts with law enforcement. For example, MBA and the FBI signed a memorandum of agreement to work together to promote the FBI's Mortgage Fraud Warning Notice. This Notice makes clear that mortgage fraud is a serious federal offense with significant consequences for those who commit it. Use of the Notice is voluntary, but MBA has strongly encouraged lenders to integrate it into any aspect of the lending process that could be susceptible to fraudulent activity.

Lastly, during July 2007, MBA's Residential Board of Governors (RESBOG) approved a resolution of its Mortgage Fraud Task Force committing MBA to work with member companies to create a national mortgage fraud database and, subsequently, a national valuation registry. In the coming year, MBA also plans to undertake projects that will assist member firms in combating various forms of misrepresentation and develop techniques to assist in the monitoring and evaluation of third parties. As this year's MARI report illustrates, "the need for lenders to know their borrowers, vendors, and employees is greater than ever."

Though the past year has presented a number of challenges in battling mortgage fraud, I think you will agree that MBA is providing leadership in this effort not only among lenders but also between the real estate finance industry and law enforcement. I fully believe that as MBA continues these efforts, the industry will significantly enhance its ability to not only identify and catch fraudsters, but to also prevent lenders from becoming victims in the first place.

We will continue to keep you apprised of our efforts in the fight against mortgage fraud.

Most sincerely,

A handwritten signature in black ink, reading "Jonathan L. Kempner". The signature is written in a cursive, flowing style.

Jonathan L. Kempner  
President and Chief Executive Officer



TENTH PERIODIC  
**MORTGAGE  
FRAUD**  
CASE REPORT



TO THE MORTGAGE BANKERS ASSOCIATION

**TENTH PERIODIC  
MORTGAGE FRAUD  
CASE REPORT  
TO THE  
MORTGAGE BANKERS ASSOCIATION**

**By**

**Merle Sharick  
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**Mortgage Asset Research Institute, LLC  
A ChoicePoint® Service**



**March 2008**

## **TENTH PERIODIC MORTGAGE FRAUD CASE REPORT TO MORTGAGE BANKERS ASSOCIATION**

### Executive Summary

The conditions in the mortgage industry for the last half of 2007 made the year one for the record books. They had a strong influence on all parts of the economy. High-level conditions included:

- Lowest origination volume since 2002
- Highest number of delinquencies and foreclosures
- Rapid and near complete shut-down of the non-conforming secondary market
- Hundreds of announced closures of mortgage originators

The current mortgage market environment, specifically, and the national economy, in general, have clearly been the focus of attention over the past several months. The media and industry attention given to general mortgage market conditions have caused mortgage fraud to become a secondary issue in our industry – except, of course, for the investor relations and quality control personnel who continue to contest repurchase requests. However, based upon our analysis, our assertion is that mortgage fraud and the role it played in our current market environment must command greater attention, especially if we intend to boost investor confidence in non-conforming mortgage-backed securities.

This is the tenth annual report by the Mortgage Asset Research Institute (MARI), a ChoicePoint company, to the Mortgage Bankers Association (MBA) members. These annual reports examine the current composition of residential mortgage fraud and misrepresentation in the United States. (See Appendix I at the end of this report for information about MARI and the methods it uses to collect data on mortgage fraud.) This year's report will continue that trend, but will also explore the impact of mortgage fraud on the current mortgage market environment and provide some insight from other respected industry sources.

The highlights of this report include:

- Though Florida retains the top spot for the second consecutive year, there are changes in the state fraud rankings in terms of their mortgage fraud experience, with Nevada taking over the second spot and Colorado showing the greatest improvement from the prior year's rankings.
- The most common types of fraud found in 2007 originations are in the areas of employment history and claimed income. These were the same types of fraud found in the 2006 originations, though the tertiary issue of undisclosed or incorrect debts, liens or judgements increased 50 percent between 2006 and 2007.
- The dramatic cutback in non-conforming lending and the large number of lender closures suggests future sub-prime fraud reports may be infrequent enough to make trend analysis difficult.
- As stated in last year's report, the unsettled state of the mortgage market as a whole does not bode well for avoiding fraud in the coming year.

The body of this report presents the data and reasoning behind the conclusions cited above.

