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# *The Detection and Deterrence of Mortgage Fraud Against Financial Institutions: A White Paper*

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# The Detection and Deterrence of Mortgage Fraud Against Financial Institutions

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**Disclaimer: Definitions used in this White Paper are intended to provide general information to the reader and are not intended to supersede any regulatory or legal definition.**

## Section 1: Overview

## PURPOSE

This White Paper is intended to raise the awareness of and assist examiners in identifying various mortgage fraud schemes perpetrated against financial institutions. The White Paper also provides best practices for deterring such schemes.

## INTRODUCTION

In February 2005, the FFIEC agencies (Agencies)<sup>1</sup> issued a White Paper entitled [\*The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties \(2005 White Paper\)\*](#). The 2005 White Paper focused on methods to detect, investigate, and deter third party mortgage fraud.

Financial institutions have experienced an increase in the number, volume, and types of mortgage fraud schemes resulting in significant losses. The 2009 White Paper updates mortgage fraud trends and schemes currently impacting financial institutions. This White Paper is divided into three parts, followed by appendices that include a glossary, mortgage<sup>2</sup> transaction flow charts, listing of applicable criminal statutes, and reference materials. The first section covers:

**Background:** Information on the proliferation of and losses resulting from mortgage fraud.

**Basic Mortgage Transactions:** Descriptions of basic mortgage transactions for retail and broker-originated loans, as well as mortgage loans purchased from a correspondent.

**Common Mortgage Fraud Schemes:** Definitions of common mortgage fraud schemes used to perpetrate mortgage fraud.

**Common Mechanisms of Mortgage Fraud Schemes:** A list of common mechanisms used to perpetrate mortgage fraud schemes.

**Common Participants:** A list of common participants who can be engaged in mortgage fraud schemes.

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<sup>1</sup> The FFIEC was established in March 1979 to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the State Liaison Committee. The Council's activities are supported by interagency task forces and by an advisory State Liaison Committee, comprised of five representatives of state agencies that supervise financial institutions.

<sup>2</sup> For the purpose of this paper, the term Deed of Trust is considered to have the same meaning as “mortgage” and the latter term is used throughout.

The second section provides a description of various schemes used to perpetrate mortgage fraud. For each scheme, the following information is provided:

- Definition
- Example(s) of the scheme
- Best practices to mitigate the scheme
- Red flags
- List of companion frauds associated with the scheme, if applicable

The third section provides a description of some common mechanisms used to perpetrate mortgage fraud schemes. For each mechanism, the following information is provided:

- Definition
- Example(s) of the scheme
- Best practices to mitigate the scheme
- Red flags

This paper was designed for electronic usage, and can be navigated via the embedded hyperlinks.

## BACKGROUND

Mortgage fraud has continued to increase since the release of the first mortgage fraud White Paper in 2005. Declining economic conditions, liberal underwriting standards, and declining housing values contributed to the increased level of fraud. Market participants are perpetrating mortgage fraud by modifying old schemes, such as property flip, builder-bailout, and short sale fraud, as well as employing newer schemes, such as buy and bail, reverse mortgage fraud, loan modification and refinance fraud, and mortgage servicing fraud.

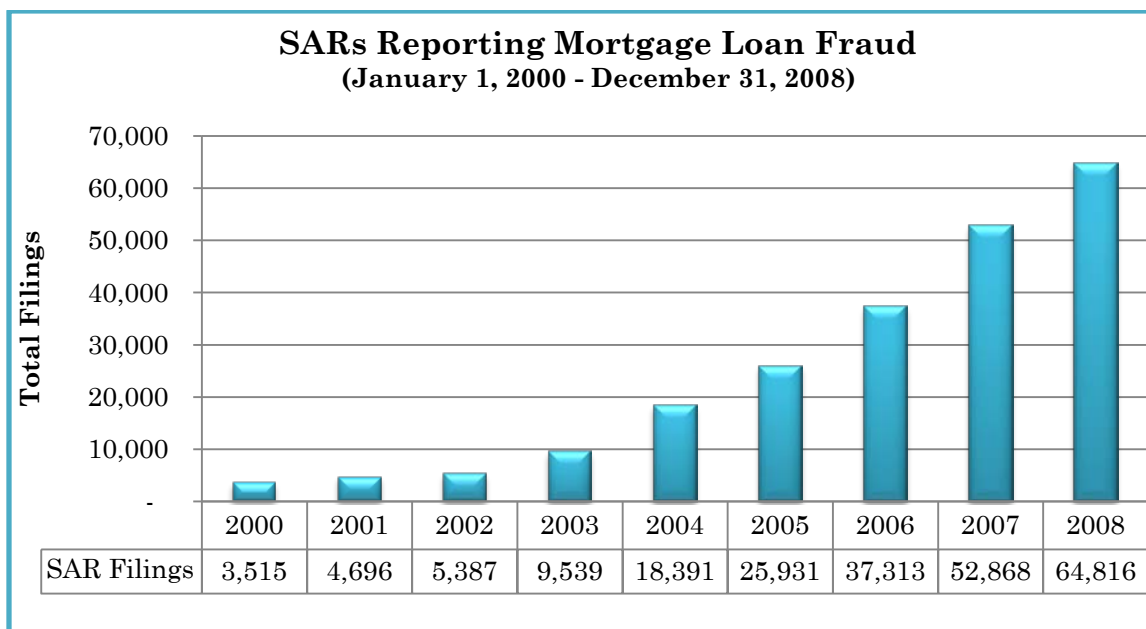
For the purpose of this paper **Mortgage Fraud** is defined as a material misstatement, misrepresentation, or omission of information relied upon by an underwriter or lender to fund, purchase, or insure a loan.

Mortgage fraud can be classified into two general categories: fraud for housing and fraud for profit.

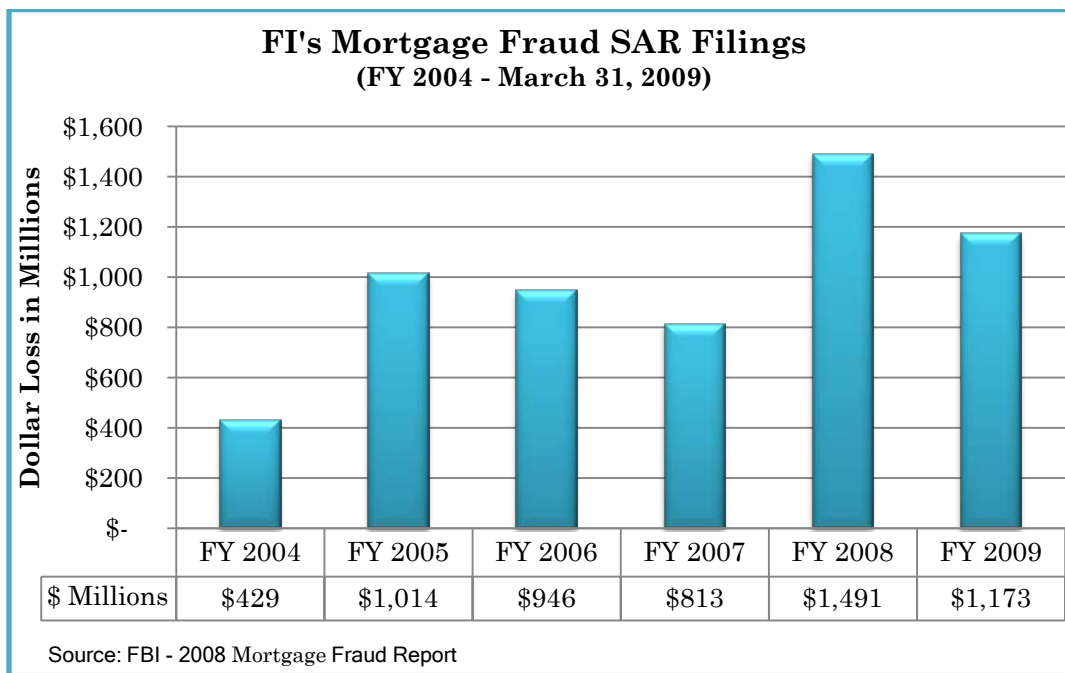
Source: FBI Financial Crimes Section, Financial Institution Fraud Unit, *Mortgage Fraud: A Guide for Investigators*, 2003.

Suspicious Activity Reports (SARs) filed by financial institutions continue to indicate that mortgage fraud is an escalating problem. According to the Financial Crimes Enforcement Network's (FinCEN)

most recent report, [SAR Activity Report – By the Numbers \(Issue 12, July 2009\)](#), SARs associated with mortgage fraud filed by financial institutions increased 23 percent from calendar year 2007 to calendar year 2008. The charts below illustrate the increase in mortgage loan SAR filings.



The total dollar loss amount attributed to mortgage fraud is unknown. However, during fiscal year 2008, at least 63 percent of all pending FBI mortgage fraud investigations involved dollar losses of more than \$1 million each. The losses reported on depository institution SARs approximated \$1.5 billion for fiscal year 2008 and \$1.2 billion for the first half of fiscal year 2009 ([FBI, 2008 Mortgage Fraud Report](#)). It is important to note, however, that losses were reported in only 7 percent of the mortgage fraud SARs filed during this period, as no loss was involved or the amount of loss was unknown at the time of the other SAR filings.



## **BASIC MORTGAGE TRANSACTIONS**

Basic mortgage transactions are generally the same whether the purpose of the loan is to purchase a property, refinance an existing loan, or obtain a loan against a property that is unencumbered and may be offered through one of the channels described below:

### ***Retail***

In retail transactions, the borrower makes an application directly with a financial institution loan officer. These mortgage transactions are the most basic and involve the fewest number of third parties, which may include appraisers and closing agents. Usually, the application package consisting of financial information, credit report, a collateral valuation report such as an appraisal or evaluation, title information, and various other credit-related documents, is compiled and forwarded to an underwriter for a credit decision. Upon approval, the financial institution then releases funds to a closing agent, who disburses funds to the various parties. The loan package is returned to the financial institution and reviewed for quality and accuracy. The loan is either held on the financial institution's books or sold into the secondary market. Retail originations only include loans closed in the financial institution's name.

### ***Broker Origination***

A broker-originated loan is similar to the retail transaction, except that the borrower makes an application with a mortgage broker. A broker is a firm or individual, acting on behalf of either the



financial institution or the borrower, who matches a borrower's financing needs with an institution's mortgage origination programs. Brokers are compensated by receiving a commission expressed as a percentage of the total loan amount (e.g., 1 percent origination fee) from the borrower or through a yield-spread premium from the lender when the loan closes.

Brokers have played a critical role in the wholesale loan origination process and have significant influence on the total loan transaction. Brokers have served as the point of contact for the borrower and the lender, and coordinated the involvement of other parties to complete the transaction. A broker can perform some or most of the loan processing functions including, but not limited to, taking loan applications; ordering credit and title reports; verifying a borrower's income and employment; etc.

Once the broker has gathered the necessary information, the application is submitted along with supporting documentation to one or more financial institutions for underwriting. The financial institution's underwriter reviews the information and makes a credit decision. The financial institution also may perform pre-funding quality assurance activities, such as re-verification of income and employment.

A copy of the loan approval package, with documents prepared in the name of the financial institution, is then returned to the broker. Once the loan has closed, the completed package should be returned directly to the financial institution. Again, the financial institution may review the loan for quality and either retain the loan in its own portfolio or sell it.

### ***Mortgage Loan Purchased from a Correspondent***

In this transaction, the borrower applies for and closes a loan with a correspondent of the financial institution, which can be a mortgage company, another depository institution, finance company, or credit union service organization. The correspondent can close the loan with internally-generated funds in its own name or with funds borrowed from a warehouse lender. Without the capacity or desire to hold the loan in its own portfolio, the correspondent sells the loan to a financial institution. The purchasing financial institution is frequently not involved in the origination aspects of the transaction, and relies upon the correspondent to comply with the financial institution's approved underwriting, documentation, and loan delivery standards. The purchasing financial institution may perform a quality control review prior to purchase. Also, the purchasing financial institution must review the appraisal or evaluation report and determine conformity with the Agencies' appraisal standards, regulations, and supervisory guidance, as well as the financial institution's requirements.

The loan can be booked in the financial institution's own portfolio or sold.

In "delegated underwriting" relationships, the financial institution grants approval to the correspondent to process, underwrite, and close loans according to the financial institution's processing and underwriting requirements. Proper due diligence, internal controls, approvals, quality control audits, and ongoing monitoring are warranted for these higher-risk relationships.

The flow of the Retail and Broker Originated Transactions are graphically illustrated in [Appendix B](#).

Each of the Agencies has issued detailed guidance on a financial institution's management of its arrangements with third parties, including brokers, and associated risk. Examiners are encouraged to review and consider the guidance issued by their Agency in evaluating broker arrangements. Additionally, the Secure and Fair Enforcement Mortgage Licensing Act of 2008 (S.A.F.E. Act) requires licensing and/or registration for all residential mortgage loan originators. The system is also used for state-licensed mortgage companies. More information is available at the website at [www.stateregulatoryregistry.org](http://www.stateregulatoryregistry.org) and contains comprehensive licensing, registration, enforcement action that is expected to be made available to the public through the website in the near future.

Note: SARs should be filed, in accordance with the appropriate regulation, for those activities considered suspicious or fraudulent in nature, involving a fraud scheme or a fraud mechanism, as described throughout this White Paper.

## **COMMON MORTGAGE FRAUD SCHEMES**

This White Paper defines schemes as the big picture or secret plan of action used to perpetrate a fraud. There are a variety of "schemes" by which mortgage fraud can take place. These schemes can involve individuals inside the financial institution or third parties. Various combinations of these schemes may be implemented in a single fraud. The descriptions provided below are examples of traditional and emerging schemes that are used to facilitate mortgage fraud. Click on the link for each fraud scheme to learn more about that particular scheme.

### ***Builder Bailout***

This scheme is used when a builder, who has unsold units in a tract, subdivision, or condominium complex, employs various fraudulent schemes to sell the remaining properties.

### ***Buy and Bail***

This scheme typically involves a borrower who is current on a mortgage loan, but the value of the house has fallen below the amount owed. The borrower continues to make loan payments, while applying for a purchase money mortgage loan on a similar house that cost less due to the decline in market value. After obtaining the new property, the borrower “walks” or “bails” on the first loan.

### ***Chunking***

Chunking occurs when a third party convinces an uninformed borrower to invest in a property (or properties), with no money down and with the third party acting as the borrower’s agent. The third party is also typically the owner of the property or part of a larger group organizing the scheme. Without the borrower’s knowledge, the third party submits loan applications to multiple financial institutions for various properties. The third party retains the loan proceeds, leaving the borrower with multiple loans that cannot be repaid. The financial institutions are forced to foreclose on the properties.

### ***Double Selling***

Double selling occurs when a mortgage loan originator accepts a legitimate application and documentation from a buyer, reproduces or copies the loan file, and sends the loan package to separate warehouse lenders to each fund the loan.

### ***Equity Skimming***

Equity skimming is the use of a fraudulent appraisal that over-values a property, creating phantom equity, which is subsequently stripped out through various schemes.

### ***Fictitious Loan***

A fictitious loan is the fabrication of loan documents or use of a real person’s information to apply for a loan which the applicant typically has no intention of paying. A fictitious loan can be perpetrated by an insider of the financial institution or by external parties such as loan originators, real estate agents, title companies, and/or appraisers.

### ***Loan Modification and Refinance Fraud***

This scheme occurs when a borrower submits false income information and/or false credit reports to persuade the financial institution to modify or refinance the loan on more favorable terms.

