Morty. Fraud - # 6

Proposed Rules
Federal Register
Vol. 70, No. 37
Department of Housing and Urban Development (HUD)
Office of Federal Housing Enterprise Oversight (OFHEO)
12 DFR, Part 1731
RIN 2550-AA31
Mortgage Fraud Reporting

RECEIVED
MAR 28 2005
OFFICE OF GENERAL COUNSEL

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Introduction

We appreciate the opportunity to provide comments on OFHEO's proposed regulation to establish safety and soundness requirements with respect to mortgage fraud reporting by Fannie Mae and Freddie Mac (the "Enterprises"). Fraud is a significant and growing problem in the mortgage industry. We laud OFHEO for its efforts to collect this information and, hopefully, to confront the problem by sharing such information with the mortgage industry.

MARI believes that one of the best methods of deterring fraud is to hold industry professionals accountable for their actions. Accountability can be achieved through various means, including law enforcement, government regulation and self-regulation. MARI believes that more could and should be done in the mortgage industry to more adequately hold such perpetrators accountable.

Mortgage Industry Fraud

The mortgage industry defines "fraud" as an action, or set of actions, by which a consumer or industry professional intentionally misrepresents information in a mortgage transaction causing a financial entity to fund, purchase or insure a mortgage loan when the entity would not otherwise have done so, had it possessed true information.

There are three basic types of fraud in the residential mortgage industry:

1. **Consumer fraud**, or "fraud for property", is perpetrated by borrowers misrepresenting information on loan applications in order to purchase more expensive homes than those for which they would normally qualify. Consumer fraud is relatively minor and does not usually result in significant losses to financial institutions. Some examples of consumer fraud include false gift letters and tax returns, and inflated income representations.

2. **Commission fraud** occurs when one or more industry professionals misrepresent information in a loan transaction in order to receive a commission on a loan that would not have been issued had the lender possessed true information. Commission fraud is becoming a more common practice in the industry and is a rising concern to financial institutions. It can result in significant losses to lenders and insurers. Consumers are also harmed by taking on more debt than they can afford. Commission fraud can include false employment and occupancy verifications, inaccurate financial statements and tax returns, and inflated income representations.

3. **Fraud for profit** consists of systematic transactions by industry professionals attempting to steal substantial funds in one or more mortgage transactions. This type of fraud often involves multiple

parties in various segments of the mortgage industry, such as mortgage originators, appraisers, real estate agents, closing agents, builders and/or title companies. Fraud for profit often results in significant, and sometimes catastrophic, losses to financial entities involved in mortgage loan transactions. It is a major concern to the mortgage industry. Some examples of this type of fraud include land flips, fictitious lien releases, identity theft and diversions of funds at closing.

Cost and Frequency of Mortgage Fraud

MARI is often asked how much fraud occurs in the mortgage industry and what cost does this fraud have on the economy each year? The answer to such inquiries is easy: The amount of fraud and its cost are unknown at this time. The primary reason for such is the lack of a central organization that collects fraud loss information in a consistent and coherent manner.

The closest we come to having an adequate collection system is the Financial Crimes Enforcement Network ("FinCEN"), which collects information from Suspicious Activities Reports ("SARs"). While FinCEN gathers important information, it has serious weaknesses in the data it might use to quantify mortgage fraud losses. These weaknesses include the following:

1. The primary purpose of past FinCEN data collection activity has been to track money laundering.

2. SARs only cover activities at federally insured financial institutions. SAR submissions are not required by state-chartered mortgage lenders that are not affiliated with insured financial institutions.

3. There is no standard industry definition of "loss" for mortgage fraud cases. In many cases, losses due to fraud are inappropriately categorized as credit losses and included as part of the loan-loss reserve. Fraud loss calculations by lenders, insurers and investors can range from (a) the entire loan balance, (b) the difference between the loan balance and what they will receive from the sale of the collateral and (c) the net proceeds plus selling and carrying costs (appraisals, repairs, real estate commissions, etc.)

We understand the FinCEN is considering the following modifications to the SARs process:

1. Expanding those required to submit SARs to include non-federally insured entities in the mortgage industry.

2. Expanding the safe harbor provision to include these new entities.

3. Changing the SAR form to make it more suitable for reporting the mortgage industry fraud.

The development of a broader, more central collection system by OFHEO and FinCEN would greatly facilitate the tracking of fraud levels and its cost to the industry and, ultimately, the consumer.

Mortgage Fraud Trends

MARI maintains a private, subscription database called the Mortgage Industry Data Exchange (MIDEX®). It was established on the premise that unethical and illegal activities in the residential mortgage industry could be significantly reduced though the responsible exchange of information among mortgage lenders, investors and insurers. MIDEX is a cooperative database that contains three basic categories of information on companies and industry professionals:

1. Non-public incidents of alleged fraud, material misrepresentation and serious misconduct perpetrated by mortgage industry professionals and companies. These incidents are contributed

by members of the cooperative database, which include approximately 500 lenders, private mortgage insurance companies and mortgage investors.