March 2008

### Mortgage Fraud and the 2007 Credit Crunch

Rising real estate values over the past few years threatened to price new homebuyers out of the market and led some to attempt purchases before they were creditworthy. The higher valuations also led some individual real estate investors to speculate and stretch the truth on applications for multiple properties, especially in active markets, such as Florida and Nevada. They were aided in this tactic by industry professionals who hoped that any future loan problems would be covered by a profitable sale of the collateral. Credit standards were loosened. More importantly for fraud, documentation requirements were also reduced. There has been a long history of fraud and sour consequences associated with low/reduced/no documentation loans. As an example, loan servicing staffs are discovering a substantial percentage of prime and non-conforming delinquencies are for loans where the applicants stated their intent to occupy, but were in fact, rental properties at the outset.

As John Robbins, CMB, the former Chairman of the MBA, stated in the December 2007 edition of *Mortgage Banking Magazine*<sup>i</sup>: all segments of the mortgage industry contributed to the current state of the market.

The MBA continues to give anti-fraud initiatives high priority. Examples of which are their continuing lobbying efforts for Congress to allocate dedicated FBI funding to track and prosecute mortgage fraud, promoting industry usage of the FBI's Mortgage Fraud Warning Notice and issuing their *Mortgage Fraud: Strengthening Federal and State Mortgage Fraud Prevention Efforts*<sup>ii</sup> policy paper last October.

### Technology and Mortgage Fraud

The use of automated underwriting systems has grown over the past few years. Such systems have been validated in their ability to effectively return a valid credit granting decision – assuming the input data are legitimate. These systems have become less valuable or accurate as the amount of data collected is reduced and/or the remaining pieces are fabricated.

Technology is not the enemy, but could be a key solution to regaining investor confidence in all loan products. As the industry moves closer to e-mortgages in the goal of wringing out costs and time between application and closing, there will also be a need to make better credit decisions in less time. What is critical in this next evolutionary step is to incorporate identity risk management and data validation services before lenders engage in the credit decisioning process. Creating identity risk management procedures which verify and authenticate the borrower(s), vendor(s) and employees involved with a loan's origination, coupled with experienced underwriters (with knowledge of local markets) reviewing borderline loans, is crucial. As a result, lenders will have a better idea about who they are doing business with before they engage in the credit approval process, which will save time and resources. They will also gain an improved value of derivative investments, which the investors are demanding before they will re-enter the non-conforming market.

## Subprime Lending

While subprime lending standards specifically and nontraditional product lending standards in general have been a major vehicle for misrepresentation, the need to focus on how to serve these borrowers with loan programs rooted in the traditions of the “3 Cs” (credit, capacity and collateral) remains. However, relying on loan programs that make it difficult to evaluate the strength of borrowers’ 3 Cs is almost an open invitation to fraud. As we stated in prior Case Reports, low documentation, stated income and option ARM loan programs offered to non-conforming loan program borrowers are the key culprits in the current state of the meltdown.

## Data and Information Sources Used in This Case Report

For more than a decade, major mortgage lenders, agencies and insurers have been submitting information describing incidents of alleged fraud and material misrepresentation to a central database, known as MIDEX (Mortgage Industry Data Exchange), in order to share their experiences within the mortgage industry. Subscribers use the MBA-endorsed MIDEX service to help combat mortgage fraud by performing background checks on mortgage professionals and companies as part of their business relationship credentialing process. MARI utilizes this database to obtain statistics on a wide range of mortgage fraud characteristics. Findings from MARI’s research are presented in these Case Reports on a periodic basis, as requested by the MBA, as a means of highlighting mortgage fraud trends.

In addition to MIDEX data, this report utilizes Home Mortgage Disclosure Act (HMDA) data provided by the MBA which is key to calculating a state’s MARI Fraud Index (MFI) value. Please refer to Appendix II for information on the MARI Fraud Index and its computation.

## Geographical Distribution of Mortgage Fraud

Table 1 on the next page was developed from fraud cases submitted to MARI by MIDEX subscribers. The first three columns of the table show the rankings of states with the most serious mortgage fraud problems in loans originated<sup>iii</sup> during 2007. The remaining columns of the table show the rankings and a numerical measure of the same 10 states in the years from 2006 back to 2003.

The numerical measure of each state’s fraud problem is represented by the MARI Fraud Index (MFI). An MFI of 0 would indicate no reported fraud from a state. An MFI of 100 would indicate that the reported fraud for a state is exactly what one would expect in terms of fraud rates, given the level of loan originations in that state. That is, a state that has 5 percent of the cases in MIDEX for 2007 and also has 5 percent of the country’s loan originations in the same year would have an MFI of 100. Appendix II at the end of this report explains in detail how the MFI is calculated.