### ***Mortgage Servicing Fraud***

This fraud is perpetrated by the loan servicer and generally involves the diversion or misuse of loan payments, proceeds from loan prepayments, and/or escrow funds for the benefit of the service provider.

### ***Phantom Sale***

This scheme generally involves an individual or individuals who falsely transfer title to a property or properties and fraudulently obtain funds via mortgage loans or sales to third parties.

### ***Property Flip Fraud***

A fraudulent property flip is a scheme in which individuals, businesses, and/or straw borrowers, buy and sell properties among themselves to artificially inflate the value of the property.

### ***Reverse Mortgage Fraud***

Reverse Mortgage Fraud involves a scheme using a reverse mortgage loan to defraud a financial institution by stripping legitimate or fictitious equity from the collateral property.

### ***Short Sale Fraud***

Fraud occurs in a short sale when a borrower purposely withholds mortgage payments, forcing the loan into default, so that an accomplice can submit a “straw” short-sale offer at a purchase price less than the borrower’s loan balance. Sometimes the borrower is truly having financial difficulty and is approached by a fraudster to commit the scheme. In all cases, a fraud is committed if the financial institution is misled into approving the short-sale offer, when the price is not reasonable and/or when conflicts of interest are not properly disclosed.

Two additional fraud schemes, which are briefly addressed below, are debt elimination and foreclosure rescue schemes. While these schemes are typically not perpetrated directly on financial institutions, and therefore not expanded upon to the same degree as the above-mentioned schemes, the end result of the scheme can have a negative impact on the financial institution.

## **DEBT ELIMINATION SCHEME**

Debt elimination schemes are illegal schemes that offer to eliminate a borrower's debt for an up-front fee. The organizers of these schemes create phony legal documents based on the borrower's loan(s) for presentation to the borrower's financial institution or other lending institution in an attempt to falsely satisfy the loans.

The threat this fraud scheme presents to a financial institution is the borrower's cessation of loan payments. Financial institutions may find that the use of the false documents complicates the collection process and may temporarily prevent any final action against the borrower.

## **FORECLOSURE RESCUE SCHEME**

Foreclosure rescue schemes prey upon homeowners in financial distress or facing foreclosure, with the promise to help save their home. There are multiple variations of this scheme, often charging up-front fees and/or convincing the homeowner to deed the property to the fraudster, with the premise that the homeowner can rent or buy the property back once the individual's credit has improved. The goal of the fraudster is to collect fees or mortgage payments that are intended for the lender, but are not delivered, usually resulting in the loan going into default and ultimately foreclosure, causing loss to the financial institution.

## **COMMON MECHANISMS OF MORTGAGE FRAUD SCHEMES**

This White Paper defines mechanism as the process by which fraud is perpetrated. A single mortgage fraud scheme can often include one or more mechanisms and may involve collusion between two or more individuals working in unison to implement a fraud. Click on the links to learn more about that particular mechanism. The following is a list of common mechanisms used to perpetrate mortgage fraud schemes:

### ***Asset Rental***

Cash or other assets are temporarily placed in the borrower's account/possession in order to qualify for a mortgage loan. The borrower usually pays a "rental" fee for the temporary "use" of the assets.

### ***Fake Down Payment***

In order to meet loan-to-value requirements, a fake down payment through fictitious, forged, falsified, or altered documents is used to mislead the lender.

### ***Fraudulent Appraisal***

Appraisal fraud can occur when an appraiser, for various reasons, falsifies information on an appraisal or falsely provides an inaccurate valuation on the appraisal with the intent to mislead a third party.

### ***Fraudulent Documentation***

Fraudulent documentation consists of any forged, falsified, incomplete, or altered document that the financial institution relied upon in making a credit decision.

### ***Fraudulent Use of Shell Company***

A business entity that typically has no physical presence, has nominal assets, and generates little or no income is a shell company. Shell companies in themselves are not illegal and may be formed by individuals or business for legitimate purposes. However, due to lack of transparency regarding beneficial ownership, ease of formation, and inconsistent reporting requirements from state to state, shell companies have become a preferred vehicle for financial fraud schemes.

### ***Identify Theft***

Identity theft can be defined as assuming the use of another person's personal information (e.g., name, SSN, credit card number, etc.) without the person's knowledge and the fraudulent use of such knowledge to obtain credit.

### ***Straw/Nominee Borrower***

An individual used to serve as a cover for a questionable loan transaction.

## **COMMON PARTICIPANTS**

Various individuals participate in mortgage fraud schemes. The following list consists of common participants in such schemes and each is linked to the glossary:

[\*Appraiser\*](#)

[\*Borrower\*](#)

[\*Buyer\*](#)

[\*Closing/Settlement Agent\*](#)

[\*Loan Servicer\*](#)

[\*Originator\*](#)

[\*Processor\*](#)

[\*Real Estate Agent\*](#)

[\*Seller\*](#)

[\*Title Agent\*](#)

[\*Underwriter\*](#)

[\*Warehouse Lender\*](#)

## CONCLUSION

Mortgage fraud continues to result in significant losses for financial institutions. It is imperative that examiners and financial institution personnel understand the nature of the various schemes and recognize red flags related to mortgage fraud. This knowledge and use of best practices will help with the prevention and deterrence of mortgage fraud in the financial industry.

### Expansion of the Review

Examiners may encounter red flags indicating potential supervisory issues. The mere existence of red flags does not mean that actual abuses are present, but they should not be ignored. In many instances, a combination of several red flags represents more compelling evidence that a problem does in fact exist. In other cases, warning signs in and of themselves represent actual deficiencies requiring corrective action. When red flags are evident, the examiner should question management and/or staff relative to the issue involved.

Examiners should consult with the appropriate level of Agency management prior to any expansion of scope. This is particularly important when another regulated institution or regulatory agency is involved, e.g., another institution is a purchaser of the loans. Any additional actions taken should be in accordance with the examiner's respective agency guidelines. Also, this is important when a law enforcement agency is involved. Please refer to the [2005 White Paper](#) for recommended tools that examiners may use during the examination process when fraud is suspected or discovered.

## Section 2: Schemes



## **Builder Bailout**

A builder bailout occurs when a builder, who has unsold units in a tract, subdivision, or condominium complex, employs various fraudulent schemes to sell the remaining properties. In stressed economic or financial conditions, a builder may be pressured to liquidate remaining inventory to cover financial obligations. To sell the remaining properties, the builder may use a variety of tools including, but not limited to, hidden down payment assistance or excessive seller concessions to elevate the sales price. As a result of the scheme, the unsuspecting financial institution is often left with a loan secured by inflated collateral value and the “real” loan-to-value is greater than 100 percent.

### **Examples**

- A builder convinces buyers to purchase property by offering to pay excessive incentives that are undisclosed to the lender, including down payments, “no money down promotions”, and/or closing cost assistance.
- In an effort to attract participants, a builder promises to manage properties as rentals and absorb any negative cash flow for the first 12 to 18 months.
- A builder forms one or more companies to purchase the builder’s inventory at inflated market values. The affiliated company finances 100 percent of the purchase amount and funnels the excess cash back to the builder. This scheme falsely inflates the property value, clouds the builder’s true ability to move the inventory, and disguises the fact that the builder is ultimately responsible for repayment of the loan.
- A builder forms a mortgage origination affiliate to originate fraudulent loans. The loan files contain credit discrepancies, fraudulent appraisals, and/or erroneous certificates of occupancy and completion.
- When the builder can no longer lure investors/speculators, the builder may employ straw buyers to purchase the properties.

## Best Practices

- Obtain a complete copy of the purchase contract.
- Ensure that the terms of the purchase contract match the mortgage application.
- Follow a sound appraisal management process (refer to [Fraudulent Appraisal.](#))
- Verify the earnest money deposit and funds to close (seasoned vs. recent deposits).
- Verify borrower employment and income.
- Review the credit report for an excessive number of mortgage loan inquiries.
- Review the Settlement Statement (HUD-1) for disbursements of funds to non-lien holders.
- Be aware of changing conditions in the subject property's marketplace.
- Review marketing materials associated with the development (printed or electronic).
- Obtain attestation from seller and buyer that there are no undisclosed terms.
- Review for arms-length transaction.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Excessive or unsubstantiated down payment.
- Unexplained large or multiple deposits reflected on deposit account statements.
- Borrower states that the property will be owner-occupied, but the property is located in a market dominated by investment properties or second homes (beach properties, duplexes, apartment buildings).
- Use of gift funds or grant funds.
- The HUD-1 shows disbursements from the builder's (as seller) funds to persons or entities not reflected as lien-holders or vendors on the title commitment.
- Robust condominium sales in a slow market.
- All comparable properties are from the same project.
- Many loans to one applicant (credit report).
- No-money-down sales pitch (noted in marketing brochures or website).
- Reference to secondary financing on purchase contract, but not on the loan application.
- Parties to the transaction appear affiliated based on file documentation (personally/professionally).
- Incentives that include pre-paid condominium fees, principal and interest payments for a year, buy-down, free furniture, automobiles, parking spaces, boat slips, etc.

## Companion Frauds

- [Straw/Nominee Borrower](#)
- [Documentation Fraud](#) (associated with income and assets)
- [Fraudulent Appraisal](#)

## Buy and Bail

This scheme typically involves a borrower who is current on a mortgage loan, but the value of the house has fallen below the amount owed. The borrower continues to make loan payments, while applying for a purchase money mortgage loan on a similar but less expensive house because its value has declined. Alternatively, the borrower currently has good credit, but pending events are such that the borrower will soon be unable to afford monthly payments on the existing loan (e.g. loan term adjustments, job loss, debt accumulation, etc.) or qualify for a new loan. In either case, after the new property has been obtained, the borrower “walks” or “bails” on the first loan.

### Example

- A self-employed child-care service provider is living in a house purchased for \$500,000 two years ago that is now worth approximately \$350,000. Monthly payments on the adjustable rate mortgage loan are \$3,000. In a few months the payments will adjust upward, as a result of the rate change, to \$3,700, an amount the homeowner cannot afford. The homeowner finds a home selling for \$200,000 and obtains a loan on that property by falsely claiming to rent the existing property. After moving into the second house, the borrower defaults on the initial mortgage loan.

### Best Practices

- Review the borrower’s credit report for recent credit deficiencies.
- Closely scrutinize applications from borrowers purchasing second homes, especially when the value of the second home is significantly less than the first home.
- Verify that rental agreements are bona fide (e.g., contact parties to agreement).
- Evaluate the reasonableness of rent cash flows.

### Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Second home is substantially less in value and/or loan amount than the existing home.
- Borrower has minimal or no equity.
- Borrower is a first-time landlord (renting out the original property).
- Limited documentation is available to validate lease terms with the purported tenant.
- Purported tenant has a pre-existing relationship with the homeowner.

- Rental agreement appears suspect or projected rental cash flows appear unreasonable.
- Borrower defaults on the original mortgage loan shortly after purchasing a second property (only likely to be detected if the same lender holds both mortgages and loans).

### **Companion Fraud**

- [Fraudulent Documentation](#)

## Chunking

A third party convinces an uninformed borrower to invest in a property (or properties), with no money down, with the third party acting as the borrower's agent. The third party is also typically the owner of the property, or is part of a larger group organizing the scheme. Without the borrower's knowledge, the third party submits loan applications on the borrower's behalf to multiple financial institutions for various properties. These applications are submitted as owner-occupied or as an investment property with a falsified lease. The scheme usually requires the assistance of an appraiser, broker, and/or title company representative to ensure that the third party, as agent for the borrower, does not have to bring any money to the multiple closings. The third party retains the loan proceeds, leaving the borrower with multiple loans that cannot be repaid. The financial institutions are forced to foreclose on the properties and suffer sizable losses.

## Examples

- A borrower attended a seminar that outlined how to get rich by investing in real estate with no money down. A third party, a presenter at the seminar, encouraged the borrower to invest in three real estate properties. Under the third party's guidance, the borrower completed the required application and provided documentation for the loans. The borrower was unaware that the third party owned numerous properties in the name of a Limited Liability Company and submitted applications on not just the three properties known to the borrower, but on a total of 15 different properties. Each application was sent to a different lender, and all were scheduled to close within a one-week timeframe. The borrower attended three of the closings with a different representative of the LLC as the seller. The third party then acted as an agent for the borrower, with power of attorney, at the other 12 closings. The borrower ended up with 15 mortgage loans instead of the three for which he had knowledge, and the lenders were stuck with loans to a borrower without the ability to repay the debts and were forced to foreclose on the properties.
- Fraudsters approached nominees (straw borrowers) and enticed the nominees into allowing the fraudsters to apply for mortgage loans in the nominees' names in order to buy houses. The fraudsters paid the nominees a small amount for allowing the fraudsters to use the nominees' names to apply for the mortgage loans. The fraudsters completed the loan application paperwork with falsified information in order for the nominees to qualify for the loans. The

fraudsters then received inflated property appraisals and obtained two mortgages on each home, one for the purchase price and another for the balance of the appraisal value.

According to the fraudster, the nominee will have no involvement beyond the mortgage application and the fraudster will manage the properties, find tenants, collect monthly payments, and pay the mortgage loans. The tenants, with insufficient credit, are placed in the homes under proposed lease/option-to-buy contracts. The fraudster fails to make a majority of the nominee's mortgage loan payments, causing many of the mortgage loans to go into default. In some instances, the fraudster steals the tenants' deposit money. Ultimately, lenders foreclose on the properties.

### **Best Practices**

- Use fraud detection software for listings of owned real estate to find undisclosed properties owned by the applicant.
- Establish appraisal management practices that detail the order and review processes (refer to [Fraudulent Appraisal](#).)
- Determine the borrower's ability to carry the debt without a tenant.
- Establish the validity of the lease agreements.

### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Multiple mortgage applications by one borrower.
- Credit report that reflects numerous mortgage inquiries.
- Out-of-state borrower.
- Seller that is a corporation or LLC.
- Seller that owns property for a short period of time.
- Previous transfer price that is much lower than current contract price.
- Incomplete lease agreements.
- Payoffs from seller's funds to non-lien holders and vendors on the title commitment.

### **Companion Frauds**

- [Fraudulent Documentation](#)

- [Fraudulent Appraisal](#)
- [Identity Theft](#)
- [Property Flip Fraud](#)
- [Double Selling](#)



## Double Selling

A mortgage loan originator accepts a legitimate application and related documentation from a borrower, reproduces or copies the loan file, and sends the loan package to separate warehouse lenders to each fund the same loan. In some instances, double selling is self-perpetuating because, to keep the scheme going, different loans must be substituted for the ones on which documents cannot be provided. Under this scheme, the broker has to make payments to the investor who received the copied documents or first payment default occurs.

### Examples

- A borrower colluded with a mortgage broker to use the borrower's property as collateral for numerous home equity lines of credit (HELOCs) at different financial institutions. The scheme was executed by closing on multiple HELOCs in a short period of time to take advantage of the delay in recording the mortgages. In addition, the mortgage broker misrepresented the borrower's financial information in order to increase the borrower's debt capacity. The property with less than \$125,000 in equity was used to obtain over \$1 million in credit from several financial institutions.
- A mortgage company used a group of financial institutions (referred to as warehouse lenders) to temporarily fund mortgage loans, which were then sold to another group of financial institutions as long-term investments. The scheme was accomplished by reselling the same loans to multiple investors. Accumulated losses associated with this scheme were in the millions of dollars.

### Best Practices

- Monitor parties involved in the closing of the loan.
- Verify previous lien pay-off from the original lender.
- Receive a complete closing package prior to funding.

### Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Incomplete or unsigned loan application.
- Incomplete or illegible appraisal.

- Discrepancies between underwriting and closing instructions.
- Outstanding trailing documents (e.g., executed note, deed, truth-in-lending, settlement statement, etc.)
- Missing or illegible insured closing letter in the name of the originator from the title company.
- Recent and numerous changes in the wiring instructions.
- Incorrectly named insured and loss payee on the hazard insurance policy.
- Missing mortgage insurance or guaranty, certificate of eligibility.
- Missing purchase commitment from investor - investor lock.

### **Companion Frauds**

- [Fraudulent Documentation](#)
- [Identity Theft](#)

## Equity Skimming

The use of a fraudulent appraisal, unrecorded liens or other means to create phantom equity, which is subsequently stripped out through either of the following methods:

### Purchase Money Transaction

An inflated appraisal and sales contract allows the purchaser to obtain property with little or no down payment. The parties agree to raise the selling price to cover the buyer's closing costs and/or down payment, or to obtain cash back at closing. As a result, the loan amount is higher than what the house is worth, effectively skimming all of the phantom equity out of the property.

### Cash-Out Refinance Transaction

In the case of a refinance, the inflated appraisal or lack of recordation allows the borrower to extract cash in an amount greater than the actual value of the property.

### Examples

- A good example of an equity skimming scheme required a two-step process. In the first step, a loan officer and real estate agent colluded to purchase houses using false information on applications to qualify for loans. The second stage required the collusion of an appraiser to overstate the value allowing equity to be skimmed through the cash-out refinance process. Once no more equity could be extracted, the houses were allowed to go into foreclosure.
- A skimmer/purchaser convinces a property seller to provide a second mortgage loan with payments to begin later, perhaps in 6-12 months. During this period, the skimmer makes no payments on either the first or the second mortgage loan. In situations where the second mortgage is unrecorded, the skimmer will obtain a home equity or closed-end second mortgage, causing a loss to the issuing financial institution. By the time the seller realizes that they will not receive payments, the first mortgagee has begun foreclosure proceedings.

### Best Practices

- Implement sound appraisal management and review processes.
- Determine length of ownership requirements prior to cash-out refinance transactions being granted (reference application, appraisal, and title commitment).
- Control pay-off activities.

- Check for default on subject property (e.g., credit report).
- Review borrower payment history for delinquencies.
- Obtain attestation from seller and buyer that there are no undisclosed terms.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Borrower receiving cash back at closing in a purchase transaction.
- Title to property recently transferred.
- Cash-out refinance shortly after the property has been purchased (reference application, appraisal, and title commitment).
- Purpose for cash-out is not well documented.

## **Companion Frauds**

- [Fraudulent Appraisal](#)
- [Fraudulent Documentation](#) (employment and income)

## **Fictitious Loan**

A fictitious loan is the fabrication of loan documents or use of a real person's information to apply for a loan which the applicant typically has no intention of paying. A fictitious loan can be perpetrated by an insider of the financial institution or by external parties such as loan originators, real estate agents, title companies, and/or appraisers.

### **Example**

- A mortgage broker created loan applications by using names, addresses, and phone numbers out of the telephone book. These loans were subsequently funded by various financial institutions. As the loans were fabricated and no properties existed, the loans went into default and were charged off.

### **Best Practices**

- Establish prudent customer due diligence procedures.
- Verify identity of borrower.
- Require notarized documents.
- Review SSN to see if year of issuance is in line with application.
- Obtain VOD, VOE, etc.
- Review credit report for inconsistencies.

### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Signatures are not consistent throughout the file.
- No real estate agent is employed.
- SSN was recently issued, or there is a death claim filed under SSN.
- Format of the passport number is not consistent with country of issuance.
- Employment and/or address on credit report do not match borrower's application or there is an absence of credit history.
- Credit history is inconsistent with the borrower's age.
- Returned mortgage loan payment coupons and/or monthly statements.
- Early payment default.

## **Companion Frauds**

- [Straw/Nominee Borrower](#)
- [Fraudulent Documentation](#)
- [Fraudulent Appraisal](#)

## Loan Modification and Refinance Fraud

Borrower submits false income information and/or false credit reports to persuade a financial institution to modify or refinance a loan on more favorable terms.

With respect to any mortgage loan, a loan modification<sup>3</sup> is a revision to the contractual payment terms of the related mortgage note, agreed to by the servicer and borrower, including, without limitation, the following:

1. Capitalization of any amounts owed by adding such amount to the outstanding principal balance.
2. Extension of the maturity.
3. Change in amortization schedule.
4. Reduction or other revision to the mortgage note interest rate.
5. Extension of the fixed-rate payment period of any adjustable rate mortgage loan.
6. Reduction or other revision to the note interest rate index, gross margin, initial or periodic interest rate cap, or maximum or minimum rate of any adjustable rate mortgage loan.
7. Forgiveness of any amount of interest and/or principal owed by the related borrower.
8. Forgiveness of any principal and/or interest advances that are reimbursed to the servicer from the securitization trust.
9. Forgiveness of any escrow advances of taxes and insurance and/or any other servicing advances that are reimbursed to the servicer from the securitization trust.
10. Forbearance of principal whereby the servicer “moves” a certain interest free portion of the principal to the “back-end” of the loan, lowering the amortizing balance and the monthly payment.

Concerns with mortgage loan modifications do not always involve fraud. Each state has provisions and requirements for a senior lien holder to modify a loan and retain their lien position. The financial institution should consult an attorney versed in the laws of the state in which the real estate is located to ensure all of the loan modification documents meet state law standards to protect the financial institution’s interest in the collateral.

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<sup>3</sup> American Securitization Forum: Recommended Definitions and Investor Reporting Standards for Modifications of Securitized Residential Mortgage Loans, December 2007

Refinancing is the process of paying off an existing loan by taking a new loan and using the same property as security. A homeowner may refinance for the following legitimate reasons:

- In a declining interest rate environment a refinance generally will lower monthly payments.
- In a rising interest rate environment a refinance to a fixed rate loan from an adjustable rate loan will generally allow the borrower to lock in the lower rate for the life of the loan.
- In a period of rising home prices the refinance allows the borrower to withdraw equity.

## Examples

- Two years after the origination of a mortgage loan, a borrower contacted the lender, claiming a need to modify the loan. In an attempt to deceive the lender into modifying the loan, the borrower stopped making loan payments. The borrower's original loan application indicated that the borrower earned \$7,500 per month; however, the borrower subsequently claimed income of only \$1,200 per month. While evaluating the need for the modification, the bank reviewed the borrower's credit report and determined that the customer's supposed annual income of \$14,400, was insufficient in comparison to the reported \$40,000 per year servicing other debt, which was current. The bank stopped the modification process, as the borrower had intentionally understated income in an attempt to defraud the financial institution.
- A borrower contacted the lender claiming a reduction in income and trouble with making loan payments. The borrower provided the lender with a copy of his most recent tax return, which showed an adjusted gross income (AGI) of \$45,000, down from the previous year's \$96,897. The borrower signed Form 4506-T, authorizing the lender to access tax returns filed with the IRS. In reviewing the tax information obtained from the IRS, the lender found that the borrower had recently amended the most recent return, lowering the AGI from \$105,670 to \$45,000. In this scenario, the borrower had purposely amended the return to reflect a lower AGI, possibly with the intent of amending it a second time to reflect the true amount of income.
- A borrower requests a loan modification for a property that he claims to occupy. Based on the various facts provided to the lender, it appears that the borrower is eligible for a modification. When underwriting the modification, the lender verifies the borrower's income with the IRS. During the verification process, the lender recognizes two potential problems with the information provided. The address on the tax return is different than the address of the house collateralizing the loan, and the return reflects rental income from real property. After



additional investigation, the lender concludes that the customer was trying to modify the loan on rental property and not on the primary residence.

## **Best Practices**

- Underwrite all modifications. The financial institution should ensure that modification files include:
  - Documentation of Hardship.
  - Borrowers' willingness and ability to continue to pay debt and retain property.
  - Independent verification of information (employment, income, occupancy) provided.
  - New credit report.
  - Analysis of sustainability of performance post-modification.
  - Referral to reputable credit counseling service.
- Establish legal department protocol for review of modification agreement (different states have different laws and language).
- Establish strong post-modification loan performance reports.
- Review Uniform Retail Classification and Account Management Policy
- Ensure proper accounting for delinquencies, trouble debt restructuring, charge-offs, and the allowance for loan and lease losses.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Borrower states that the property is his primary residence and is therefore owner-occupied but the mailing address and telephone number are not for the subject property (e.g., property is located in North Carolina; mailing address and telephone number are in New York).
- Vague and/or unrealistic hardship (“the national economy”).
- No documented resolution of hardship.
- No or limited financial analysis in file.
- No employment/income verification.
- Credit Report inconsistent with borrower's stated hardship.
- Financial reports that reflect low delinquencies that are inconsistent with local economic conditions or the bank's loan portfolio composition.

## Companion Frauds

- [Fraudulent Documentation](#)
- [Fraudulent Appraisal](#) (refinance)

## Mortgage Servicing Fraud

Mortgage servicing typically includes, but is not limited to, billing the borrower; collecting principal, interest, and escrow payments; management of escrow accounts; disbursing funds from the escrow account to pay taxes and insurance premiums; and forwarding funds to an owner or investor (if the loan has been sold in the secondary market). A mortgage service provider is typically paid on a fee basis. Mortgage servicing can be performed by a financial institution or outsourced to a third party servicer or sub-servicer.

Mortgage servicing fraud generally involves the diversion or misuse of principal and interest payments, loan prepayments, and/or escrow funds for the benefit of the service provider. Mortgage servicing fraud can take many forms, including the following:

- A mortgage servicer sells a loan it services, but fails to forward funds to the owner of the loan following the sale. The servicer continues to make principal and interest payments on the loan so the owner is not aware that the loan had been sold.
- A mortgage servicer diverts escrow payments for taxes and insurance for its own use. This action would jeopardize a financial institution's collateral protection.
- A mortgage servicer that fails to forward principal and interest payments to an institution that holds the note and mortgage, could report that loan as past due for a short period of time, and then use proceeds from other loans to bring that loan current. This would be similar to a lapping scheme involving accounts receivable. Deliberately failing to post payments in a timely manner causes late fees to increase which directly elevates the servicers' income.
- A mortgage servicer makes payments on loans originated for or on behalf of a financial institution as a means to avoid repurchase pursuant to first payment default provisions.

### Examples

- Several insiders of a mortgage company fraudulently sold serviced loans belonging to other financial institutions and kept the proceeds. An insider modified data in the servicing system to make it appear the loans were still being serviced and were current.

- Two executive officers of a mortgage company took out personal mortgage loans in their names which were subsequently sold to an investor, with servicing retained by the mortgage company. The executives did not make any payments on their loans and suppressed delinquency reporting to the investor, allowing them to “live free” for a period of time until the investor performed a servicing audit and discovered the fraud.

## **Best Practices**

- Perform annual on-site review of loan files and servicer reports.
- Establish internal audit reviews that include a sampling of loans handled by each servicer and verify collateral lien status for such loans.
- Obtain and reconcile reports to document and verify total amount of loans serviced, payments and allocation, servicer fees, delinquent loans, etc.
- Verify receipt of funds on loans authorized for sale by a servicer.
- Review, at least annually, the servicer’s registration status, licensing status, financial health and capability, and compliance with the servicing contract/agreement.
- Establish a contingency plan should the servicer be unable to perform its contractual obligations.
- Verify current insurance policies and amounts of coverage (flood and hazard).
- Verify payment of property taxes.
- Review, as documented in board meeting minutes, management reports on mortgage servicers (annual reviews, quarterly performance reports, aging reports, loan modification reports, delinquency reports, etc.)
- Establish appropriate limitations on access to internal bank systems and records.
- Establish appropriate conflict of interest policies prohibiting compensation/ payments from service providers to bank employees.
- Review of internal and external audit reports of the servicer.
- Review customer complaint processes, procedures, and reports.
- Review analysis and trend reports comparing a servicer’s operations and statistics with Mortgage Bankers Association’s statistics.
- Obtain and review samples of original payment documents (e.g., borrower loan payment checks) to verify that the borrower is the source of payments and that funds from other sources are not being used to make payments or hide delinquencies.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Failure of the financial institution to perform an on-site review of the servicer (loan documents, servicing records, etc.)
- A review of remittance reports provided to the financial institution by servicer finds a:
  - Lack of detail within the remittance reports (principal reduction, interest paid, late fees charged and paid).
  - Remittance reports that fail to reconcile with bank records.
- A review of delinquency reports provided to the financial institution by the servicer finds a:
  - Lack of detail within delinquency reports.
  - High volume of delinquent loans.
- A review of portfolio reports provided to the financial institution by the servicer finds a:
  - Lack of detail within portfolio reports (listing of loans owned by the financial institution being serviced by the servicer including current balance).
  - Portfolio reports that fail to reconcile with bank records.
- Annual review reveals detrimental information or deteriorating financial condition of the servicer.
- County records indicating lien holders are unknown to the financial institution.
- Excessive delay in a servicer's remittance of principal and interest payments, escrow payments, or prepayments.
- Cancellation or reductions in coverage on servicer's insurance policies, including errors and omissions policies.
- Failure of the servicer to maintain copies of original payment documents (e.g., loan payment checks) verifying borrower as the source of payments.
- Excessive errors related to payment calculations on adjustable rate loans or escrow calculations.

## Companion Fraud

- [Fraudulent Documentation](#)

## Phantom Sale

Phantom sales typically involve an individual or individuals who falsely transfer title to a property or properties and fraudulently obtain funds via mortgage loans or sales to third parties.

### Example

- The perpetrator identifies an apparently abandoned or vacant property and records a fictitious quit claim deed to transfer the property into the perpetrator's name. Once the perpetrator has recorded the necessary document, he has several options:
  - Apply for and execute a loan secured by the property. He pockets the loan proceeds and disappears.
  - Transfer the property to a co-conspirator. The new owner applies for a loan, splits the proceeds with the original perpetrator, and both disappear with the money.
  - Transfer the property to a false name, apply for a loan in the false name, pocket the proceeds and disappear.
  - Sell the property to an uninvolved third party, pocket the proceeds, and disappear.

In the first three scenarios the financial institution is left with a mortgage loan that has no payment source and is collateralized by fraudulently obtained property. This results in a 100 percent loss to the financial institution once the fraud is exposed. In the last example, both the purchaser and financial institution are defrauded.

### Best Practices

- Closely scrutinize loan requests resulting with quit claim deed transfers.
- Know your customer.

### Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Title search reveals a recent ownership transfer via quit claim deed.
- Ownership transfers via quit claim deeds in an area where such is not normal.
- Quit claim deed owner is not from subject area.
- Quit claim deed owner is unrelated to former owner.

- Quick sale to third party after quit claim deed owner acquires property.

### **Companion Frauds**

- [Fraudulent Appraisal](#)
- [Identity Theft](#)
- [Straw/Nominee Borrower](#)

## Property Flip Fraud

A fraudulent property flip is a scheme in which individuals, businesses, and/or straw borrowers buy and sell properties amongst themselves, normally within a short time frame, to artificially inflate the value of the properties. This scheme is designed to extract as much cash as possible from the property, and the loan proceeds are often used for purposes not stated on the application.