2. Public sanctions and legal actions. MARI collects these sanctions and enforcement actions from over 200 federal and state regulators in the mortgage, securities, commercial bank, real estate and appraisal industries. It then converts this information into a standard format, and makes reports available to MIDEX subscribers that are doing background checks on mortgage industry professionals.

3. State and federal licensing data for the mortgage and commercial banking industries. The licensing data come from over 60 federal and state regulators.

By analyzing subscriber contributions to MARI's MIDEX database, we are able to track trends of alleged fraud and misrepresentation that occur in the residential mortgage industry in the United States. Contributors to the MIDEX database include a cross-section of mortgage lenders, insurers and investors.

MARI has constructed a state-by-state MARI Fraud Index (MFI). This index quantifies the amount of fraud found in each state and reported to MARI by MIDEX subscribers. The figures are adjusted for differences in states' population size.

In the past, MFI scores from California and Florida have led the nation by a substantial margin. Florida and California continue to have high fraud scores, but Florida now ranks second and California has slipped to ninth place. Table 1 shows that for loans originated[1] during the past four years, Georgia is the nation's leading hot spot.

Table 1

MARI Fraud Index (MFI) By State 2001 through 2004		
Rank	**State**	**MFI**
1	Georgia	274
2	Florida	234
3	Nevada	220
4	Utah	217
5	South Carolina	176
6	Colorado	161
7	Illinois	139
8	Michigan	137
9	California	133
10	Missouri	124
NA	Washington, DC	325

Source: Case submissions to the MIDEX system

An MFI value of 0 indicates no reported fraud for a state. An MFI of 100 indicates that the reported fraud for a state is exactly what is expected in terms of fraud rates, given its population size. A state with an MFI of 100 is "average." An MFI value of 200 indicates that the reported fraud for a state is twice the amount expected relative to its population.

[1] The dates used in MARI's Fraud Index are the loan origination dates. Subscribers to the MIDEX system may not discover that a loan involved fraud for months, or even years, after it was originated. Therefore, the index will change as additional incidents are received from MARI's MIDEX subscribers.

Sharing of Enterprise Incidents with Industry

Many mortgage industry companies find that the information presented above is valuable in helping to protect against mortgage fraud. These companies tend to be more careful and implement more extensive quality control procedures in those areas that have high MFI scores. Mortgage Bankers Association (MBA) has endorsed MIDEX and encourages its members to participate in this cooperative system of sharing information about mortgage fraud.

The proposed OFHEO regulations discuss the mechanics of collecting information from the Enterprises, but do not address OFHEO's intended use of the information. We believe it would be extremely beneficial to mortgage industry participants (lenders, investors, insurers, title entities, etc.) to have access to the fraud incidents reported to OFHEO by the Enterprises.

The sharing of these incidents could be in an aggregate form indicating the types of fraud schemes and the geographic areas where such schemes are occurring as well as the overall levels and estimated costs of fraud. OFHEO could also issue alerts to the industry concerning specific, ongoing scams that are being perpetrated. Such alerts would assist industry participants in detecting similar incidents in their own portfolios. We strongly encourage OFHEO to commit to providing such information to the mortgage industry, and to become a valued partner and resource for the professionals who are committed to combating fraud.

Issues for Consideration

Based on MARI's experience in mortgage fraud information-sharing, there are several issues we believe OFHEO needs to address.

1. The term "possible mortgage fraud" should be modified to "attempted mortgage fraud". Mortgage industry participants are not likely to agree on cases when "possible mortgage fraud" has occurred. Attempts to define this term will be challenging. However, failed attempts to commit mortgage fraud should be reported.

2. Investigations of mortgage fraud are often complex and time-consuming. OFHEO needs to be specific regarding when the Enterprises are expected to report fraud incidents. That is, what level of validation or verification must be achieved before an Enterprise makes a report? Do the Enterprises need to re-verify information reported by sellers/servicers? For incidents involving multiple types of fraud or misrepresentation in one or more loan files, should the incident be reported after one fraud type has been investigated, or upon completion of the entire case?

3. Which parties should be named in any report of fraud? Do the Enterprises report (a) all parties to the transaction (borrower, co-borrower, loan officer, appraiser, closing agent, realtor, loan processor, and any other person close to the transaction), (b) only those parties who have responsibility for areas that involved the alleged fraud, or (c) only clearly responsible perpetrators?

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From: William Matthews [wmatthews@mari-inc.com]

Sent: Monday, March 28, 2005 1:45 PM

To: RegComments@ofheo.gov

Subject: RIN 2550-AA31

Alfred M. Pollard: Mortgage Asset Research Institute (MARI®) submits the attached comments to OFHEO's proposed rule regarding RIN 2550-AA31, Mortgage Fraud Reporting.

Please contact me with any questions or comments.

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