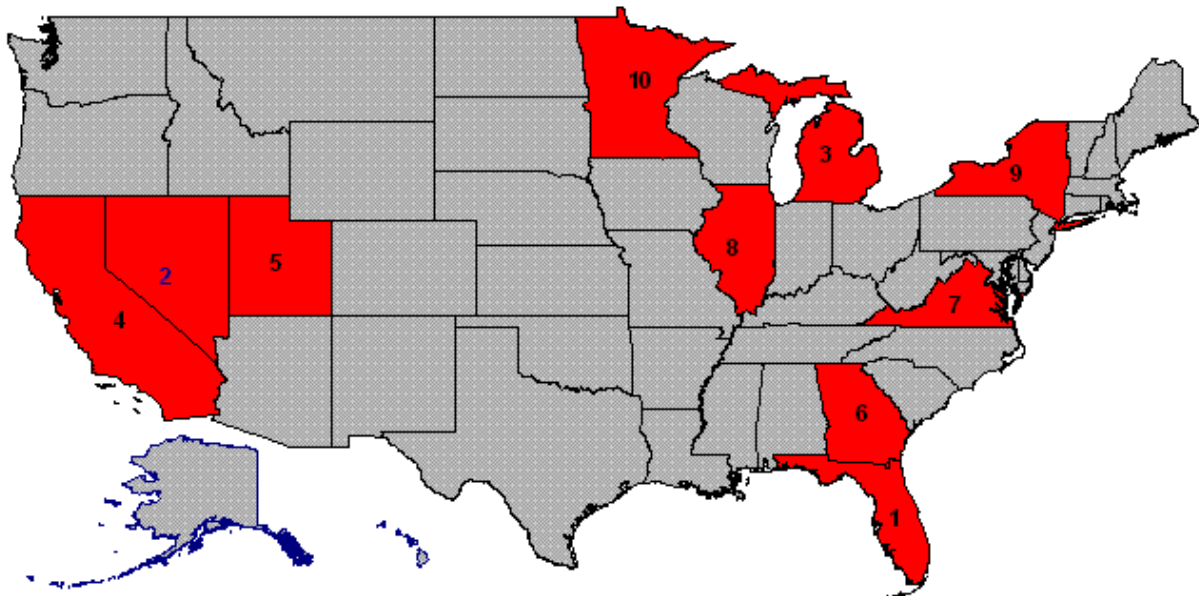
The first row of numbers in Table 1 should be read as follows. Based on fraud reports submitted to MARI through the first quarter of 2008, Florida ranked first in the nation for loans with misrepresentation originated in 2007. The reported fraud rate was more than twice

( $MFI_{FL/2007} = 215$ ) what we would expect, based solely on its origination volume, as was also the case for loans originated in 2006. For loans originated in 2005, Florida had a reported fraud rate nearly 70 percent above what it should have had ( $MFI_{FL/2005} = 169$ ) and ranked third – or roughly half the reported fraud rate of Georgia ( $MFI_{GA/2005} = 311$ ), the highest ranked state that year.

It should be noted that the 2003 through 2006 MFI values for all states listed in Table 1 differ somewhat from those shown in the same table of last year’s Case Report to the MBA. This is due to the fact that Table 1 is based on an additional year of submissions, some of which were reported on loans originated in the 2003 through 2006 period.

**Table 1**

MARI Fraud Index (MFI) <sup>iv</sup> By State (2003-2007 All Originations)										
State	2007		2006		2005		2004		2003	
	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	215	1	217	3	169	5	180	7	159
Nevada	2	204	6	120	14	85	37	27	13	112
Michigan	3	200	3	141	2	200	3	207	4	176
California	4	170	2	204	8	121	18	66	22	55
Utah	5	156	11	95	7	124	6	168	3	181
Georgia	6	125	4	123	1	311	1	417	1	499
Virginia	7	114	14	68	24	49	30	39	37	28
Illinois	8	107	8	102	4	159	7	134	10	145
New York	9	94	9	99	11	106	12	101	14	109
Minnesota	10	90	5	121	9	121	17	72	27	47



**Figure 1 (Top Ten States Overall for 2007)**

The MFI numbers in Table 1 show how states rank against one another for reported fraud taking place within the same year. But these numbers do not compare the rates of reported fraud from one year to the next.

