

Focus on...

Preventing, Detecting & Reporting Mortgage Fraud

December 2005

This newsletter¹ summarizes the different types of fraud most commonly found in the mortgage industry. It includes the results of a survey of lenders Fannie Mae conducted on the topic, and an analysis of misrepresentations we found on recently-originated loans. A Fannie Mae attorney answers some common questions about mortgage fraud. What we and the federal government require in reporting fraudulent activities is addressed. We also provide you with online tools and resources to help you prevent, detect and report fraud, including two free upcoming web seminars.

- [Types of Mortgage Fraud](#)
- [Fannie Mae Survey and Misrepresentation Findings](#)
- [Q&A: Ask the Expert](#)
- [What the Government and Fannie Mae Require](#)
- [Online Tools and Resources](#)
- [Free Upcoming Web Seminars](#)

Types of Mortgage Fraud

There are two primary types of fraud found in the mortgage industry. They are—

- **Fraud for property**, which is perpetrated by borrowers when they misrepresent information on loan applications, including income, employment, assets, and/or occupancy to purchase homes for which they normally would not qualify.
- **Fraud for profit**, which consists of systematic transactions by individuals who steal significant amounts of funds associated with mortgage lending. This type of fraud generally involves multiple parties in various roles within the mortgage industry, such as mortgage originators, appraisers, real estate agents, closing agents, builders, and title companies. Some examples of fraud for profit include property flips, fictitious lien releases, and diversion of funds at closing. It can also include commission fraud, when one or more industry professionals misrepresent information in loan transactions in order to receive commissions on loans that would not normally be acceptable to lenders.

¹ Note: This publication is posted on efanniemae.com for informational and archival purposes and, as a result, some of the hyperlinks and referenced resources may no longer be available.

Our Survey & Misrepresentation Findings

In a recent survey, 79 percent of lenders surveyed reported that mortgage fraud is a very serious issue. Collusion among industry insiders, they said, represents the biggest risk, and fraud schemes and perpetrators are growing more sophisticated. Lenders indicated that they expect to see an increase in fraud cases, especially in the areas of identity theft, falsified or misrepresented loan application data and support documentation, artificial home price appreciation, and property flipping. Those surveyed said that they want better tools—with fraud detection capabilities built into their existing business workflows—to mitigate their risks against all types of fraud perpetration so that they can detect fraud upfront before loans close.

In an analysis of significant misrepresentations on loans originated in the last two years, Fannie Mae found that—

- The borrower's income/employment information was inflated or fabricated (25%)
- The borrower's credit history, liabilities and/or identity were misrepresented (21%)
- The property value was inflated and there was misrepresentation in other areas of the loan transaction (18%)
- A specific fact about the property and/or the comparable sales was misrepresented (15%)
- The borrower's intent to occupy the subject property was materially misrepresented (15%)
- The rest of the misrepresentations involved assets (5%) and predatory lending (1%), where the loans were in violation of one or more of our predatory lending rules and there was misrepresentation in other areas of the loan transaction

The loans were identified through random and discretionary post-purchase reviews (58%), post foreclosure reviews (27%), and early payment defaults, recourse violations and loss mitigation (15%).

Ask the Expert^[1]:

Q: *What is wrong with property flipping? Aren't these legitimate real estate transactions?*

A: Property flipping generally refers to purchasing existing properties with the intention of immediately reselling the properties for a profit. It is not illegal per se. When, however, an immediate resale is accompanied by acts of fraud or

^[1] Miriam Smolen, a former assistant U.S. attorney, is an Associate General Counsel in the Legal & Regulatory Policy Division of Fannie Mae's Legal Department. You can ask her questions directly during the January 17th and 18th web seminars on this topic.

misrepresentation, including but not limited to appraisals with inflated property values and other misleading or fraudulent documentation, it can result in fraud.

Q: How do Mortgage Fraud Incident Notices (MFINs) differ from Suspicious Activity Reports (SARs)?

A: MFINs, which are required to be filed by Fannie Mae under OFHEO's new mortgage fraud reporting rule, are filed directly with OFHEO. Unlike SARs, there is no dollar value threshold for filing a MFIN. Reporting is required when possible mortgage fraud is identified as belonging to a certain type of fraud, such as involvement by company insiders, fraud committed by institutional insiders, pattern fraud, or fraud being investigated by the government. Similar to a SAR, the institution filing an MFIN is not allowed to disclose the fact of that filing to any party. Unlike a SAR, there is no statutory safe harbor protection for a MFIN filer.

Q: Will you provide relief from repossessions and warrants if we use anti-fraud tools?

A: No.

Q: Does our use of anti-fraud tools send perpetrators to our competitors down the street?

A: Given that fraud perpetrators will look for the easiest means to achieve their goals, lenders who do not incorporate fraud management into their mortgage lending process may be targeted by individuals trying to commit fraud, and ultimately have higher exposure to losses. The use of anti-fraud tools to verify borrowers' identity, income, employment and other loan data can reduce both the incidence of fraud and lender costs and repurchase risk.

Q: How do we refer possible mortgage fraud to law enforcement?

