MORTGAGE FRAUD: A Real Crime with Pen
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I. INTRODUCTION

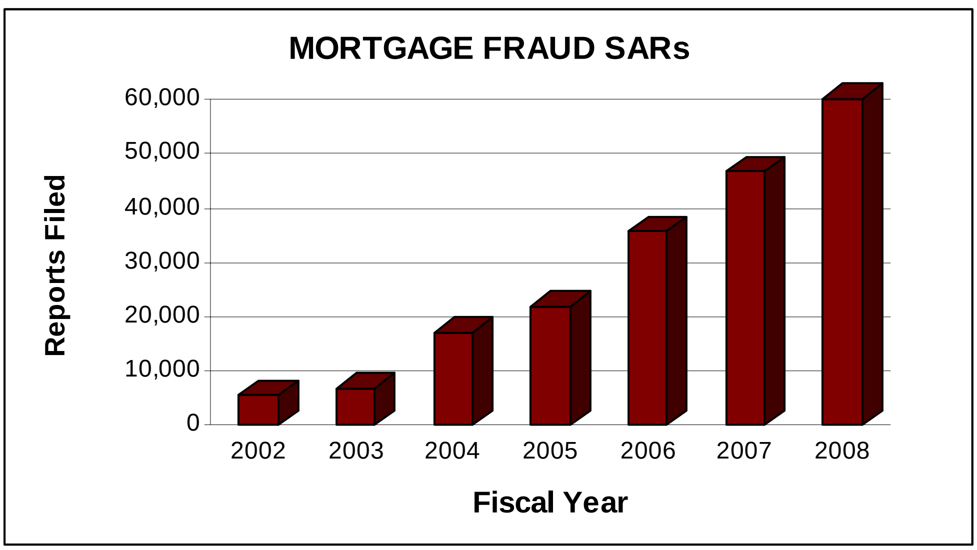
A. Mortgage Fraud is on the Rise

1. The Scope of the Problem

According to the FBI, the estimated annual losses from mortgage fraud are between $4 billion and $6 billion, and mortgage fraud is one of the fastest growing white collar crimes in the United States.[1] Treasury Department's Financial Crimes Enforcement Network ("FinCEN") reports of suspected mortgage fraud have doubled since 2005 and increased eightfold since 2002.[2]

Mortgage fraud has a negative effect on the economy, the soundness of financial institutions as well as individuals and local communities. The recent collapse of Bear Sterns and near collapse of Countrywide Mortgage Company under the weight of sub-prime lending practices are illustrative of a lack of due diligence in the mortgage process to detect potential fraud.

The list below is reflective of the Number of Violations of Mortgage Related Fraud Suspicious Activity Reports (SARs) received.[3] It should be noted however, that only regulated financial institutions are required to report suspicious activity such as mortgage fraud. The vast majority of the mortgage industry, such as mortgage companies, mortgage brokers and mortgage title companies are not regulated and therefore do not report suspected fraud to the FBI. Therefore, the below numbers are likely understated.[4]



Industry studies indicate that a significant portion of the loss associated with residential real estate loans can be attributed to fraud. Industry experts estimate that up to 10% of all residential loan applications, representing several hundred billion dollars of the annual U.S. residential real estate market, have some form of material misrepresentation, both inadvertent and malicious. An in-depth review by The Prieston Group of Santa Rosa, California of early payment defaults, an indicator of problem loans, revealed that 45-50% of these loans have some form of misrepresentation. This study also showed that approximately 25% of all foreclosed loans have at least some element of misrepresentation, and losses on fraudulent loans equate to approximately 37% of the loan balance.[5]

A recent FinCEN report states that 43% of cases sampled in a FinCEN study involved misrepresentation of income, assets or debts. However, available tools, such as verifying a person's income with the IRS, was only used in about 5% of loans funded in 2006 according to industry experts.[6]

2. Why is Mortgage Fraud Increasing so Rapidly?

There are a number of reasons for the increase in this type of fraud. The overall best reason is greed. Mortgage fraud has been a low-risk, high return endeavor. The mortgage industry is self regulating. Pressure to close mortgage applications translates in many instances to inadequate quality controls by the lender or the title company in the review process. There are no fees to the participants in the mortgage process, such as mortgage brokers, until the loan closes and funding takes place. Automated loan processing, which in some cases resulted in lenders never meeting borrowers has also contributed to an increased opportunity to commit fraud.[7]