There are a number of variations of the fraudulent property flip, some of which are more prevalent than others depending on the current economic conditions. Some schemes occur in geographic areas experiencing significant property value appreciation or in stagnant markets, where properties have been on the market for extended periods of time. An essential party in this scheme is a complicit appraiser, who fraudulently provides an inflated opinion of the property's market value. The following are two variations of fraudulent property flips:

- A buyer purchases a property at market value and on the same day sells the property, at an inflated price in excess of the true market value to a straw buyer who has been paid to act as a buyer. The financial institution lending to the straw buyer typically is unaware of the prior purchase by the fraudster earlier that same day.
- A seller, whose property has been on the market for an extended period of time, is approached by a buyer/borrower who makes an offer on the property that is substantially higher than the market value. A financial institution funds the loan based on a fraudulent appraisal that inflates the value of the property. In some cases, the inflated value is supported by non-existent home improvements that were to be made. For example, a seller lists a property for \$250,000 and a buyer/borrower offers \$299,000. At closing, the seller receives the net proceeds of \$250,000 on the original asking price of the home and the surplus of \$49,000 is disbursed to the fraudsters through a payoff from the seller's funds on the HUD-1 Settlement Statement at closing.

### Example

- A group of individuals was organized by a real estate agent to flip properties. Each participant acquired a property with 100 percent financing, prior to the real estate market peak. The properties were then sold repeatedly amongst the individuals and /or their spouses to increase the market value. Title to some of the properties is held in trusts, obscuring ownership.



However, once the group obtained the requisite amount of cash, the loans were allowed to go into default. The participants split the loan proceeds in excess of the true market value for perpetrating the scheme.

## Best Practices

- Closely analyze the borrower’s financial information for unusual items or trends.
- Independently verify employment and income.
- Review the title commitment in the pre-funding quality assurance program.
- Compare elements of the final title policy to the original title commitment and with other closing documents (e.g., HUD-1).
- Employ a post-closing review to identify any inconsistencies.
- Establish a periodic independent audit of mortgage loan operations.
- Periodically conduct physical verification of the location and condition of selected subject properties and comparables.
- Monitor real estate market values in areas that generate a high volume of mortgage fraud loans or where concentrations exist.
- Review the appraisal’s three-year sales history to aid in identifying property flipping.
- Perform pre-funding reviews of appraisals and evaluations.
- Implement effective internal controls to ensure compliance with regulatory requirements ([Interagency Appraisal and Evaluation Guidelines](#)) and sound business practice. (Refer to [Fraudulent Appraisal](#) for additional red flags.)
- Establish an employee-training program to include:
  - An overview of common mortgage fraud schemes and red flags;
  - the appraisal (USPAP) standards; and,
  - R/E appraisal valuation techniques.
- Establish an approved appraiser list for use by retail, brokers and correspondents.
- Implement sound appraisal review processes.
- Implement a “watch” list and monitoring systems for appraisers that exhibit suspect practices.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Property listed for extended period of time and sells for higher than list price.

- Property has been transferred or sold within the last six months.
- The property is advertised as “For Sale by Owner”.
- Value of the property has notably increased with no improvements or improvements are insufficient to justify the increase.
- Borrower has limited capacity to repay (e.g., high debt-to-income ratio)
- The property seller is not the owner of record.
- Purchase is disguised as refinances to circumvent down payment.
- Seller is an entity/corporation.
- Power of attorney used without explanation.
- Borrower owns excessive amount of real estate.
- Similarities on multiple applications received from a specific seller or broker.
- Notes in loan file suggest borrower pushed for a quick closing.
- Appraiser is not on list of approved appraisers.
- Appraisal was ordered by a party to the transaction or before the sales contract, or appraisal is a fax.
- Borrower named on the appraisal is different from applicant.
- Appreciation is noted in an area with stable or declining real estate prices.
- Comparables on the appraisal are unusual.
- Inconsistencies in VOE or VOD.
- Violation of the lender’s closing instructions.
- Same individuals involved as buyers and/or sellers in multiple transactions, which may be noted on the deed, title abstract, or other real estate documents found in file.
- Unusual credits or disbursements on settlement statements or discrepancies between the HUD-1 and escrow instructions.
- First payment default on loan.

## **Companion Frauds**

- [Fraudulent Appraisal](#)
- [Fraudulent Documentation](#)
- [Identity Theft](#)
- [Straw/Nominee Borrower](#)

## Reverse Mortgage Fraud

The rapid growth in and changes to the reverse mortgage market have created a lucrative environment for fraudulent activities. The vast majority of reverse mortgage loans are offered through HUD and are FHA-insured; the products are commonly referred to as Home Equity Conversion Mortgages (HECMs). According to data maintained by HUD and other sources, the reverse mortgage loan market increased over the last 5 years from approximately “\$5.4 billion a year to more than \$17.3 billion in 2008.”<sup>4</sup> In addition, recent legislation increased the dollar amount of HECMs to \$625,000, and purchase money transactions became effective in 2009. The primary requirements imposed by HUD are that the borrower has attained age 62 and that the collateral value supports the loan amount. There is no requirement to have owned the property for any minimum amount of time, and the loans do not require monthly repayment. Therefore, the loans are primarily underwritten based on the age of the youngest borrower and value of the home being used as collateral.

Reverse mortgage fraud is a scheme where legitimate or fictitious equity is stripped from the collateral. The lump-sum cash-out option will yield the greatest amount of loan proceeds, and likely will be where most fraud occurs. However, fraud may occur in other reverse mortgage loan products. For example, under the term program, where a borrower receives equal monthly payments for a fixed period of time, older borrowers will receive higher payments due to a shorter payment stream, creating a direct incentive to falsify age. Due to the structure of the HECMs, there are no warnings, such as past-due status or default, to raise suspicions, and possibly limit losses, as repayment is only required upon the borrower moving out of the property; upon death; default of property taxes or hazard insurance; or the property is in unreasonable disrepair.

### Example

- Property title is transferred into the perpetrator’s name and quickly re-titled into a straw buyer’s name. A lump-sum cash-out reverse mortgage loan is obtained and is premised on collusion of an appraiser who provides an “as if” renovated appraised value to fraudulently increase the market value. The perpetrator also places fictitious liens on the property to divert loan proceeds to himself.

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<sup>4</sup> *Inside Mortgage Finance*, March 20, 2009, issue 2009:11, “Interest in Reverse Mortgages Likely to Continue to Grow”

## Best Practices

- Obtain a title search and review for: the types of property titles shown (such as, abandoned title), type of deed transferred (quit claim or warranty deed), the owner of record, the dates of deed transfers, and amount and dates of any prior mortgages.
- Obtain information on the borrower's previous address and length of residence at the previous address. Determine whether the address is associated with governmental housing, homeless shelters, or group homes. Straw borrowers are often recruited from such housing and then used by the perpetrators to meet borrower age requirements in the program.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- No notes in loan file pertaining to how the proceeds will be used, or notes indicate that proceeds will be used for unspecified monthly living expenses, but the loan is a lump-sum cash-out option.
- File notes indicate that the borrower does not exhibit any knowledge of the property, such as location, number of rooms, etc.
- The property title may have been "abandoned" by the local government and then transferred into the perpetrator's name. The property may then be re-titled into the borrower's name via either a warranty deed or a quit claim deed.
- Files contain notices that property taxes are delinquent, indicating default under the terms.
- Files contain notices that property insurance has lapsed, indicating default under the terms.
- Loan file information shows mail as returned to sender, possibly indicating the "owner" is no longer occupying the property and did not provide a forwarding address. An event of default occurs, when the owner no longer lives in the property.
- The title search (if performed) showed that the property title recently transferred to the borrower's name, following a very short ownership by the seller, indicating the possibility of a flip transaction.
- Lender search of public records for either assessed value or sales prices show that the neighborhood is valued at substantially less than the subject property.
- Problems with the appraisal report may include:
  - The report was prepared for a third party and not ordered by the financial institution.
  - Comparable properties are not in the same neighborhood.

- Prior sales history is inconsistent with title search results.
- Refer to [Fraudulent Appraisal](#) for further details on potential appraisal fraud red flags.

### **Companion Frauds**

- [Fraudulent Appraisal](#)
- [Fraudulent Documentation](#)
- [Property Flip Fraud](#)

## Short Sale Fraud

A short sale is a sale of real estate in which the proceeds from the sale are less than the balance owed on the loan. The borrower may claim to have financial hardship and offers to sell the property so the financial institution will not have to foreclose. The financial institution and all interested parties, including other lien holders and any mortgage insurer, must approve the transaction. Some institutions may be motivated to approve a short sale because it is faster, results in a smaller loss than the prospect of a foreclosure, and does not increase the level of Other Real Estate Owned. Depending on the settlement and the state where the property is located, the deficiency balance may be forgiven by the financial institution.

Not all short sales are fraudulent. However, fraud occurs when a borrower withholds mortgage loan payments, forcing the loan into default so that an accomplice can submit a “straw” short-sale offer at a purchase price less than the borrower’s loan balance. Sometimes the borrower is truly having financial difficulty and is approached by a fraudster to commit the scheme. In all cases, a fraud is committed if the financial institution is misled into approving the short-sale offer when the price is not reasonable and/or when conflicts of interest are not properly disclosed.

### Example

- A fraudster uses a straw buyer to purchase a home for the purpose of defaulting on the mortgage loan. The straw buyer makes no payments on the loan and the property goes into default. Prior to foreclosure the fraudster makes an offer to purchase the property from the lender in a short sale agreement below market value. The lender agrees without knowing that the short sale was premeditated.

### Best Practices

- Establish short sale policy and review/approval process.
- Obtain an appraisal or evaluation to determine the market value of a property.
- Determine if the sales transaction is arms length; identify common surnames, telephone numbers, addresses, etc.
- Obtain sworn statements from all parties, including real estate agent that the transaction is a true sale and parties do not know each other.
- Require seller to vacate property and certify they will not occupy home again for next five years.
- Inform seller that occupancy checks will be periodically performed.

- Verify borrower’s reason for financial hardship; for example, verify unemployment insurance is being received, medical payments, divorce, etc.
- Include the FBI Mortgage Fraud Notice in loan documents.

## Red Flags<sup>5</sup>

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Sudden default with no workout discussions and immediate request for short sale.
- Loan file documentation suggests ambiguous or conflicting reasons for default.
- Mortgage loan delinquency is inconsistent with the borrower’s spending, savings, and other credit patterns as indicated in the credit report.
- Short-sale offer is from a related party, which is sometimes not disclosed, or straw buyer.
- Short-sale offering price is less than current market value.
- HUD-1 Settlement statement shows cash-back at closing to the delinquent borrower, or other disbursements that have not been expressly approved by the servicer (sometimes disguised as “repairs” or other payouts).
- Fraudulent appraisal to support below market price.
- Seller intentionally lowers value of property by causing excessive, but cosmetic, damage or hiding dead animals to produce offensive odors. Adjustment to value is exaggerated downward even though costs for rehabilitation are low.
- Seller feigns financial hardship and hides assets - large volume of assets on original loan application have dissipated without explanation.
- County records show that the property was flipped soon after short sale with a higher price.
- County records show ownership is transferred back to the seller after short sale.
- Site visit or registered mail is not returned indicates seller continues to reside in the property.
- Real estate agent is in collusion with seller and withholds competitive/higher offers.
- Unusually high commission is paid to real estate agent.

## Companion Fraud

- [Fraudulent Documentation](#)

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<sup>5</sup> Portions of these red flags were taken from the 2009 Fannie Mae: Mortgage Fraud Program – Fraud Schemes and their Characteristics; Resources to Help You Combat Mortgage Fraud; <https://www.efanniemae.com/utility/legal/pdf/fraudschar.pdf> ; retrieved 7/16/2009.

## **Section 3: Fraud Mechanisms**



## Asset Rental

Asset rental is the rental of bank deposits or other assets, which are temporarily placed in a borrower's account, in order for a borrower to qualify for a loan. The borrower usually pays some fee, such as a rental fee, for the temporary "use" of the asset. Asset rental programs have been generally described as tools to help borrowers whose financial condition poses a roadblock to being approved for a loan. Most often, the rental involves deposits or credit histories. Asset rental is a tool that can be used to commit mortgage fraud.

Deposit rental is a means to inflate an individual's assets. An individual typically pays an origination fee of 5 percent of the amount of the deposit to be rented and a monthly fee of 1 percent to 1¼ percent of the deposit amount. The rented deposit can be owned by a third party that purports to be a financial institution or adds the borrower's name to a real deposit account without granting access. The third party agrees to verify the deposit to any party authorized by the borrower. Written statements and verifications of deposit are available for an extra fee.

Credit histories are rented in an effort to raise an individual's credit score. An individual typically pays a fee and is added to another individual's credit card account as a non-user. The borrower has no access to or use of the credit card but benefits from the actual credit card holder's timely payments.

In addition to asset rental, some companies also have advertised verification of employment and income services. Individuals fill out a form listing annual and monthly income and sources. Upon receipt of fees, the company verifies income and employment to lenders or others as authorized by the borrower.

### Example

- A borrower would like to purchase a \$450,000 house. Unfortunately, his \$71,000 bookkeeper salary and \$13,000 in a savings account do not meet the underwriting standards for the amount of the loan. The borrower, however, is certain that his salary will continue to increase at a minimum of 10 percent per year.

The borrower rented a \$40,000 deposit account, for a fee of \$2,000; the loan application reflected the \$40,000 account as an asset. In addition, the borrower expected a raise the following year to \$78,000, and enlisted an entity to verify that salary amount. The \$78,000 was shown on the loan application as his current income. The loan file contained a verification of deposit for the

\$40,000 account, a verification of employment form verifying his job as an accountant, and a verification of income form for his \$78,000 salary.

### **Best Practices**

- Establish independent verification procedures to ensure the accuracy of submitted information
- Required a signed perjury statement that the documents submitted are true and accurate.
- Implement audit procedures and practices that identify, review, and report on loans where a third party verifier exists that is not the employer or institution holding the deposit.

### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Verification of Deposit (VOD), Verification of Employment (VOE) and Verification of Income (VOI) from a common source that is not the employer or the financial institution where the deposit is held.
- Information on credit report that is not consistent with information on VODs, VOEs and VOIs.
- Even numbers only appearing on the VODs and VOIs. Discrepancies between the deposit account establishment date and the date the borrower says it was established in the loan application process.

## **Fake Down Payment**

In order to meet loan-to-value requirements, a fake down payment through fictitious, forged, falsified, or altered documents is used to mislead the lender. Collusion with a third party, such as a broker, closing agent, appraiser, etc. often exists to raise the purchase price and make it appear that the buyer is making a down payment to cover the difference between the purchase price and proposed loan. A fake down payment reduces the financial institution's collateral position and in some cases, a financial institution may be financing over 100 percent of the purchase. Without the fake down payment, the financial institution would not have otherwise made the loan.

### **Examples**

- A borrower wants to purchase property but does not have the money for a down payment. He offers the seller more than the asking price to give the appearance that the buyer is putting money down in order to get the loan. The seller agrees to amend the contract to reflect the increased price. The increase in sales price is not disbursed to the seller. Instead, a false payoff from the seller's funds is reflected on the HUD-1 Settlement Statement when in reality, the seller provides the funds to the borrower for the down payment.
  
- A third party broker has a borrower interested in a loan to finance the purchase of a home. The borrower does not have sufficient funds available to meet the lender's LTV requirements. Therefore, the broker loans the borrower \$10,000 to use as a down payment, and the funds are represented to be a gift from family. The borrower and broker then enter into a loan agreement. The loan is to be secured by a lien against the house. Approximately ten days after closing of the purchase transaction, the broker records the second lien against the house to secure the down payment loan.