We can draw a number of interesting conclusions from Table 1 and from the map:

- The highest MFI value for the 2007 loans to date is Florida at 215. Similarly, the ninth and tenth ranked states, New York and Minnesota, have MFI values below 100, the expected or “average” MFI value. These results suggest that the 2007 fraud reports received to date are continuing the trend from last year in being more uniformly spread among the states rather than being concentrated in just a few states with problems dramatically more serious than the rest of the country, as years 2005 and earlier demonstrate.
- As we began to notice last year, the stagnant and/or declining real estate markets in Florida, Nevada and California have resulted in easier identification of mortgage fraud. Borrowers unable to re-sell their property, end up becoming delinquent on their loans, unmasking the misrepresentation(s) and therefore higher rates of MIDEX reporting.
- Virginia makes its first appearance on our annual reports with an overall ranking of seventh.
- Colorado, which ranked ninth in last year’s report, showed the most dramatic change by ranking seventeenth on its 2007 book of business.

#### Prime Versus Subprime Fraud Levels

Losses related to loan defaults and fraud in 2006 and 2007 led to greatly diminished investor funding, and subprime originations fell sharply. Credit standards have tightened and sources of investor funding have become scarce. Regardless of which investors fill the funding void, this segment of originations will continue to have an impact on mortgage fraud trends over the next few years. It will likely take three to five years to uncover most of the fraud and misrepresentation in the 2007 book of business as MARI continues to receive MIDEX reports on 2007 loans. During this period of time, many ARM loans will be refinanced, potentially blocking discovery of some of these issues. In spite of these variables, it is still appropriate to look at the geographic distribution of fraud found in subprime loans to determine if it follows the same pattern found in loans taken as a whole.

As stated in previous reports, the true size of mortgage fraud is unclear. The impact to mortgage fraud and reporting trends due to the current credit crunch is also unclear. However, what is certain is that the people who perpetrate mortgage fraud will find new avenues to exploit.

Table 2 shows the subprime MARI Fraud Indices of the top 10 states over the past five years. Just as in Table 1, the states are ranked by their 2007 MFI values. Those states’ MFI ranks and values for 2003 through 2006 are also listed.

Table 2

MARI Fraud Index (MFI) By State (2003-2007 Subprime Originations)										
State	2007		2006		2005		2004		2003	
	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	260	1	199	4	187	3	198	2	229
Michigan	2	238	4	166	2	211	4	176	4	178
Nevada	3	194	7	127	24	42	26	55	10	109
Utah	4	177	6	153	3	191	2	245	3	179
Georgia	5	141	3	167	1	327	1	376	1	654
Ohio	6	128	13	96	11	109	10	132	13	96
New York	7	121	8	121	10	111	7	155	14	96
California	8	116	5	157	13	88	25	57	21	58
Illinois	9	116	10	106	7	166	14	87	15	94
Virginia	10	114	31	41	22	45	21	60	34	37