An example of relaxed quality control is "stated-income" loans, which require no proof of income. "The stated-income loan deserves the nickname used by many in the industry, the 'liar's loan,'" says the Mortgage Asset Research Institute ("MARI"), which works with lenders to prevent fraud. A recent review of a sampling of about 100 stated-income loans revealed that almost 60% of the stated amounts were exaggerated by more than 50%, MARI says.[8] It would have been easy for institutions to verify these representations. At least 90% of borrowers have to submit a form 4506T which allows lenders to verify income with the Internal Revenue Service. Lenders rarely did so – perhaps because of the cost or perhaps because they turned a blind eye in hopes that the borrowers could continue paying. Of course, this was more likely when property values were continuing to rise.[9]

Investigative resources are also inadequate. Federal investigative resources have decreased since 9/11 making the investigation of this type of white collar crime more unlikely, unless the loss numbers are large enough to warrant an investigation. State resources to investigate this type of crime are almost non-existent, except in the largest jurisdictions.

3. Where is Mortgage Fraud Taking Place?

Mortgage fraud is taking place all across America with about 6% of all loan applications showing some type of deception. Fannie Mae, a federal lender, reports that the Texas region, which includes Oklahoma, Arkansas and Louisiana, has shown a 9% increase in fraudulent loan applications in 2006-2007. The largest increase in fraudulent loans applications was in the Florida region with a rate of over 30%. Houston is in the top 10 cities in the country where 25% of loan applications have various forms of misrepresentations.[10]

According to 2006 statistics, 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.[11]

4. Who is Involved?

a. Perpetrators - Anyone who knowingly participates in a fraud. Professionals are often necessary to carry out most mortgage fraud schemes involving the transfer of real property. These professionals include mortgage brokers, appraisers, and closing attorneys.

b. Victims - Normally the lender, the title company, the underwriter and ultimately the federal government are the typical victims in this type of fraud.

II. TYPES OF FRAUD

A. Definition and Types

Mortgage fraud is defined as a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan.[12] There are two types of mortgage fraud: fraud for property and fraud for profit.[13]

B. Fraud for Property

Fraud for property, also known as fraud for housing, usually involves the borrower as the perpetrator on a single loan. The borrower makes a few misrepresentations, usually regarding income, personal debt, and property value or there are down payment problems. The borrower wants the property and intends to repay the loan. Sometimes industry professionals are involved in coaching the borrower so that they qualify. Fraud for property/housing accounts for 20 percent of all fraud.[14]

C. Fraud for Profit

Fraud for profit involves industry professionals. There are generally multiple loan transactions with several financial institutions involved. These frauds include numerous gross misrepresentations including: income is overstated, assets are overstated, collateral is overstated, the length of employment is overstated or fictitious employment is reported, and employment is backstopped by co-conspirators. The borrower's debts are not fully disclosed, nor is the borrower's credit history, which is often altered. Often, the borrower assumes the identity of another person (straw buyer). The borrower states he intends to use the property for occupancy when he/she intends to use the property for rental income, or is purchasing the property for another party (nominee). Appraisals almost always list the property as owner-occupied. Down payments do not exist or are borrowed and disguised with a fraudulent gift letter. The property value is inflated (faulty appraisal) to increase the sales value to make up for no down payment and to generate cash proceeds in fraud for profit.[15]

D. Common Frauds

The following are some examples of different types of mortgage fraud. According to FinCEN, the most common suspicious activity reports, and likely mortgage fraud schemes, involve false statements and identity theft is a fast growing secondary scheme.

According to a November 2006 FinCEN report, the prevalence of the following types of fraud are as follows. Material misrepresentations and false statements were reported on 66% of the SARs reviewed in a FinCEN study. Identity fraud was reported on 23% of the narratives and identity theft was reported on 4% of the narratives. Misrepresentation of loan purpose or misuse of loan proceeds was found in 12% of the narratives and the most commonly reported of such misrepresentations was occupancy fraud which was found in 80% of the 12% of the narratives. Fraudulent property flipping, based on inflated appraisals, were described in 10% of the narratives and notably 42% of these reports stated they suspected the fraudulent activity was perpetrated with the collusion of mortgage brokers, appraisals, brokers and/or real estate agents/brokers. Approximately 3% of the SARs involved the use of straw buyers. Approximately 2% of the SARs listed the use of forged documents.[16]