### **Best Practices**

- Review appraisal to determine if purchase price is reasonable.
- Obtain VOD, VOE, etc.
- Verify legitimacy of deposit.
- Scrutinize HUD-1 statement.
- Use only approved appraisers.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Source of funds for down payment cannot be verified.
- Down payment appears to be accumulated suddenly instead of over time.
- Deposit is a rented account (refer to asset rental) or has a round dollar balance.
- Down payment source is held in a non-financial institution such as an escrow trust account, title company, etc.
- Market value of property is inflated.
- Property sells above asking price even though on the market for an extended period of time.

## **Fraudulent Appraisal**

Appraisal fraud can occur when an appraiser for various reasons falsifies information on an appraisal or falsely provides an inaccurate valuation on the appraisal with the intent to mislead a third party. In addition, appraisal fraud occurs when a person falsely represents himself as a State-licensed or State-certified appraiser or uses the identity of an appraiser as his own.

One common form of appraisal fraud relies on overvalued or undervalued property values, also known as artificial inflation/deflation using one or more valuation approaches. A buyer and a real estate professional will use a willing appraiser to artificially modify the value of a property. The property's false inflated value can be used to secure a second mortgage, place the property on the market at a greatly inflated price, or secure an initial mortgage loan that will be defaulted upon at a later time. An undervalued appraisal can be used to assist in a short sale or loan modification fraud scheme.

### **Examples**

- A couple obtains financing for the purchase of their first house, contingent upon the house value. The couple plan to use the \$8,000 tax credit for the down payment and closing costs and only have nominal cash available, so there is no possibility that the couple could cover the difference if the house doesn't appraise. The couple's loan officer arranges for an appraisal of the property, but sends the appraiser the standardized form with the final market value section completed. The appraiser wants to continue his relationship with the mortgage broker, so he agrees to develop an appraisal report to support the value provided. The property is compared to properties outside of the general area where the subject house is located. Without knowledge of that area, it appears, to anyone reviewing the appraisal report, that the comparable properties provide support for the value. However, no adjustments have been made for the facts that the comparable properties are newer, larger, in better condition, and in a better location than the subject property.
- A house being appraised has materially less square footage than the comparable properties. To boost the square footage of the subject property, the appraiser doubles the square footage of the unheated out-building, that is used for lawn equipment, and adds that square footage to the square footage of the house. No adjustments are made to the comparable properties, since now the subject and comparable properties have similar square footage. A review of the square

footage of the house and out-building clearly shows that the appraiser intentionally misrepresented the property value.

## Best Practices

- Establish written internal control procedures in accordance with the Agencies' appraisal regulations, supervisory issuances, institutional policies, and sound business practices that include:
  - Procedures for reviewing all appraisals and evaluations on a pre-funding basis for reasonability, completeness, and compliance with the Agencies' appraisal regulations, which incorporates by reference the Uniform Standards of Professional Appraisal Practice (USPAP) and procedures to address discrepancies and irregularities.
  - Standards of independence to ensure that the collateral valuation functions (such as selecting appraisers, ordering appraisals, reviewing appraisals) operates independently from and isolated from influence by the institution's loan production staff.
  - Establish criteria to select, evaluate, and monitor the performance of persons who perform an appraisal or evaluation.
- Establish a listing of appraisers who have been "suspended" or "terminated" by the institution and procedures to ensure such appraisers are prohibited from engaging in future transactions with the institution either directly or through any third parties.
- Use of website [www.ASC.gov](http://www.ASC.gov) to determine if there are any enforcement actions against appraisers on the National Registry, which list appraisers who are eligible to perform appraisals in connection with federally related transactions.
- Establish policy and procedures for complying with the Agencies' guidance on managing arrangements with third parties including performing initial due diligence review and on-going monitoring of all third Party vendors (e.g., appraisal management companies, agents acting on behalf of the financial institution to obtain appraisals).
- Establish an employee training program that provides an understanding of:
  - Common mortgage fraud schemes.
  - Appraisal standards and requirements under the Agencies' appraisal regulations and supervisory issuances.
  - Appraisal techniques and valuation methods.
  - Use of Red Flags to aid in identifying appraisal irregularities.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

There are various red flag indicators that can be used to identify the possibility of appraisal fraud. The identification of red flags could suggest individual fraud activities or more complex fraud schemes. Such red flag indicators for appraisal fraud are subdivided into categories below<sup>6</sup>:

### *Appraisal Engagement Letter/Appraisal Ordering*

- There is no appraisal engagement letter in file or the appraisal does not correspond to the engagement letter.
- The appraisal was ordered or provided by the buyer, seller, or an unidentified third party to the transaction rather than the financial institution or its agent.
- The appraisal was order by the financial institution loan production staff rather than from an independent office within the institution.

### *The Appraiser/Appraiser Compensation*

- Appraiser was not located in reasonable proximity of the subject property and it is unclear that the appraiser has appropriate knowledge of the local market.
- Appraiser licensing/certification information is missing or appraiser information is clouded in some way.
- Appraisal fee is based on market value of subject property.
- Appraiser has had enforcement action taken against him or is not otherwise eligible to perform appraisals for federally related transactions ([www.ASC.gov](http://www.ASC.gov)).

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<sup>6</sup> Florida Mortgage Corp., **Mortgage Fraud**, 2008.

Web Site: <http://www.floridamortgagecorp.com/mortgagefraud.htm>

Washington State Department, **Mortgage Fraud -Florida Property**, Undated  
Website [www.dfi.wa.gov/cs/mb\\_exam.../mortgage\\_fraud\\_red\\_flags.doc](http://www.dfi.wa.gov/cs/mb_exam.../mortgage_fraud_red_flags.doc)

Moye C, CALMO Realty Services, **Appraisal Fraud Presentation**, Presented at FFIEC Fraud Investigations Symposium, July 2009.

Federal Financial Institutions Examination Council, (FFIEC), **The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper**, Issued February 2005

Federal Financial Institutions Examination Council, (FFIEC), Appraisal Subcommittee (ASC), **FFIEC Fraud Symposium Presentation**, July 2009.

Federal Deposit Insurance Corporation, **Interagency Appraisal and Evaluation Guidelines**, October 1994.  
Website <http://www.fdic.gov/regulations/laws/rules/5000-4800.html>

### ***Property Comparables***

- Comparable properties are materially different from subject property.
- Comparable properties are outside a reasonable radius of the subject property (except for rural properties).
- Comparable property sales are stale without an explanation.
- Appraiser makes large value adjustments to comparable properties without adequate explanation.
- Recent and multiple sales for subject and/or comparables are shown in the appraisal without adequate explanation as to the circumstances.

### ***Appraisal Information and Narrative***

- The market value in the appraisal report is lower than purchase price.
- Listing rather than sales information was used to determine value.
- Evidence of appraisal tampering (e.g., different font style, handwritten changes).
- Refinance transaction shows property recently listed “for sale”.
- Market rent is significantly less than rent amounts indicated on lease agreement.
- Income approach is not used on a tenant-occupied, or rented single-family dwelling.
- Significant appreciation or devaluation in short period of time.
- Appraisal indicates transaction is a refinance when it is a purchase.
- Appraised value is contingent upon property improvements or curing of property defects.
- Abnormal capitalization or discount rates without explanation.
- Appraisal dated before loan application date.
- Significant variances in property value among the Cost, Income, and Sales approach.
- Appraisal excludes one or more valuation approaches when such an approach is pivotal to the loan underwriting decision.
- Owner is someone other than seller shown on sales contract.
- Unusual or frequent prior sales are listed for subject and/or comparables without adequate explanation.
- Occupant noted as “tenant” or “unknown” for owner-occupied refinances.

### ***Appraisal Photographs and Mapping (Comparable and Subject)***

- Photos missing, non-viewable, or blurry.



- A “For Rent” or “For Sale” sign shows in the photos of the subject property for an owner-occupied refinance.
- Photos do not match property description.
- Photo background image is inconsistent with the date or season of the appraisal.
- Photos of subject property taken from odd angles to mask unfavorable conditions.
- Negative valuation factors are not disclosed in appraisal (e.g., commercial property next door, railroad tracks, or another structure on premises).
- Photos for the subject property and comparables appear to be from different photo source (e.g., internet photos).
- Appraisal maps showing location of subject and comparables is either absent or shows wide geographical separation from subject property.

### ***Other Appraisal Information***

- Documentation in loan file suggests a re-appraisal due to appraisal results or the stated value of subject property without an explanation.
- Loan file contains more than one recent appraisal with significant variance in value without an explanation.
- House number of property in photo does not match the subject property address.
- A fax or an electronic version of the appraisal is used in lieu of the original containing signature and certification of appraiser.
- The appraisal was not reviewed prior to loan funding or appraisal was reviewed by loan production rather than an independent office within the institution.

## **Fraudulent Documentation**

Documentation fraud occurs when any document relied upon by the financial institution to make a credit decision, is forged, falsified, or altered. Fraud can also occur if proper due diligence and verification practices are not consistently applied. Similarly, obtaining documents to satisfy a checklist is not the same as having verified the authenticity of the document.

### **Documentation Types**

#### **1. Sales Contract**

Sales contracts may be falsified to reflect higher sales prices. These higher sales prices are intended to produce higher comparables for appraisal purposes and result in artificially inflated values. The inflated values result in a higher loan amount than would otherwise be justified. Additionally, falsified seller identity may be used to perpetrate frauds, such as transferring property via falsified deeds or listing property for sale that the seller does not legally own. The identity of the buyer and/or seller may also be falsified in order to disguise a flip transaction or the use of a straw borrower.

#### **Best Practices**

- Ensure all parties sign the sales contract.
- Ensure borrower signature on contract matches the loan application and other file documents.
- Ensure earnest money deposits on contract match HUD-1.
- Verify seller to property records.
- Monitor real estate markets where the financial institution's mortgage loans were originated.

#### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Borrower is not listed as purchaser on the sales contract.
- Seller listed on contract is not the owner listed on title or appraisal.
- All parties did not sign the sales contract and/or addendum.
- Sales contract is not dated or dated after other file documents (unless it is a pre-qualification.)
- Sales contract is received at the last minute or has been changed from the previously submitted contract.

## 2. Loan Application

Parts of or the entire application may be falsified.

### Best Practices

- Independently verify employment by researching the location and telephone number of the employer.
- Use pre-funding and post-closing reviews to detect any inconsistencies within the transaction.
- Conduct risk-based quality control audits on loan files prior to funding.
- Assess the volume of critical post-closing missing documents.
- Establish a periodic independent audit of the mortgage loan origination process.
- Provide fraud updates/alerts to employees.
- Review patterns on declined loans, such as, individual social security number, appraiser, real estate agent, loan officer, and broker.
- Establish a fraud hotline for anonymous fraud tips.

### Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Application states purpose is for refinance, but the credit report and/or tax records do not indicate the borrower owns the property.
- Purchase amount of the property differs from the sales contract.
- Borrower claims the property will be owner-occupied, when the intent is for investment/rental purposes.
- Application shows all assets, but liabilities are inconsistent with those reported on the credit report.
- Assets are inconsistent with job position and income.
- Omission of some or all properties owned by the borrower in the real estate section of the application.
- Borrower declarations are inconsistent with credit report.
- Debt-to-Income ratios are exactly at maximum approval limits
- Misrepresentation of employment and income.

### **3. Credit Report**

The credit report contains significant information reflective of the borrower's ability and desire to repay debt obligations. Credit reports are sometimes altered so that a borrower can meet specific loan requirements. For example, credit scores can be changed (increased) through scanning and alteration of information.

#### **Best Practices**

- Include an analysis of the credit report in the pre-funding quality assurance program.
- Make direct inquiries to the borrower and creditors to obtain an explanation of unusual or inconsistent information.
- Obtain an updated credit report if the report is older than six months.
- Compare employment and residence history on the credit report to that listed on the application.
- Be knowledgeable of community property issues in your state.

#### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- The absence of credit history indicating the possible use of an alias and/or multiple social security numbers.
- Borrower recently pays many or all accounts in full, possibly indicating an undisclosed debt consolidation loan.
- Indebtedness disclosed on the application differs from the credit report.
- The length of time trade lines were opened is inconsistent with the buyer's age.
- The borrower claims substantial income but only has credit experience with finance companies.
- All trade lines opened at the same time with no explanation.
- Recent inquiries from other mortgage lenders are noted.
- AKA (also known as) or DBA (doing business as) are indicated.

### **4. Driver's License**

Government issued driver's licenses can be partially verified through entities that can identify whether the licensing number sequence complies with the state's system. However, state issued identification cards do not always have the same quality.

## Best Practices

- Compare driver's license with state requirements.
- Compare with a second form of picture ID (e.g., passport, picture credit card, work ID badge, etc.)

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- No hologram.
- No photograph.
- Name, address, physical characteristics do not match.
- Expired driver's license.
- Illegible driver's license.

## 5. Social Security Number

The first five digits of a Social Security Number (SSN) signify the state and the date range in which it was issued. SSNs should be compared to numbers associated with deceased taxpayers. Identity alerts are also a useful tool if accessed via the credit reporting system.

## Best Practices

- Review for legitimate format on social security cards: 3-2-4 format in the center of the card (XXX-XX-XXXX).
- Verify the name and SSN with the Social Security Administration.
- Use credit reporting agency fraud alerts when ordering credit reports.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Credit report alert states that SSN has not been issued.
- Credit report alert states that SSN is on the master death index.
- Format and digits are not correct.
- Improper color and weight of the social security card.
- Highly unlikely series of digits (999-99-9999 or 123-45-6789).

- Ink smudges, poorly aligned, and odd fonts.

## **6. Bank Statement**

Deposit account statements may include legitimate financial institution names and addresses, but can be fraudulently modified to include falsified telephone numbers that are answered by a party to the scheme.

### **Best Practices**

- Copy the original bank statements – avoid accepting copies made by the borrower/broker.
- Execute a direct verification of deposit to the bank.
- Review balances and any large unexplained deposits and withdrawals.

### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Altered copies.
- Missing pages.
- Application information (name and address) does not match the account holders.
- Inconsistency in the color of original bank statements.

## **7. Deposit Verification (VOD)**

A party to the scheme may verify deposits held at a depository institution, even though no such financial institution, account, or deposits in that name exist.

### **Best Practices**

- Establish specific deposit verification procedures in the pre-funding quality assurance program.
- Verify the legitimacy of the depository by researching its location and phone number.
- Validate borrower provided information on the application by making direct inquiries to the depository regarding the account's name, age, average balance, number of monthly transactions, recent large dollar transactions, etc.
- Employ a post-closing review to detect any inconsistencies within the transaction.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- The VOD is completed on the same day it is ordered.
- Deletions or cross outs exist on the VOD.
- No date stamp receipt affixed to the VOD by the depository to indicate the date of receipt.
- The buyer has no deposit accounts, but a VOD is in the file.
- The deposit account is not in the borrower's name or is a joint account with a third party.
- The borrower's account balance at the financial institution is insufficient to close the transaction.
- The deposit account is new or has a round dollar balance.
- The closing check is drawn on a different financial institution.
- An illegible signature exists with no further identification provided.
- Significant balance changes are noted in depository accounts during the two months prior to the date of verification.
- The checking account's average two-month balance exactly equals the present balance.
- Funds for the down payment are only on deposit for a short period.
- An IRA is shown as a source of down payment funds.
- Account balances are inconsistent with application information.
- The down payment source is held in a non-depository "depository," such as an escrow trust account, title company, etc.
- An escrow receipt is used as verification which may have been from a personal check not yet cleared or a check returned due to insufficient funds.
- The VOD is not folded indicating it may have been hand carried.
- The VOD is not on original financial institution letterhead or a recognized form.