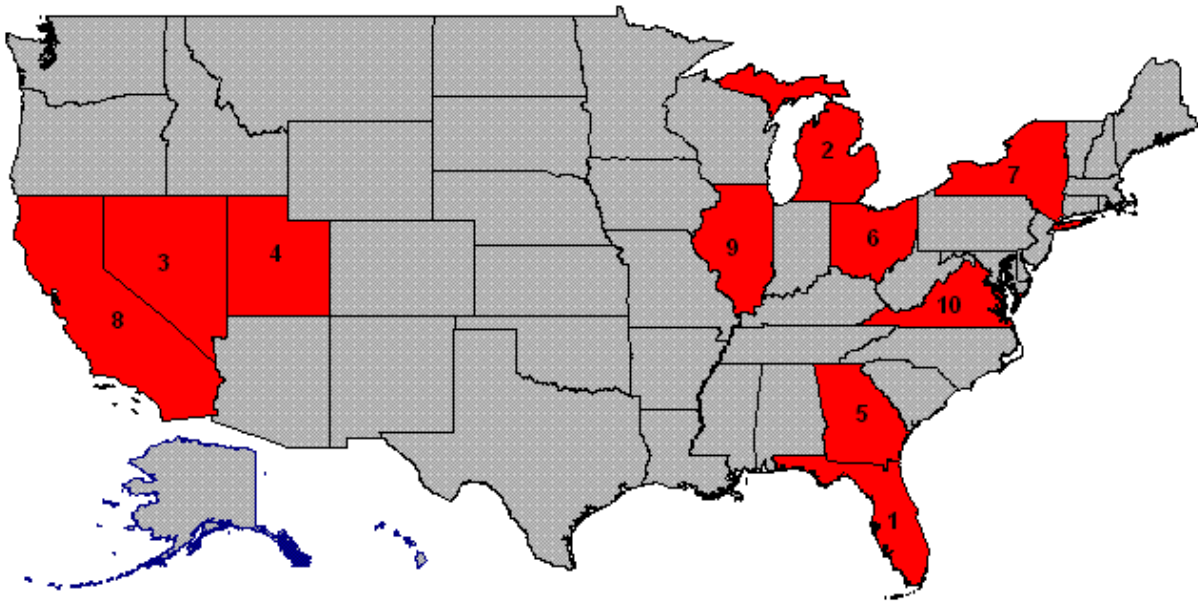


Figure 2 (Top Ten States Subprime MFIs for 2007)

The preliminary values in Table 2 warrant a couple of observations:

- The states with the highest subprime MFIs this year are similar to those for all loans.
- With the exception of Nevada, California and Virginia's appearance this year, the majority of states and rankings are similar to last year's report.

### Types of Fraud Reported

MARI's MIDEX system classifies the types of alleged fraud involved in each incident reported by its cooperating subscribers. These classifications are shown in Table 3 for loans originated in the five-year period from 2003 through 2007. The numbers on 2007 loans are preliminary since fraud perpetrated in 2007 will continue to surface for another two years or more.

Table 3 shows each type of fraud as a percentage of all fraud cases submitted to the MIDEX database. For instance, 60 percent of overall fraud incidents reported to the database for mortgages originated in 2007 contained application fraud, while the subprime equivalent is higher at 63 percent. These percentages are hardly surprising given that the application form is comprehensive in collecting personal identity, employment, asset and liability information.

**Table 3**

<b>Mortgage Fraud Types</b>					
<b>Fraud Classification</b>	<b>Mortgage Origination Year (Overall / Subprime)</b>				
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Application	60% / 63%	60% / 66%	65% / 67%	65% / 64%	63% / 62%
Tax/Financial Statements	20% / 22%	21% / 16%	20% / 19%	25% / 26%	20% / 24%
Verifications of Deposit	26% / 23%	21% / 17%	18% / 15%	16% / 14%	18% / 16%
Appraisals/Valuations	16% / 17%	16% / 16%	20% / 17%	22% / 18%	31% / 22%
Verifications of Employment	12% / 12%	10% / 17%	11% / 7%	13% / 8%	13% / 8%
Escrow/Closing Documents	14% / 10%	10% / 9%	11% / 8%	11% / 9%	15% / 11%
Credit Reports	9% / 5%	12% / 12%	8% / 6%	9% / 7%	8% / 7%

It should be noted that the total percentage for each year (the sum of each column in Table 3) exceeds 100 percent. That is because most incidents involve more than one type of fraud.

Many of the percentage figures shown in this table are similar to those MARI has reported for several years.

### SAR Filing Trends

The Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) is the agency that collects Suspicious Activity Reports (SARs) from all federally-insured financial institutions. Table 6 shows the significant increase in mortgage fraud SAR submissions to FinCEN over the past several years.

Table 6

Mortgage Fraud SARs	
Fiscal Year	SAR Submissions
2007	46,717
2006	35,617
2005	21,994
2004	17,127
2003	6,936
2002	5,609
2001	4,210
2000	3,245

Source: FBI

Prior MARI Case Reports to the MBA explained how these year-over-year increases in SAR submissions are not entirely reflective of fraud activity. It must be noted that SAR submissions are currently only required of federally-insured financial institutions and their affiliates. Therefore, the fraud experiences of independent mortgage banking companies are not reflected in Table 6.