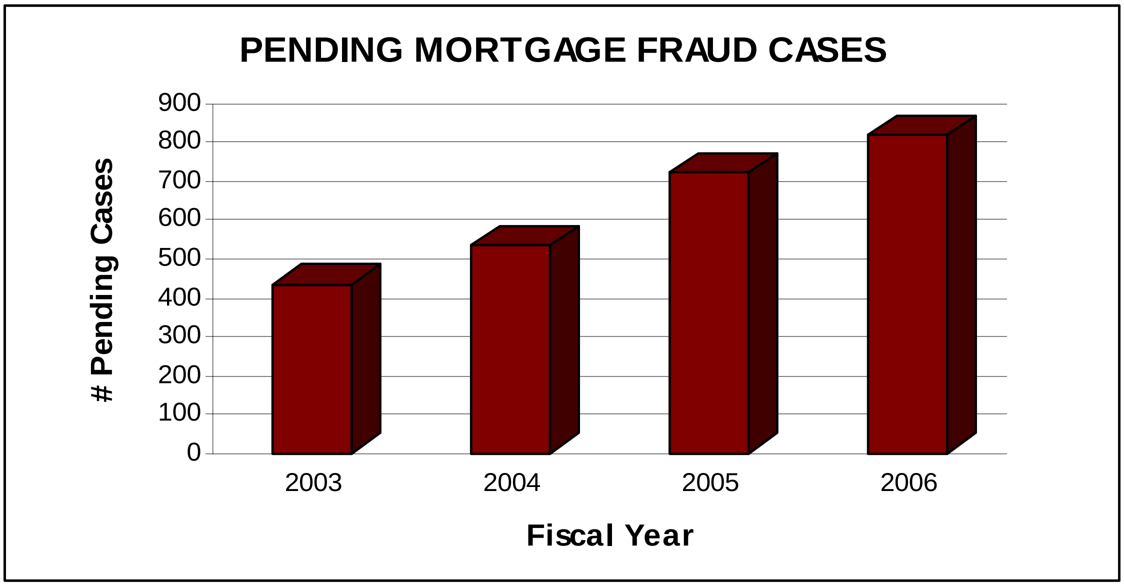
Other less commonly perpetrated frauds are air loans (non-existent property loans where there is usually no collateral),[17] double selling, (scheme wherein a mortgage loan broker accepts a legitimate application, obtains legitimate documents from a buyer, and induces two financial institutions to each fully fund the loan),[18] mortgage warehousing, (a mortgage banker warehouses the same mortgage on more than one institution),[19] obtaining multiple home equity lines of credit on the same property,[20] false statements regarding down payments,[21] phantom sales, (identifying an apparently abandoned property and record a fictitious quitclaim deed to transfer the property and pocketing the loan proceeds),[22] and foreclosure fraud.[23]

III. PROSECUTIONS

Overview

The following are some of the latest statistics on investigations and prosecutions. FBI officials opened 1,210 mortgage related probes in 2007.[24] There are 1,338 FBI Mortgage Fraud Task Forces/Working Groups as of March 2008.[25] In 2007, 462 cases were opened and there were 321 indictments and informations returned and 260 convictions.[26]

The chart below reflects the number of pending cases from FY 2003 through FY 2006.[27]



The following are some examples of recent prosecutions. As discussed in further detail below, Courts are imposing significant sentences on perpetrators of Mortgage Fraud.

CHALANA MCFARLAND (Atlanta): This case involves a mortgage fraud property flip scheme which operated from the summer of 1999 through March 2004. Chalana McFarland was an attorney who operated her own law firm. She acted as a title agent for title insurance companies as well as the closing attorney for various lenders.[28]

McFarland used the stolen identity of numerous victims to submit fraudulent loan applications. Appraisals were inflated and straw buyers were used to complete the fraudulent sales of over 100 properties. McFarland paid her identity thief $10,000 per stolen identity, as well as paying the appraiser who inflated property values over $400,000. Fraudulently obtained mortgages valued in excess of $20 million with losses in excess of $12 million.[29]

McFarland and 16 other subjects were indicted. Fifteen have been sentenced, with McFarland receiving 30 years in prison—the largest sentence ever for Mortgage Fraud.[30]

1. **BURGESS, SIEBERT AND MANNERS (Dallas)**: Dallas businessman Charles Cooper Burgess, 52, was sentenced in March 2008 by U.S. District Judge Barbara M.G. Lynn to 262 months (nearly 22 years) in prison and ordered to pay more than $3 million in restitution. Burgess pled guilty in January 2006 to his involvement in two fraudulent schemes, one involving mortgage fraud and one involving defrauding individuals who invested in golf course property in Arkansas. In November and December 2006, Burgess testified against two co-defendants.[31]