## 8. Employment Verification (VOE)

Fake employment verification can be used by those who collude in mortgage fraud. This is usually associated with an organized scheme.

### Best Practices

- Establish specific employment verification procedures in the pre-funding quality assurance program.

- Verify employment by researching the location and phone number of the employer.
- Ensure the address information on W-2 forms and tax returns matches data provided on the application.
- Determine if the borrower's work location is within a reasonable distance from subject property.
- Employ a post-closing review to detect any inconsistencies within the transaction.
- Establish a periodic independent audit of mortgage loan operations.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- The seller and applicant have similar names.
- Borrower's employer does not know borrower or borrower was terminated from employment prior to the closing date.
- The VOE is not on original letterhead or a standard Federal National Mortgage Association (FNMA)/Federal Home Loan Mortgage Corporation (FHLMC) form.
- The VOE is completed the same day it is ordered, indicating it may have been hand-carried or completed before the initial application date.
- An illegible signature exists with no further identification provided.
- The employer uses only a mail drop or post office box address.
- The business entity is not in good standing with the State or registered with applicable regulatory agencies.
- An overlap exists with current and prior employment.
- Excessive praise is noted in the remarks section of response.
- Round dollar amounts are used in year-to-date or past earnings.
- Income is not commensurate with stated employment, years of experience, or type of employment.
- Income is primarily commission based, although borrower claims he is a salaried employee.
- The borrower's interest in the property is not reasonable given its distance from the place of employment.
- The borrower has a recent large increase in income or started a new job.
- Faxes are used in lieu of original documents.
- CPA letter is used to validate employment.
- Leases are used to evidence additional income.



## 9. W-2 Statement or Paystub

Off-the-shelf software and internet sites make the creation of fake W-2 statements and paystubs relatively easy.

### Best Practices

- Encourage use of red flags or other checklists for W-2 or paystub review.
- Compare employment against the credit report, bank statements (for direct payroll deposits), and tax returns.
- Review unusual patterns and inconsistencies between documents.

### Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Borrower income is inconsistent with type of employment.
- Social security number on W2 or paystub is invalid, differs from loan application, or has been recently issued.
- Name misspelled.
- Variances in employment data with other file documentation.
- Commission-type position with “base” salary only (and vice versa).
- Round dollar amounts for year-to-date or prior year’s earnings.
- Numbers that appear to be “squeezed in”.
- Document alterations, such as white-outs or cross-outs or inconsistent fonts.
- Not computer-generated, especially from large employer.
- W-2 is typed, but paystubs are computer-generated.
- Check numbers do not increase chronologically.
- Amounts withheld for Social Security, Medicare and other government programs are inconsistent with the level required.
- Debts reflected as deduction from pay (credit union loans, etc.) not disclosed on application.
- Year-to-date totals do not total accurately from paycheck to paycheck.
- An employer identification number that is not in the XX-XXXXXXX (two digits, hyphen, seven digits) format, or is not all numeric.
- Employer and employee names or addresses are inaccurate.

- Income reflected on W-2 statements is different than income reported on mortgage loan application, VOE, and tax returns.
- Federal Insurance Contribution Act (FICA) and Medicare wages/taxes and local taxes, where applicable, exceed ceilings/set percentages.
- Copy submitted is not “Employee’s Copy” (Copy C).

## **10. Tax Return/Amended Tax Return**

Fake tax returns may be provided to the underwriter as the borrower believes that no verification will occur. In other instances, amendments to tax returns may be made to further the scheme, regardless of whether the income amount increases or decreases.

### **Best Practices**

- Provide training for documentation fraud awareness.
- Require borrowers to sign and date Form 4506-T Request for Transcript of Tax Return.
- Compare income claimed against other file documentation such as W2s, paystubs, application, and credit report.

### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Address and/or profession do not agree with other information submitted on the mortgage loan application.
- Type of handwriting varies within return.
- Evidence of “white-out” or other alterations.
- Unemployment compensation reported, but no gap in employment is disclosed.
- Estimated tax payments by self-employed borrower (Schedule SE required); or self-employment tax claimed, but self-employment not disclosed.
- Tax returns are not signed/dated by borrower.
- IRS Form 1040 - Schedule A:
  - Real estate taxes and/or mortgage loan interest is paid but no property is owned, or vice versa.
  - Tax preparation fee is deducted, yet prior year’s return is prepared by borrower.
  - Minimal or no deductions for a high-income borrower.

- IRS Form 1040 - Schedule B:
  - Borrower with substantial cash in the bank shows little or no related interest income.
  - No dividends are earned on stocks owned.
  - Amount or source of income does not agree with the information submitted on the mortgage loan application.
- IRS Form 1040 - Schedule C:
  - Business code is inconsistent with type of business.
  - Gross income does not agree with total income on Form 1099s.
  - No “cost of goods sold” on retail or similar type of business.
  - Borrower takes a depreciation deduction for investment real estate not disclosed, or vice versa.
  - Borrower shows interest expense but no related loan, such as a business loan with personal liability.
  - No deductions for taxes and licenses.
  - Wages are paid, but no tax expense is claimed.
  - Wages are paid, but there is no employer identification number.
  - Salaries paid are inconsistent with the type of business.
  - Business expenses are inconsistent with type of business (e.g., truck driver with no vehicle expense).
  - Income significantly higher than previous years.
- IRS Form 1040 - Schedule E:
  - Additional properties are listed, but not shown on the mortgage loan application.
  - Mortgage loan interest is deducted but no mortgage is disclosed.
  - Borrower shows partnership income (may be liable as a general partner for partnership’s debts).

## **11. Deed**

Quit Claim and Warranty Deeds may be used by someone who is transferring the property’s title, but is not the owner or the owners’ representative. The purpose of such transactions is to sell the property outright or to refinance the debt in a cash-out transaction to collect loan proceeds. A fake Power of Attorney may be used as authorizing the deed transfer.

## **Best Practices**

- Verify Power of Attorney with maker and appropriate local authority.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Recent ownership transfer or multiple transfers in a short period of time via quit claim or warranty deed.
- Representative not local or from out of state.
- Deeds involving individuals not party to the transactions.
- Deeds where parties share common names/hyphenated names, suggesting family relationships.
- Obvious errors, such as misspelled names, or other items.

## **12. Title or Escrow Company/Title Commitment**

Fraudulent loan schemes may involve the use of a fake title company or may involve an employee of the title company. The company appears to provide legitimate documentation, which was possibly stolen from a legitimate title company (such as a falsified closing protection letter). Employees of legitimate title companies may be part of a scheme, where they either fabricate title commitments or delete information that would help identify fraudulent activity, such as flipping.

## **Best Practices**

- Review title commitment in the pre-funding quality assurance program.
- Review the final title policy and check for discrepancies with the original title commitment.
- Compare the final title policy with other closing documents, like the HUD-1, to ensure consistency regarding the first lien holder, lien amount, property size and location, and other pertinent information.
- Employ a post-closing review to detect any inconsistencies within the transaction.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- The seller either is not on the title or is not the same as shown on the appraisal or sales contract.
- The seller owned the property for a short time with cash out on sale.

- The buyer had a pre-existing financial interest in the property.
- The chain of title includes the buyer, real estate agent, or broker.
- The title insurance or opinion was prepared for and/or mailed to a party other than the lender.
- Income tax or similar liens are noted against the borrower on refinances.
- Non-lien holders are shown on HUD-1.
- The title policy is not issued on the property with the lien or on the whole property.
- Faxed documents are used rather than originals or certified copies.
- Title commitment and final title policy reflect two different title insurers.
- Closing instructions are not followed.
- Delinquent property tax exists and does not appear on the title commitment.
- A notice of default is recorded and does not appear on the title commitment.

### **13. Business License**

Business licenses may be fabricated to show that a supposed self-employed borrower owns a business. In this instance, the borrower owns no such business. Others may actually formally incorporate with the state office to conceal the fact that no such business operates.

#### **Best Practices**

- Contact appropriate state regulator to determine validity of business.
- Compare information on business with tax returns.
- Perform internet search on borrower and business.

#### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- No physical address (P.O. Box only) or physical address belongs to mail box rental company. Various search engines can help determine if disclosed physical address belongs to mail box rental.
- No telephone number or email address.
- No state franchise or other required annual filings.

### **14. Notary stamps**

Notary stamps may be stolen and used in fraudulent transactions. In addition, notaries may be

participants in furthering a scheme and receive funds for their participation. While e-notary will prevent stealing of physical stamps, it will not necessarily eliminate the coercion of notaries. Also, the fact that e-notary does not require the log to be downloaded daily to an impartial party that maintains a database of transactions, can allow for information to be changed after-the-fact. This would be the equivalent of changing the hand-written log.

### **Best Practices**

- Ask the borrower where and when the notarization took place, to determine if the documents were pre-notarized.
- Confirm that the notary is authorized by the state.
- Compare dates of the notary to other documents provided.
- Contact the notary to determine that the stamp was authorized.

### **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Seal is not embossed.
- Seal appears to be photocopied, rather than original.
- Notary is either related to or has a business relationship with a party to the transaction.

## **15. Power of Attorney**

Powers of Attorney (POA) are legal documents authorizing another party to act on the first party's behalf. POAs can be Limited, General, or Durable. Durable POAs have the longest duration, as they cease upon the death of the authorizing person, whereas General POAs cease upon a pre-established date, competency, or incapacitation. Limited POAs are identified with a specific timeframe or certain acts. Documents can be easily fabricated to show that one party has a legal right to enter into financial transactions on behalf of another. POAs may or may not be filed with the appropriate governmental office.

### **Best Practices**

- Confirm with the party that the POA was authorized.
- Verify the identity of the person named as POA and the relationship to the authorizing party.
- Review the POA to determine that the type of POA corresponds to the described situation.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- A General or Durable POA is dated at approximately the same date as the transaction.
- Person, who supposedly authorized the Limited or General POA, is unaware of the document.
- In those areas where all POAs are recorded documents, the document is not recorded.
- The POA is not prepared by an attorney, but by using off-the-shelf software.
- POA is used in cash-out refinances or reverse mortgage loans.

## 16. HUD-1 Settlement Statement

The HUD-1 settlement statement is an accounting of the transaction from both the borrower's and seller's standpoint. This form is often falsified to withhold information from the lender, or there are often two distinctly different HUD-1 forms in fraudulent transactions.

### Best Practices

- Review both the buyer and seller sides of the HUD-1 prior to closing for unusual entries or amounts.
- Compare payouts from seller's funds to lien holders on the title commitment.
- Compare signatures on the HUD-1 to signatures throughout the file.

## Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Borrower receives cash-back at closing.
- Payoff of non-lien holders typically reflected as marketing fees, payment for repairs, or renovations.
- Existence of multiple, different HUD-1's.
- Items paid outside of closing (outside of normal appraisal and credit report fees).
- Overpayment of fees and commissions to realtor, broker, etc.
- Signatures on the HUD-1 do not match other signatures throughout the file.

## **Fraudulent Use of a Shell Company**

A shell company is a business entity that typically has no physical presence, has nominal assets, and generates little or no income. Shell companies in themselves are not illegal and may be formed by individuals or businesses for legitimate purposes. However, due to lack of transparency regarding beneficial ownership, ease of formation, and inconsistent reporting requirements from state to state, shell companies have become a preferred vehicle for financial fraud schemes.

Both the U.S. Government Accountability Office (GAO) and FinCEN have reported on shell companies and their role in facilitating criminal activity. These reports have focused on limited liability corporations (LLCs) due to their dominance and growth in popularity. However, any type of business entity can be a shell company. To further obscure ownership and activity, there are numerous businesses that can provide a shell company with a registered agent and mail forwarding service, or offer nominee services, such as nominee officers, directors, shareholders, or nominee bank signatory. Other businesses sell established shell companies for the purpose of giving the appearance of longevity of a business, and a history of creditworthiness which may be required when obtaining leases, credit, or bank loans.

### **Example**

- Several individuals with the intent of committing fraud formed a shell company as a way of disguising their identities. The individuals purchased properties in the name of the shell company and at the same time recruited straw borrowers to purchase the properties from the shell company at inflated prices. Owners of the shell company provided the straw borrowers with fake documents in order to qualify for the loans. The shell company owners profited from the difference between the original purchase price and the mortgage loan proceeds, less the fee paid to the straw borrower. The straw borrower defaulted on the loan, forcing the financial institutions to foreclose on the houses.

### **Best Practices**

- Obtain a certificate of good standing for the entity, which can usually be obtained online from the state in which the entity was formed.
- Obtain and review the entity's operating agreement.
- Obtain the names of all individuals with ownership and control of the entity (principals) and evaluate the appropriate factors of creditworthiness.



- Determine if the entity has a complete and proper management plan in place in the form of a well-written and articulated operating agreement.
- Ensure personal business and financial affairs are maintained separate from the entity.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Entity has no telephone number or email address.
- No physical address (P.O. Box only) or physical address belongs to mail box rental company.
- No company logo.
- No website, if one would be expected.
- No domestic address/contact if a foreign company.
- Newly-formed entity.
- Registered agent recently changed.
- Transacting businesses share the same address; provide only a registered agent's address; or other address inconsistencies.
- Unusual cash withdrawals from business accounts.

## Identity Theft

Identity theft can be defined as assuming the use of another person's personal information (e.g., name, SSN, credit card number, etc.) without the person's knowledge and the fraudulent use of such knowledge to obtain credit. Perpetrators commit identity theft to execute schemes using fake documents and false information to obtain mortgage loans. These individuals obtain someone's legitimate personal information through various means, (e.g., obituaries, mail theft, pretext calling, employment or credit applications, computer hacking, trash retrieval, etc.) With this information, they are able to impersonate homebuyers and sellers using actual, verifiable identities that give the mortgage transactions the appearance of legitimacy.

### Example

- A university student database, which included social security numbers and other personal identifying information, is compromised by a computer hacker. The investigation revealed that the hacker subsequently sold the personal identification information to a third party, who then proceeds to submit falsified mortgage loan applications to numerous financial institutions which resulted in approximately \$5 million in losses to the financial institutions. Law enforcement stated that the third party, in collusion with a notary, appraiser, and other industry insiders, used the student information to purchase homes owned by the third party and other collaborators at highly inflated prices. In addition to identity theft, the loan files also included misrepresentations of employment, falsified down payments, and inflated appraisals.

### Best Practices

- Review credit report for large numbers of recently opened accounts and conflicting information with the application.
- Obtain valid government identification at the time of application.
- Use fraud detection software to assist in verification of identity.
- Check the Social Security Administration's death master index.
- Implement policy and procedures in accordance with the Fair Credit Reporting Act (FCRA) and Fair and Accurate Credit Transactions Act of 2003 (FACTA) requiring institutions to have policies and procedures in place to detect, prevent, and mitigate identity theft.

### Red Flags

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant;

however, multiple red flags may indicate an operating environment that is conducive to fraud.

- Credit report contains a fraud alert or consumer-driven freeze on their credit report, which means no credit reports can be pulled until the consumer lifts the freeze.
- Credit report indicates that the social security number was not yet issued.
- Recently-opened accounts.
- Employment and residence history on the credit report and application do not match.
- Copy of driver's license does not match profile on the application.
- Recently issued SSN.
- Current address on the application does not match other documents in the file (e.g., bank statements, W-2's, utility bills, etc.)
- Additional red flags may be found in the FCRA under Appendix J of 12 CFR 41 ([Subpart J – Identity Red Flags](#))

## Straw Borrower / Nominee Borrower

A straw (nominee) borrower is an individual used to intentionally disguise the true beneficiary of the loan proceeds. Straws can be willing participants in the transaction or victims whose identity is being used without their knowledge. Often a willing straw borrower does not think the transaction is dishonest because they believe the recipient of the loan proceeds will make the payments. Reasons why a beneficiary of the loan proceeds may use a straw borrower are because the beneficiary:

- Does not qualify for the mortgage loan,
- Has no intent to occupy the property as a primary residence, or
- Is not eligible for a particular loan program.