#### Future Problems

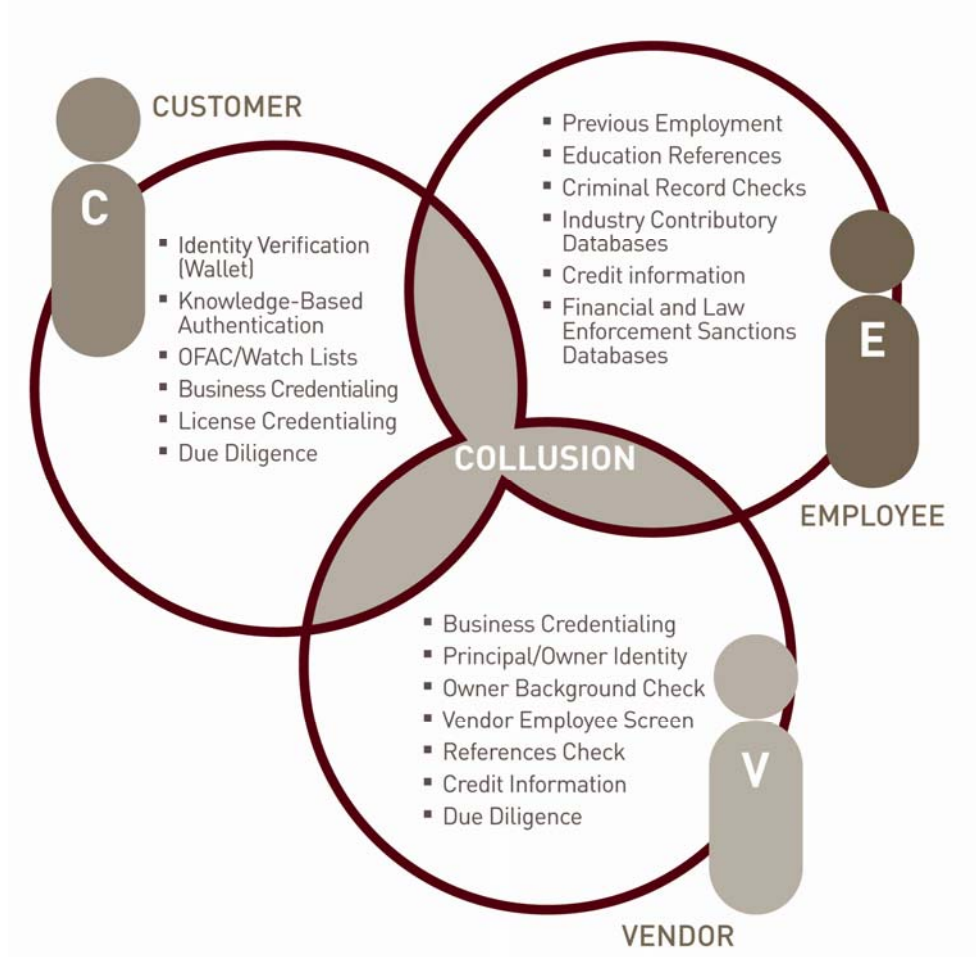
A number of issues are currently facing the mortgage market. Each will have an impact on future mortgage fraud. The subprime lending market specifically is currently dormant and non-conforming lending activity in general is modest at best. Hundreds of lenders whose business plans were dependant upon the secondary market have either closed their doors or declared bankruptcy in 2007. This has resulted in tougher acceptance criteria for borrowers who would potentially use these loan products.

The relative contributions to lender failures that have been made by fraudulent activity versus mortgage products that produced unintended results are not known and may never be clear. However, the future impacts of current industry dislocations on mortgage fraud are less difficult to predict. They are likely to include a confluence of the following conditions that could be a recipe for mortgage fraud disaster:

- Continued stagnating/declining residential real estate market values
- Raised loan quality threshold
- Large number of financially over-extended borrowers
- Oversupply of new construction

As we stated last year, the current mortgage market conditions will have more professionals chasing a smaller pool of *conforming* business. There will be even greater pressure on all industry players to generate volumes. Professional fraudsters will devise new and improved schemes to exploit the weaknesses in the current market. The need for lenders to know their borrowers, vendors and employees is greater than ever. Figure 3 depicts the recommended categories that lenders should be able to understand to minimize exposure to mortgage fraud:

Figure 3



The model above suggests business credentialing for those buyers who may be business entities.

### Identity Risk Management

Identity Risk Management, or IRM, means knowing the parties with whom you do business. As remote transactions continue to play a part in the lending process, and e-mortgages grow in acceptance and popularity, truly understanding the parties with whom you are doing business with becomes an increasingly important part of the business transaction. Table 3, Fraud Classifications, lists application fraud as a significant contributor to overall mortgage fraud. Knowing your customer (“the applicant”) is key to helping prevent fraudulent applications from being submitted into the lending process. Just as there is a short-term downward movement of the mortgage market, there will be associated movement with employees, thus, institutions should screen employees prior to hiring, and re-screen them periodically, as life events over the course of employment may lead to nefarious behavior opportunities. Due to recent fluctuations in the lending market, it is also very important to screen vendors using industry information databases such as MIDEX. Reports have shown significant employment

movement not only in the wholesale lending business, but transcending other lending areas as well.