   Relating to the mortgage fraud scheme, Burgess admitted that he recruited 20 straw buyers with good credit but limited funds to sign loan and closing documents to purchase homes. As part of a signed "investor management agreement," Burgess promised to provide the down payment at closing as well as make all mortgage payments, which he did not. The defendants paid these straw buyers between $5,000 and $10,000 "for the use of their credit" after the closing. Co-defendant Siebert agreed to release escrow funds to Burgess for the borrowers' down payment for a kickback payment of $5,000. Burgess also pled guilty to a fraudulent scheme involving the sale of golf course property in Arkansas, whereby he induced investors by making false representations and used the funds to live on.[32]

ROBERT A. AMICO ET AL (Buffalo): Robert A. Amico and his sons Robert J. Amico and Richard N. Amico engaged in a large conspiracy with loan brokers, appraisers, and buyers to submit over 100 fraudulent mortgage applications that overstated the value of all houses so that no down payment was made and so that the buyers could qualify for loans that they could not otherwise afford. All of the conspirators plead guilty, with the exception of the Amicos. Some of these conspirators were sentenced to probation and testified at the Amicos trial. Others were sentenced to jail terms of up to five years. After a six month jury trial the Amico sons were convicted and the father died of cancer. Fraudulently obtained mortgage applications were valued at $58 million with losses totaling $14.7 million. Robert J. Amico was sentenced to 17 years in prison and Richard N. Amico was sentenced to 9 years in prison. This case was joint investigation with IRS/CID.[33]

IV. CONCLUSION

The current credit crisis facing the financial industry is directly related to fraudulent mortgage practices and a lack of real due diligence by the mortgage industry. Mortgage fraud is much easier to successfully commit than robbing a bank and is much more profitable. Current investigative and prosecution resources are at best inadequate to combat this crime.

Congress and the Federal Reserve are discussing tightening the rules for the largely unregulated mortgage industry, but financial lenders are concerned that more regulation will drive the cost of lending higher. It is clear that some regulation is necessary, otherwise we will continue to see large scale fraud in this industry.

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[1] FBI.gov/pressrel/ressre105/quickflip121405.htm.
[2] Financial Crimes Enforcement Network, SAR Activity Review, June 2007 (Section 1, Exhibit 5).
[3] www.fbi.gov/publications/financial/fcs_report2006/financial_crime_2006.htm; The SAR form can be found at www.fincen.gov.
[4] *Id.*
[5] FFIEC Fraud Investigations Symposium, *The Detection, Investigation and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper,* February 2005.
[6] *A Road not Taken by Lenders,* Gretchen Morgenson, New York Times, April 6, 2008.
[7] www.*fincen*.gov/mortgageloanfraud.pdf_2006-11-02.
[8] Michael Corkery, *Fraud Seen as a Driver in Wave of Foreclosures*, The Wall Street Journal, December 21, 2007
[9] Gretchen Morgenson, *A Road not Taken by Lenders, New York Times,* April 6, 2008.
[10] Fannie Mae Loan Reviews 2007.
[11] www.fbi.gov/publications/financial/fcs_report2006/financial_crime_2006.htm.
[12] http://www.fbi.gov/pressrel/pressrel05/quickflip121405.htm.
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] www.fincen.gov/mortgageloanfraud.pdf-2006-11-02.
[17] http://www.fbi.gov/pressrel/pressrel05/quickflip121405.htm.
[18] FFIEC Fraud Investigations Symposium, *The Detection, Investigation and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper,* February 2005.
[19] *Id.*
[20] www.fbi.gov/puclications/financial/fcs_report2006/financial_crime_2006.htm.
[21] FFIEC Fraud Investigations Symposium, *The Detection, Investigation and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper,* February 2005.
[22] *Id.*
[23] www.fbi.gov/puclications/financial/fcs_report2006/financial_crime_2006.htm.
[24] Carrie Johnson and Tomoeh Murakami Tse, *FBI to Focus on Area Mortgage Loan Fraud*, Washington Post, December 6, 2007.
[25] *Id.*
[26] http://www.fbi.gov/hq/mortgage_fraud.htm.
[27] www.fbi.gov/publications/financial/fcs_report2006/financial_crime_2006.htm.
[28] http://www.fbi.gov/page2/dec05/operationquickflip121405.htm.
[29] *Id.*
[30] *Id.*
[31] http://dallas.fbi.gov/dojpressrel/pressrel08/burgess030808.htm.
[32] *Id.*
[33] http://www.fbi.gov/pressrel/pressrel05/quickflip121405.htm.