Also straw borrower activities are commonly used with family members who step in for the purchase or refinance when the true home owner (family member) does not qualify for a loan.

### Examples

- A couple wanted to buy a home but did not qualify because their debt ratio was much too high. They also had very little cash to use as a down payment. To "help" them, one of their parents applied for the loan and was approved for a 97 percent LTV product. The couple moved into the house, and could not make the monthly payments. The servicer called the straw borrower, who informed the servicer that he did not live in the home and that his daughter and son-in-law were supposed to be making the payments. Despite, being contractually obligated, the straw borrower parent refused to bring the loan current. The lender was forced to foreclose and took a loss on the sale of the REO.
- A fraud ring acquired 25 properties, all of which were in various stages of disrepair. Some were even uninhabitable and slated for condemnation by the city. The ring then recruited individuals through their church, clubs, and other associations to each buy a property sight unseen. Each borrower was told they would not need to live in the property, and each borrower was also promised payment of \$7500. The fraud ring arranged for inflated appraisals to be performed by promising the appraiser the job of appraising all 25 properties. The applications were submitted to several different lenders with numerous misrepresentations surrounding not only the true property values, but occupancy intent, borrower employment, income, and assets as well. The loans closed and resulted in first payment defaults, as the straw borrowers were

told that their properties were passive investments that would not require any monthly payments due to tenants already being in the properties. A handful of the straw borrowers did receive their \$7500 as promised, but most did not. Upon receiving collection calls, the straw borrowers determined they had been misled. The lenders ultimately foreclosed on the properties, discovered the true condition of the properties, and suffered losses upon the sale of the REO.

## **Best Practices**

- Ensure an adequate appraisal review process is in place to determine if the appraisal sets forth an accurate market value of the subject property.
- Ensure pre funding and post funding reviews are conducted to identify inconsistencies in loan documentation.
- Ensure an adequate loan documentation review is performed on loan file prior to funding or loan purchase. Such a review might include determining if any straw borrower Red Flag indicators are present.
- In-house underwriting practices fully determine the parties involved in the transaction; specifically, the proposed property owner, the proposed occupant(s), and final use of the property.

## **Red Flags**

A red flag is an indicator that calls for further scrutiny. One red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud.

- The application is unsigned or undated.
- Borrower's income is inconsistent with job or position.
- A quit claim deed was used either right before or soon after the loan was closed.
- Investment property is represented as owner-occupied on loan application.
- Loan documents show someone signed on the borrower's behalf.
- Names were added to the purchase contract.
- Sale involves a relative or related party.
- No sales agent or realtor was involved.
- The name and address of borrower on credit report does not correspond with information on the loan application.
- Appraisal irregularities exist regarding property valuation and documentation. (See

Fraudulent Appraisal.)

- Power of attorney was used in place of borrower.
- Good assets, but “gifting” was used as all or part of down payment.
- Repository alerts on credit report.

# Appendix A

## Glossary

Appraisal Management Company (AMC)	A business entity that administers a network of certified and licensed appraisers to fulfill real estate appraisal assignments on behalf of mortgage lending institutions and other entities. The company recruits, qualifies, verifies licensing, and negotiates fees and service-level expectations with a network of third-party appraisers. It also provides administrative duties like order entry and assignment, tracking and status updates, pre-delivery quality control, and preliminary and hard copy report delivery. Furthermore, the AMC oversees ongoing quality control, accounts payable and receivable, market value dispute resolution, warranty administration, and record retention.
Appraiser	One who is expected to perform valuation services competently and in a manner that is independent, impartial, and objective.
Borrower	One who receives funds in the form of a loan with the obligation of repaying the loan in full with interest. The borrower may be purchasing property, refinancing an existing mortgage loan, or borrowing against the equity of the property for other purposes.
Buyer	A buyer is a person who is acquiring property.
Closing	The culmination of any RE transaction in which the interested parties or their representatives meet to execute documents, exchange funds, and transfer title to a property.
Closing Costs	Moneys expended by a party in completing a RE transaction, over and above the purchase price, including: legal fees, taxes, origination fees, discount points, mortgage insurance premium, interest adjustments, registration fees, appraisal fees, title

insurance premium, etc.

Closing/Settlement/  
Escrow Agent

An individual or company that oversees the consummation of a mortgage transaction at which the note and other legal documents are signed and the loan proceeds are disbursed. Title companies, attorneys, settlement agents, and escrow agents can perform this service. Local RE law may dictate the party conducting the closing.

Concessions

Benefits or discounts given by the seller or landlord of a property to help close a sale or lease. Common concessions include absorption of moving expenses, space remodeling, upgrades (also called "build-outs"), and reduced rent for the initial term of the lease.

Collusion

An agreement, usually secretive, which occurs between two or more persons to deceive, mislead, or defraud others of their legal rights, or to obtain an objective forbidden by law, typically involving fraud or gaining an unfair advantage.

Correspondent

A mortgage originator who underwrites and/or sells mortgage loans to other mortgage bankers or financial institutions.

Credit Report Fraud Alert

A notation at the bottom of a credit report indicating that some items of identification, i.e., Social Security number, address, etc., are associated with past fraudulent activities. For example, an address may be flagged because the previous occupant allegedly used the property for financial misbehavior. Each credit reporting agency has different names for these alerts: TransUnion – HAWK Alerts, Experian – Fraud Shield, and Equifax – Safescan.



Deed	The document by which title to real property is transferred or conveyed from one party to another. (See <a href="#">Quitclaim Deed</a> and <a href="#">Warranty Deed</a> .)
Deed of Trust	A type of security instrument in which the borrower conveys title to real property to a third party (trustee) to be held in trust as security for the lender, with the provision that the trustee shall re convey the title upon the payment of the debt. Conversely, the third party will sell the land and pay the debt in the event of default by the borrower. (See <a href="#">Mortgage</a> .)
Developer	A person or entity, who prepares raw land for building sites, constructs buildings, creates residential subdivisions or commercial centers, rehabilitates existing buildings, or performs similar activities.
eNotary	An electronic notary that may include the use of a digital seal to notarize digital documents. (See also <a href="#">Notary</a> .)
Escrow Instructions	Instructions prepared by a lender and/or underwriter to direct the progression of a mortgage closing transaction from start to finish.
Evaluation	A valuation required by the Agencies' appraisal regulations for certain transactions that are exempt from the regulations.
Federal Home Loan Mortgage Corporation (Freddie Mac)	Commonly used name for the Federal Home Loan Mortgage Corporation (FHLMC), a government sponsored entity that provides a secondary market for conforming conventional residential mortgage loans by purchasing them from primary lenders.

Federal Housing Administration (FHA)	A federal agency established to advance homeownership opportunities. The FHA provides mortgage insurance to approved lending institutions.
Federal National Mortgage Association (Fannie Mae)	A government sponsored entity that, as a secondary mortgage loan institution, is the largest single holder of residential mortgage loans in the United States. Fannie Mae primarily buys conforming conventional residential loans from primary lenders.
Federally related transaction	Means any real estate-related financial transactions entered into after the effective date hereof that: <ul style="list-style-type: none"> <li>(1) The FDIC or any regulated institution engages in or contracts for; and</li> <li>(2) Requires the services of an appraiser.</li> </ul>
Foreclosure	A legal proceeding following a default by a borrower in which real estate secured by a mortgage or deed of trust is sold to satisfy the underlying debt. Foreclosure statutes are enacted by state government.
Form 1003	The standardized loan application form used in residential mortgage loan transactions.
Form 4506T	An IRS form that taxpayers execute to authorize the IRS to release past tax returns to a third party. Many lenders require mortgage loan applicants to execute this form in order to verify income.
Fraud	A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to their detriment.

Government National Mortgage Association (Ginnie Mae)	A government-owned corporation that provides sources of funds for residential mortgage loans, insured or guaranteed by the FHA or VA.
HUD-1 Form	A standardized form prescribed by the Department of Housing and Urban Development that provides an itemization listing of funds paid at closing. Items that appear on the statement include RE commissions, loan fees, points, taxes, initial escrow amounts, and other parties receiving distributions. The HUD-1 statement is also known as the "closing statement" or "settlement sheet."
Lapping	A fraud that involves stealing one customer's payment and then crediting that customer's account with a subsequent customer's payment.
Loan Servicer	A loan servicer is a public or private entity or individual engaged to collect and process payments on mortgage loans.
Loan-to-Value Ratio (LTV)	Relationship of loan amount to collateral value, expressed as a percentage.
Market Value	<p>The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:</p> <ol style="list-style-type: none"> <li>(1) Buyer and seller are typically motivated;</li> <li>(2) Both parties are well informed or well advised, and acting in what they consider their own best interests;</li> <li>(3) A reasonable time is allowed for exposure in the open market;</li> <li>(4) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and</li> <li>(5) The price represents the normal consideration for the</li> </ol>

property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Modification Agreement	A document that evidences a change in the terms of a mortgage loan, without refinancing the loan. Commonly, changes are made to the interest rate, repayment terms, guarantors, or property securing the loan.
Mortgage	A lien on the property that secures a loan. The borrower is the mortgagor; the lender is the mortgagee.
Mortgage Banker	An individual or firm that originates, purchases, sells, and/or services loans secured by mortgages on real property.
Mortgage Broker	An individual or firm that receives a commission for matching borrowers with lenders. Mortgage brokers typically do not fund the loans they help originate.
Mortgage Fraud	A knowing misrepresentation of the truth or concealment of a material fact in a mortgage loan application to induce another to approve the granting of a mortgage loan. For the purpose of this paper, mortgage fraud refers solely to fraudulent schemes pertaining to residential mortgage loans.
Nominee Loan	A loan made to one individual in which the proceeds of the loan benefit another individual without the knowledge of the lender.
Notary	A person who certifies the authenticity of required signatures on a document, by signing and stamping the document. (See also <a href="#">eNotary</a> .)

Originator	The individual or entity that gathers application data from the borrower. Alternatively, a person or entity, such as a loan officer, broker, or correspondent, who assists a borrower with the loan application.
Power-of-Attorney	A legal document that authorizes a person to act on another's behalf. A power-of-attorney can grant complete authority or can be limited to certain acts (closing on a property) or timeframes (from date granted until a termination date). A durable power-of-attorney continues until the grantor's death.
Pretext Calling	A scheme associated with identity theft in which a fraudster, pretending to represent a legitimate entity, calls an unsuspecting party seeking personal identification data, such as social security numbers, passwords, or other forms of account information. The fraudster then uses this information to assume the identity of the unsuspecting victim. Among other things, the fraudster can obtain a mortgage loan in the name of the unsuspecting victim.
Processor	The processor is an individual who assembles all the necessary documents to be included in the loan package.
Quitclaim Deed	A deed that transfers without warranty whatever interest or title, if any, a grantor may have at the time the conveyance is made. A grantor need not have an interest in the property to execute a quitclaim deed.
Real Estate Agent	An individual or firm that receives a commission for representing the buyer or seller, in a RE purchase transaction.

Reverse Mortgage	A reverse mortgage loan converts the equity in the home into cash. Unlike a traditional loan, no repayment is required until the borrower no longer uses the house as a principal residence. To be eligible under FHA's program, Home Equity Conversion Mortgage (HECM), the homeowner must be at least 62 years old, and live in the house. The program was expanded in 2009 so that HECMs can be used to purchase a primary residence.
Secure and Fair Enforcement Mortgage Licensing Act of 2008 (S.A.F.E. Act)	Legislation designed to enhance consumer protection and reduce fraud by encouraging states to establish minimum standards for the licensing and registration of state-licensed mortgage loan originators and for the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to establish and maintain a nationwide mortgage licensing system and registry for the residential mortgage industry. The S.A.F.E. Act further requires the federal agencies to establish similar requirements for the registration of depository institution loan originators.
Secondary Market	The buying and selling of existing mortgage loans, usually as part of a "pool" of loans.
Seller	Person offering to sell a piece of real estate.
Short Sale	Sale of the mortgaged property at a price that nets less than the total amount due on the mortgage loan. Servicers and borrowers negotiate repayment programs, forbearance, and/or forgiveness for any remaining deficiency on the debt to lessen the adverse impact on borrowers' credit records.

Straw Buyer/Borrower	A person used to buy property or borrow against property in order to conceal the actual owner. The straw buyer does not intend to occupy the property or make payments and often deeds the property to the other individual immediately after closing. The straw buyer is usually compensated for use of his identity.
Third Party	The parties necessary to execute a residential mortgage transaction other than a financial institution and a legitimate borrower. Third parties include, but are not limited to, mortgage brokers, correspondents, RE appraisers, and settlement agents.
Title Agent	The title agent is a person or firm that is authorized on behalf of a title insurer to conduct a title search and issue a title insurance report or title insurance policy.
Title Company/Abstract Company	Entity that researches recorded ownership of and liens filed against real property and then issues a title insurance policy guaranteeing the lien position of the lender or provides a title opinion. Some states also require an attorney opinion supported by an abstract.
Title Insurance	An insurance policy that indemnifies the lien position of a lender against losses associated with property interests not disclosed in the title opinion. The borrower can also obtain this coverage by purchasing a separate policy.
Title Opinion/Commitment/Binder	An examination of public records, laws, and court decisions to ensure that no one except the seller has a valid claim to the property, and to disclose past and current facts regarding ownership of the subject property.

Underwriting	The credit decision-making process which can be automated, manual or a combination of both. In an automated process, application information is entered into a decision-making model that makes a credit determination based on pre-determined criteria. In a manual process an individual underwriter, usually an employee of the financial institution, makes the credit decision after evaluating all of the information in the loan package, including the credit report, appraisal, and verifications of deposit, income, and employment. Financial institutions often use a combination of both, with the automated decision representing one element of the overall credit decision. In each case, the decision may include stipulations or conditions that must be met before the loan can close.
Verification of Deposit (VOD)	Written document sent to the borrower's depository institution to confirm the existence of a down payment or cash reserves.
Verification of Employment (VOE)	Written document sent to the borrower's employer to confirm employment/income. Employment is often reconfirmed by calling the employer prior to funding.
Verification of Income (VOI)	Written documentation supporting the borrower's income level and income stream.
Warehouse Lender	A short-term lender for mortgage bankers. Using mortgage loans as collateral, the warehouse lender provides interim financing until the loans are sold to a permanent investor.
Warehouse (Loan)	In mortgage lending, warehouse loans are loans that are funded and awaiting sale or delivery to an investor.