### A Final Thought

Fraud is persistent. In constricting markets, fraud becomes a tool of desperation that dishonorable companies and individuals use to maintain lifestyles, livelihoods and bottom lines.

The mortgage/credit and housing/real estate markets are separate but intertwined. The mortgage/credit market has begun to repair itself (as a result of conforming lending and reverse mortgages being primary credit avenues), and though the housing/real estate market will have to work through supply issues, stability and property values realigned to legitimate market drivers will eventually follow.

Mortgage bankers have been tasked by the MBA with getting “Back to Basics” in originations, ethics and practices. They have a key role to play in adopting effective practices and procedures to ensure knowledge (through verification/authentication) of customers, employers and vendors.

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## **Appendix I**

### **Source and Analysis of MARI's Mortgage Fraud Data**

The statistical data presented in Tables 1 through 3 of this report were derived from information in a cooperative mortgage fraud database operated by the Mortgage Asset Research Institute, Inc. (MARI). MARI has designed and offered various mortgage industry databases for the past 17 years. Its most recognized database system is the Mortgage Industry Data Exchange (MIDEX<sup>®</sup>) that contains information about licensing, public sanctions and incidents of alleged fraud reported to MARI by MIDEX subscribers.

The MIDEX statistical data discussed in this document were derived from the incidents that MIDEX subscribers describe in reports to MARI. (Agreeing to submit reports describing their fraud investigation findings to the non-public section of MARI's MIDEX system is required for those who wish to access other subscribers' non-public reports.) Only "material misrepresentations" are included in these reports. That is, companies only submit reports to MIDEX in those cases where, knowing what they know after thorough investigations, they would not have originated, bought or insured the loans in question.

The reports submitted to MARI include the following information about each incident:

- Location of the collateral (state, city and address, to the extent known)
- Names of the originating entity and the loan officer who took the application
- Date the misrepresentation took place
- The method used to verify the existence of the reported misrepresentation(s)
- A short narrative description of the misrepresentation(s) found during the MIDEX subscriber's investigation
- Names of any other professionals who appear to be in a position to influence the accuracy of the information found to be misrepresented; e.g., the name of the appraiser and appraisal firm in cases where the property value is found to be significantly inflated
- A certification from an authorized individual at the submitting mortgage entity that the report is, to the best of his/her knowledge, complete and accurate

MARI staff reviews the reports to assure they meet submission standards for severity and consistency. Submissions are input directly by MIDEX subscribers via an online form, or data entry staffers convert hard copy submissions to a standard, searchable format for inclusion in the MIDEX system. After reading the report's narrative description, MARI will classify the incident as involving one or more of the types of misrepresentations listed in Table 3.

If MARI makes any changes to a submitted report, it is returned to the submitting subscriber for review prior to its being entered into the system.

The subscribers participating in the MIDEX system represent a wide range of mortgage entities. They include secondary market agencies, all of the major private mortgage insurance companies, and lenders that account for the vast majority of wholesale lending in the country. To access a MIDEX Client List, go to [www.MARI-Inc.com](http://www.MARI-Inc.com) and click on “About MARI.”

## **Appendix II**

### **Computation of the MARI Fraud Index (MFI)**

The MARI Fraud Index, or MFI, is an indication of the amount of mortgage fraud found through MIDEX subscriber fraud investigations in various geographical areas within any particular year. It involves very straightforward calculations.

To come up with Table 1's 2007 MFI for loans in the leading state, Florida, MARI staff determines the percentage of all U.S. MIDEX fraud reports that were submitted for Florida-originated loans in 2007. They determined that, to date, slightly more than 19 percent of MIDEX reports submitted from across the country by subscribers for 2007 originations involved loans on Florida properties. But according to HMDA data, Florida had nearly 9 percent of the nation's total 2006 mortgage originations – the most recent year such data are available.