A: The Federal Bureau of Investigation and other federal law enforcement agencies take the prosecution of mortgage fraud seriously. Become familiar with whether your region has a federal law enforcement squad dedicated to mortgage fraud investigations. If not, determine which regional federal law enforcement office covers your geographic area. In addition, many states and counties have criminal investigative units that specialize in mortgage fraud housed in the states' Attorneys General Office or similar unit.

Lenders can make direct referrals to federal and state law enforcement by calling the offices directly and providing sufficient information for an investigation to be opened. In addition, cases of fraud that involve professionals, such as appraisers are appropriately referred to state licensing boards.

Many jurisdictions have law enforcement task forces with industry participants that focus on mortgage fraud. If such a task force exists in your community,

consider participating and sharing your knowledge on preventing and detecting mortgage fraud.

Q: *Once we have referred a possible mortgage fraud to law enforcement, what happens?*

A: Every law enforcement agency investigates cases according to its own priorities and availability of resources. Collection of evidence, especially where the evidence is very document intensive, can be time-consuming. Institutions which refer cases may be asked to produce documents or provide other evidence, including expert testimony in the areas of mortgage origination or purchase. In addition, cases that are referred by one source, may be developed to other include other victims or other perpetrators involved in the scheme. Each case and jurisdiction is unique.

What the Government & Fannie Mae Require

As it reported in its final rule², the Office of Federal Housing Enterprise Oversight (OFHEO) needs timely information on actual or possible mortgage fraud to assure that adequate internal controls and systems exist to protect Fannie Mae and Freddie Mac from risks associated with such fraud. Fannie Mae must file a Mortgage Fraud Incident Notice to OFHEO when it identifies possible mortgage fraud connected to mortgages requested to be funded or purchased by us. The types of possible mortgage fraud that must be reported include institutional fraud, pattern fraud (such as similar appraisal fraud in multiple mortgages), fraud incidents being investigated by the government, or incidents that may receive significant public exposure or publicity.

Financial institutions, as defined in the Bank Secrecy Act, are required to file a Suspicious Activity Report (SAR) form for any known or suspected violations of federal criminal laws or regulations committed or attempted against or through the institution if it involves or aggregates at least \$5,000 in funds or other assets. Reports must be filed if institutions know, suspect, or have reason to suspect the funds are obtained from illegal activity; intended or conducted to hide or disguise funds or assets derived from illegal activity; or designed to evade any reporting requirements of the Bank Secrecy Act.

Fannie Mae requires a lender to notify us immediately if it learns about any misrepresentation or possible breach of a selling warranty, including fraud (breach of warranty number 17). It must do so regardless of who committed the act or whether the lender believes that the act resulted in an actual breach of its selling warranties.

Our principal concern is that lenders have adequate staff and facilities to protect against fraud by any parties involved in the mortgage origination and servicing

² Federal Register, Vol. 70, No. 144 (7/28/2005)

process. We expect a lender to advise its lead Fannie Mae regional office immediately if it learns of any misrepresentation or breach of a selling warranty. This notification is required regardless of whether the act is committed by the lender, the lender's agent(s), the borrower(s), or any other third party, and whether or not the lender believes that the fraud or misrepresentation constitutes a breach of its representations and warranties.

Steps You Can Take To Combat Fraud

Fannie Mae wants to work closely with you to combat the growing problem of fraud in the mortgage industry. We assume that the information and processes on which your loan decisions are based are honest, accurate and credible and that you strive for information and process integrity at every stage in the life of a mortgage—from application through servicing.

To prevent and detect fraud, it is critical that you know your business partners, aggressively sample your loan population, carefully review transaction, and consider using outside resources. Specifically, you should—

- Have proper hiring practices in place at your institution, including careful reference checks
- Aggressively sample loans that have a high risk for fraud as part of your quality assurance plan. This includes loans that are early payment defaults or involve problem business sources, loans in high-risk areas, or those that have characteristics in common with previously detected fraudulent transactions
- Evaluate your appraisers and get references. Confirm that the appraiser is currently classified and has no disciplinary action
- Be selective in choosing closing attorneys and settlement agents and communicate your concerns about suspicious files to these individuals
- Modify your closing instructions to prevent flips without your consent.
- Report suspected fraud to proper authorities, including filing Suspicious Activity Reports (SARS)

Online Tools and Resources

If you have information concerning possible mortgage fraud, please contact Fannie Mae at 1-800-732-6643 or via email at MortgageFraud_Tips@fanniemae.com.

To file a suspicious activity report (SARS), contact the [Administrator of National Banks](#) to download software for use in preparing and filing these reports.

Fannie Mae has developed a robust suite of [anti-fraud tools](#) which are available through the Desktop Underwriter® (DU) user interface. Registered users can use the links in DU to access verification tools offered by a variety of third-party anti-fraud service providers. Lenders can access and use the tools at any stage

during the loan origination process as long as a loan is accessible through the DU pipeline.

Upcoming Free Web Seminars

To ask questions directly and learn more about mortgage fraud, [register](#) for a free web seminar, *Understanding and Managing Fraud Risk*, on either January 17th or 18th at 2 pm eastern time.

Note: If you are unable to register for one of these seminars because it is full, please put your name on the waiting list. We will notify you as soon as space becomes available or when we reschedule this topic. If you do register and find you will be unable to participate, please go online and cancel your registration so another lender can take your place.

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