Warehouse Financing

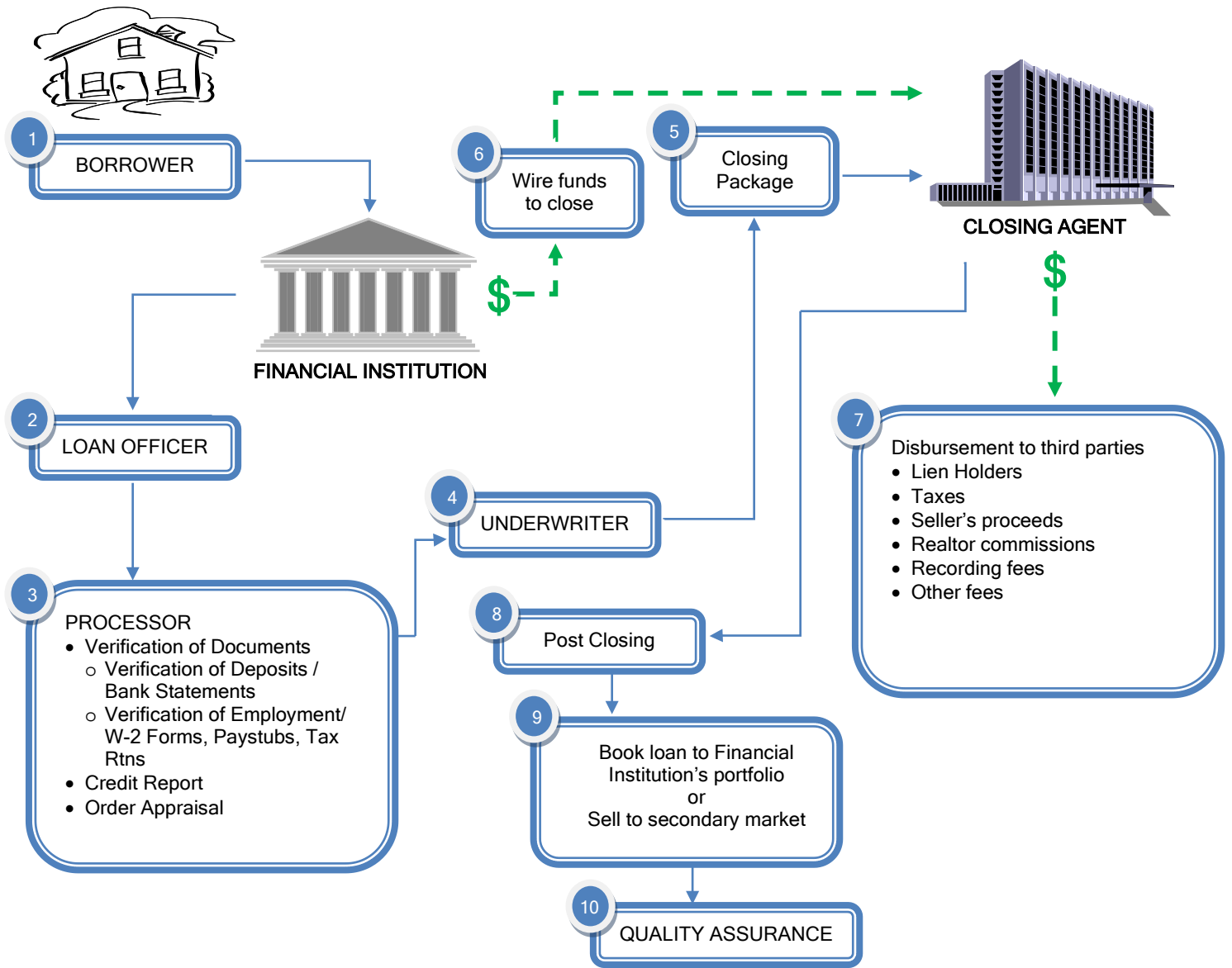
Short-term borrowing of funds by a mortgage banker based on the collateral of warehoused loans. This form of interim financing is used until the warehoused loans are sold to a permanent investor.

Warranty Deed

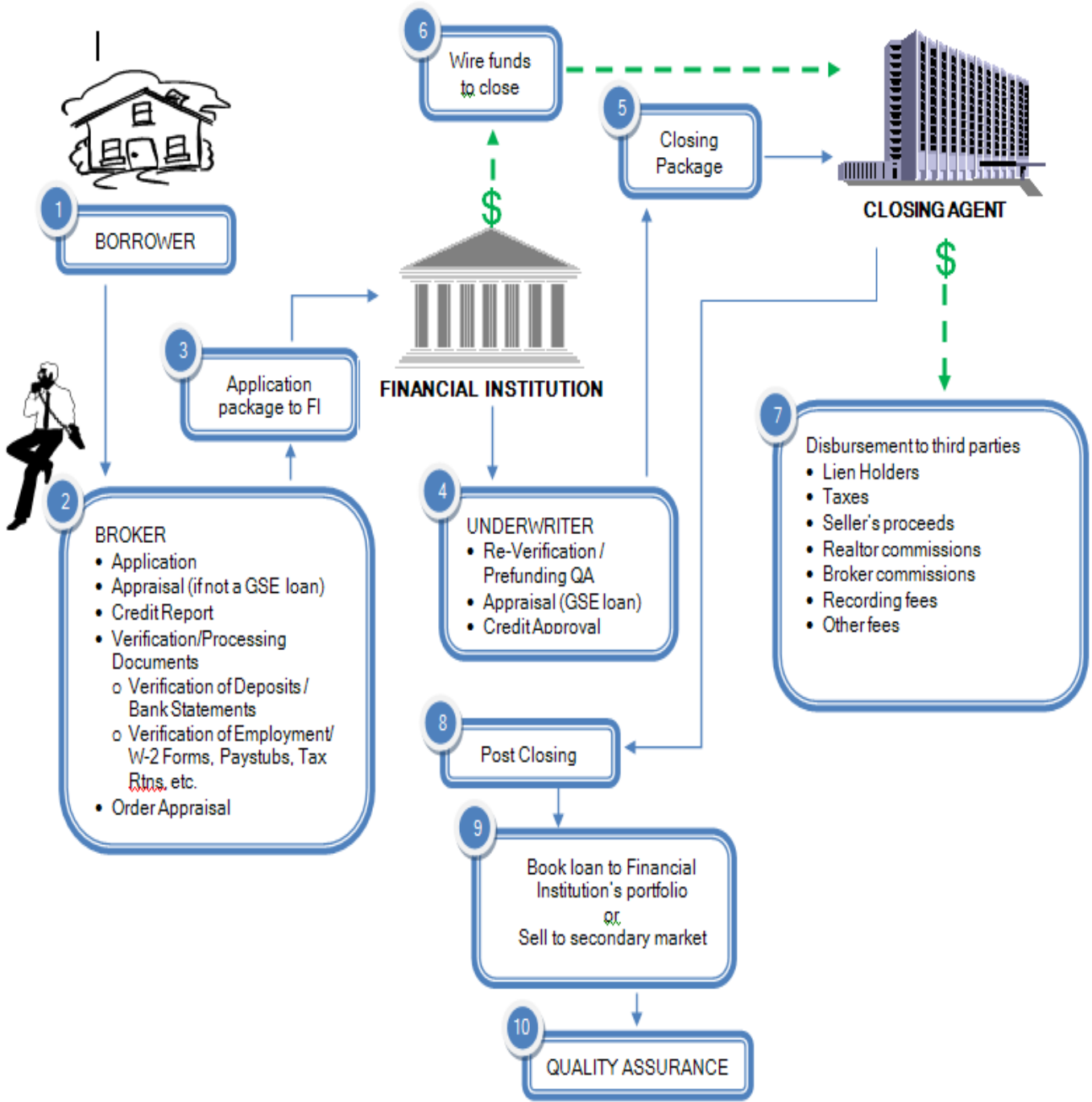
A deed warranting that the grantor has a title free and clear of all encumbrances and will defend the grantee against all claims against the property.

# Appendix B

## BASIC RETAIL TRANSACTION



# BROKER TRANSACTION



## Appendix C

### Criminal Statutes

The following is a partial list of federal criminal statutes that may be violated by perpetrators of third party mortgage fraud. This list is not exhaustive and only provides a brief description of the statute. For further detail, please visit the [GPO Access](#) website. The final decision as to whether a participant in third party mortgage fraud will be prosecuted and under which statute a participant would be charged rests with the U.S. Department of Justice. Additionally, such fraud may violate state laws.

Statute	Brief Description	Description
<a href="#">12 U.S.C. § 1829</a>	Penalty for Unauthorized Participation by Convicted Individual	Prohibits individuals convicted of any criminal offense involving dishonesty or a breach of trust or money laundering, or who has agreed to enter into a pretrial diversion regarding such an offense from (i) becoming or continuing as an Institution Affiliated Party IAP; (ii) owning or controlling a financial institution; or (iii) participating in the conduct of the affairs of a financial institution.
<a href="#">18 U.S.C. § 371</a>	Conspiracy to Defraud	Prohibits a conspiracy of two or more persons to commit a federal offense or to defraud the United States or any agency.
<a href="#">18 U.S.C. § 506</a>	Seals of U.S. Depts. or Agencies	Prohibits the misuse of any fraudulently made, forged, counterfeited, or altered seal of any federal government agency or department.
<a href="#">18 U.S.C. § 709</a>	False Advertising or Indication of Agency	Prohibits any business, firm, or person engaged in the banking, loan, brokerage, factorage, insurance, indemnity, or savings or trust business from using the terms “national,” “Federal,” “United States,” “reserve,” or “Deposit Insurance.” Also prohibits use or misuse of numerous other federal terms as part of a business, firm, or person’s name or advertising.
<a href="#">18 U.S.C. § 1001</a>	False Statements	Prohibits (i) falsifying or concealing a material fact, (ii) making a materially false or fraudulent misrepresentation or statement, or (iii) making or using any false writing or document knowing that it contains a materially false, fictitious, or fraudulent statement, in any matter within the jurisdiction of the U.S. Government.
<a href="#">18 U.S.C. § 1005</a>	False Entries	Prohibits false entries in any book, report, or statement of an insured institution, with intent to injure or defraud such institution or any other company, or to deceive any officer of such institution or its regulators.

Statute	Brief Description	Description
		<p>Also prohibits unauthorized making, drawing, issuing, or assigning of any certificate of deposit, draft, order, note, or mortgage.</p> <p>Additionally, prohibits the participation, sharing or receipt of (directly or indirectly) any money, profit, property, or benefits through any transaction, loan, commission, contract, or any other act of any insured financial institution with intent to defraud the United States or any agency, or any insured financial institution.</p>
<a href="#">18 U.S.C. § 1010</a>	Department of Housing and Urban Development and Federal Housing Administration transactions	Prohibits the making, or publishing any statement, knowing the same to be false, or altering, forging, or counterfeiting any instrument, paper, or document, or willfully overvaluing any security, asset, or income, for the purpose of obtaining any loan, with the intent that such loan will be offered to the Department of Housing and Urban Development for insurance, or otherwise attempting to influence in any way the action of the Department.
<a href="#">18 U.S.C. § 1014</a>	False Statements on a Loan or Credit Application	Prohibits oral or written false statements or misrepresentations made knowingly on a loan or credit application to an insured institution, i.e., willful over-valuing of land, property, securities or other assets or understatement of liabilities.
<a href="#">18 U.S.C. § 1028</a>	Unlawful Use of Identification	Prohibits the knowing use, without lawful authority, of a means of identification, such as an individual's social security number or date of birth, of another person with the intent to commit a crime.
<a href="#">18 U.S.C. § 1028A</a>	Aggravated Identity Theft	Prohibits, during and in relation to felony violations of certain laws (including, but not limited to, embezzlement or misapplication of bank funds; fraud or false statements; mail, bank, and wire fraud), the knowing use, transfer or possession, without lawful authority, of a means of identification, such as an individual's social security number or date of birth, of another person with the intent to commit a crime.
<a href="#">18 U.S.C. § 1029</a>	Fraud and Related Activity in Connection with Access Devices	Prohibits the production, use, and trafficking in counterfeit access devices (credit or debit cards), and the use of unauthorized access devices aggregating \$1,000 or more during a one-year period, done knowingly and with intent to defraud.
<a href="#">18 U.S.C. § 1030</a>	Computer Fraud	Prohibits knowingly accessing a computer without authorization or having accessed a computer with authorization, using it for unauthorized purposes,

Statute	Brief Description	Description
		e.g., obtaining information contained in records of financial institutions.
<a href="#">18 U.S.C. § 1341</a>	Mail Fraud	Prohibits use of the mail system in the furtherance of a fraudulent scheme.
<a href="#">18 U.S.C. § 1342</a>	Fictitious Name or Address	Prohibits the use of a false, assumed, or fictitious name, address, or title for the furtherance of a fraudulent scheme, which is carried out by means of the postal service.
<a href="#">18 U.S.C. § 1343</a>	Wire Fraud	Prohibits any scheme or artifice to defraud or to obtain property or money through use of wire, telephone, radio or television transmissions in interstate commerce.
<a href="#">18 U.S.C. § 1344</a>	Bank Fraud	Prohibits the use of a scheme or artifice to defraud an insured institution or to obtain, through misrepresentations, any of the monies, funds, credits, assets, securities, or other property owned by, or under the control of, the institution.
<a href="#">18 U.S.C. § 1517</a>	Obstructing Examination of Financial Institution	Prohibits corruptly obstructing or attempting to obstruct any examination of a financial institution by an agency of the United States with jurisdiction to conduct an examination of such financial institution.
<a href="#">18 U.S.C. § 1519</a>	Destruction, Alteration or Falsification of Records	Prohibits the knowing destruction, mutilation, concealment, alteration or falsification of records with intent to impede, obstruct, or influence the investigation of any matter within the jurisdiction of any department or agency of the United States.
<a href="#">18 U.S.C. §§ 1951-1961</a>	Racketeer Influenced and Corrupt Organizations (RICO)	Commonly referred to as "RICO" statutes. Prohibits investments in any enterprise affecting interstate commerce if the funds are derived from a "pattern of racketeering activity". These activities include murder, drug dealing, bribery, robbery, extortion, counterfeiting, mail fraud, embezzlement from pension funds, wire fraud, obstruction of criminal investigations, and fraud in the sale of securities.
<a href="#">18 U.S.C. § 1956</a>	Laundering of Monetary Instruments	A RICO statute that makes it illegal to conduct or attempt to conduct a financial transaction knowing that the property involved in the transaction represents the proceeds of some form of illegal activity. There must be intent to promote the carrying on of specified unlawful activity or knowledge that the transaction is designed in whole or in part to conceal or disguise the nature, location, source, ownership, or control of the proceeds of unlawful activity or to avoid a transaction-reporting requirement under state or federal law.
<a href="#">18 U.S.C. § 1957</a>	Engaging in Monetary	This RICO provision makes it illegal to engage or

Statute	Brief Description	Description
	Transactions in Property Derived from Specified Unlawful Activity	attempt to engage in a monetary transaction including deposits, withdrawals, transfers, or exchanges in property constituting, or derived from, proceeds obtained from a criminal offense knowing that it is criminally derived property and has a value of over \$10,000.
<a href="#">18 U.S.C. § 2314</a>	Transportation of Stolen Goods, Securities, etc.	Prohibits transportation of stolen goods, securities, moneys, or falsely made, forged, altered or counterfeited securities in interstate commerce. Obtaining money from a financial institution on either a forged check of any amount or a fraudulently obtained check of \$5,000 or more, which is drawn on a financial institution in another state, comes under this section since it is transported in interstate commerce.
<a href="#">31 U.S.C. § 5322</a>	Criminal Penalties for BSA Violations	Prohibits violations of enumerated sections of the Currency and Transactions Reporting Act.
<a href="#">31 U.S.C. § 5324</a>	Structuring Transactions to Evade Reporting Requirements	Prohibits the structuring of transactions to evade reporting requirements under 5313(a), 5325, an order issued under 5326, regulations issued under Section 21 of the FDIA or Section 123 of Public Law 91-508.
<a href="#">42 U.S.C. § 408</a>	Fraud in connection with Social Security identification documents	Prohibits falsely using a number as a legitimate social security account number, with intent to deceive and for the purpose of obtaining anything of value from any person, or for any other purpose.

## Appendix D

### References & Resources

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