If mortgage fraud were distributed throughout the country like originations, then we would expect 19 percent of mortgage fraud to occur in Nevada. But the 19 percent fraud figure for Florida in 2007 was more than double its origination figure. Therefore, the 2007 MARI Fraud Index for Florida, as of this report's date, is:

$$MFI_{FL/2007} = (19.08/8.80) \times 100 = 217$$

This is, of course, a dynamic figure. Often, a fraud investigation is not completed until a year or two after the loan was originated. MARI will continue to receive Florida fraud reports for another two to three years from its MIDEX subscribers that find misrepresentation in their 2003-2007 book of business. Therefore, Florida's (and all other states') MFI figures will continue to change somewhat in future MBA/MARI Periodic Reports, especially those containing recent years like 2006 and 2007.

It should be noted that the MFI is based on the number of fraud incidents reported for each state, and not the dollar amounts of those mortgages. Therefore, a fraud on a \$120,000 loan in Des Moines, Iowa, is counted the same as a fraud on a \$720,000 loan in Los Angeles, California. Also, there is currently no distinction made between purchases, refinances or home improvement loans in these figures.

## Appendix III

### Wholesale Access Wholesale Market Trends Analysis

As stated in this report, the poor performance of recent year loan originations is considered the primary cause for the current credit crunch. Wholesale single-family lending as a result, was effectively suspended for all but Jumbo and Reverse mortgages. MARI solicited Tom LaMalfa, the Managing Director of Wholesale Access, for his analysis of wholesale market trends, as presented below:

*“The recent decision that Bank of America made to exit the broker industry has prompted considerable talk about other firms doing the same. And indeed several—though much smaller—wholesalers such as Charter One and Webster Bank have followed suit.*

*“We don’t see Wells Fargo, Washington Mutual, Countrywide, Chase, Citigroup or any of the other major nationwide wholesalers quitting the broker channel. The primary reason for this is that the mean cost of broker business is 65 basis points (\$700) less than traditional retail production. The economics are thus too compelling and help lenders spread out expenses, especially indirect (largely allocated) expenses. (This is not to say that at least two of the Big 5 might not shut down all or part of their production due to current, growing financial problems.)*

*“However, we currently see and expect to see for some months to come a period marked by a steep drop in broker market share. We believe that this downturn is caused by the current credit crunch, which has greatly restricted lending. Lenders are uncomfortable with their retail guidelines amid the uncertainty. Should one even wonder why the broker channel would not also be affected? Once the supply-demand equilibrium is restored, broker share is most likely to return towards a 50% share of residential originations.*

*“Meanwhile, we are predicting a drop from 53,000 mortgage brokerages in early 2007 to 35,000 in mid 2008. If the economy is in recession next year, mark that down to 30,000. We expect a 50% decline in the number of loan officers at brokerages next year and we foresee a possible 50% drop in the number of lenders, especially independent mortgage companies. Many warehouse lines have been withdrawn and new restrictions make them more costly. Wholesale Access looks for \$1.8 trillion of residential first and second liens originated in 2008. The year will be challenging, difficult, volatile and under the weight of new legislation and regulations, federal and state. New rules remain as always the Achilles heel of the mortgage brokerage business.*

*“The GAO report<sup>v</sup>, ‘Home Mortgage Defaults and Foreclosures,’ appears to vindicate mortgage brokers and will help stabilize their share once the capital constraints surrounding banks lifts. So the impact should not be massive and longer term.”*

Though the well publicized decisions of some major lenders to suspend or even close their wholesale lending channels makes a return hard to imagine, the savings lenders realize from

third-party originated loans are compelling. However, lenders will have to adopt stronger IRM solutions in order to ensure those savings aren't offset by loan losses related to misrepresentation, or borrowers or industry professional's fraud schemes.

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<sup>i</sup> Robbins, John M., “*Sharing Responsibility*” (Executive Suite), December 2007, p. 20.

<sup>ii</sup> The MBA’s policy paper can be found at

<http://www.mortgagebankers.org/NewsandMedia/PressCenter/57274.htm>

<sup>iii</sup> The dates used in MARI’s Fraud Index are when the fraud occurred, which are typically the loan origination or closing dates. Subscribers to the MIDEX system may not discover that a loan involved fraud for several months, or even one or two years after it was originated. As a result, numbers for recent years are dynamic.

<sup>iv</sup> Readers that compare the MFI figures in Table 1 for the same states to those found in previous Reports in this series will find that the rates have changed. This is due to the fact that MIDEX subscribers in 2007 continued to uncover and report fraud findings from 2003 through 2006. Therefore all numbers in this Report are dynamic and will undergo some changes as time passes.

<sup>v</sup> The GAO report can be found at <http://www.gao.gov/new.items/d0878r.pdf>