Mortgage fraud. FBI Congressional testimony.

Congressional Testimony

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Introductory Statement:

Good morning Mr. Chairman and Members of the subcommittee. I want to thank you for the opportunity to testify before you today about the FBI's efforts in combating mortgage fraud. Although there is no specific statute that defines mortgage fraud, each mortgage fraud scheme contains some type of "material misstatement, misrepresentation or omission relied upon by an underwriter or lender to fund, purchase or insure a loan." The Mortgage Bankers Association (MBA) projects $2.5 trillion in mortgage loans will be made this year. The FBI compiles data on mortgage fraud through Suspicious Activity Reports (SARs) filed by financial institutions, and Department of Housing and Urban Development Office of Inspector General (HUD-OIG) reports. The FBI also receives complaints from the industry at large.

A significant portion of the mortgage industry is void of any mandatory fraud reporting. In addition, mortgage fraud in the secondary market is often under reported. Therefore, the true level of mortgage fraud is largely unknown. The mortgage industry itself does not provide estimates on total industry fraud. The industry provides incomplete or inconsistent fraud data. Based on various industry reports and FBI analysis, mortgage fraud is pervasive and growing.

The FBI investigates mortgage fraud in two distinct areas: Fraud for Housing and Fraud for Profit. Fraud for Profit is sometimes referred to as "Industry Insider Fraud" and the motive is to remove equity, falsely inflate the value of the property or issue loans based on fictitious property(ies). Based upon existing investigations and mortgage fraud reporting, 80% of all reported fraud losses involve collaboration or collusion by industry insiders. These schemes involve industry insiders to override lender controls. Fraud for Housing represents illegal actions perpetrated solely by the borrower. The simple motive behind this fraud is to acquire and maintain ownership of a house under false pretenses. This type of fraud is typified by a borrower who makes misrepresentations regarding his income or employment history to qualify for a loan.

For the past 18 months, the FBI has been evaluating the effectiveness of its national mortgage fraud program. In June 2004, I authorized the consolidation of the mortgage fraud program into the Financial Crimes Section of the FBI?s Criminal Investigative Division. Previously, mortgage fraud that impacted government programs (i.e.HUD) was managed by the Integrity in Government Section. Mortgage fraud affecting financial institutions was managed by the Financial Crimes Section. This consolidation provides the FBI a more effective and efficient management over mortgage fraud investigations. Second, I encouraged an overall strategy to addresses mortgage fraud on a proactive basis utilizing partnerships with federal agencies, state and local law enforcement, regulatory bodies, and private industry. Third, I assured adequate personnel resources were dedicated to emerging mortgage fraud problems in regions of the country encountering the greatest levels of fraud. And finally, the FBI adopted an overall strategy to focus on insiders harming the industry in order to disrupt and dismantle entire criminal enterprises.

The FBI defines industry insiders as appraisers, accountants, attorneys, real estate brokers, mortgage underwriters and processors, settlement/title company employees, mortgage brokers, loan originators and other mortgage professionals engaged in the mortgage industry. Through a mandatory reporting mechanism, industry insiders would be the front line in preventing mortgage fraud. Zero tolerance within the industry combined with a mandatory system of reporting fraudulent activities to the FBI and HUD will be a major step in addressing mortgage fraud.

The defrauding of mortgage lenders should not be compared to predatory lending practices which primarily affect borrowers. Predatory lending typically affects senior citizens, lower income and challenged credit borrowers. Predatory lending forces borrowers to pay exorbitant loan origination/settlement fees, sub prime or higher interest rates, and in some cases, unreasonable servicing fees. These practices often result in the borrower defaulting on his mortgage payment and undergoing foreclosure or forced refinancing. As one example, in 2002 and 2003, FBI, HUD-OIG and state and local agencies from Utah pursued allegations that Fairbanks Capital Corporation was engaged in predatory servicing practices. This particular case culminated in civil and other administrative actions taken by the Department of Justice.

Market Impact:

The potential impact of mortgage fraud on financial institutions and the stock market is clear. If fraudulent practices become systemic within the mortgage industry and mortgage fraud is allowed to become unrestrained, it will ultimately place financial institutions at risk and have adverse effects on the stock market. Investors may lose faith and require higher returns from mortgage backed securities. This may result in higher interest rates and fees paid by borrowers and limit the amount of investment funds available for mortgage loans.

Often times, mortgage loans are sold in secondary markets or are used by financial institutions as collateral for other investments. Repurchase agreements have been utilized by investors for protection against mortgage fraud. When loans sold in the secondary market default and have fraudulent or material misrepresentation, loans are repurchased by the lending financial institution based on a "repurchase agreement." As a result, these loans become a non performing asset. In extreme fraud cases, the mortgage backed security is worthless. Mortgage fraud losses adversely affect loan loss reserves, profits, liquidity levels and capitalization ratios, ultimately affecting the soundness of the financial institution.

Proactive Approach to Mortgage Fraud:

Over the past five years, the FBI has implemented new and innovative methods to detect and combat mortgage fraud. One of these proactive approaches was the development of a property flipping analytical computer application, first developed by the Washington Field Office, to effectively identify property flipping in the Baltimore and Washington areas. The original concept has evolved into a national FBI initiative which employs statistical correlations and other advanced computer technology to search for companies and persons with patterns of property flipping. As potential targets are analyzed and flagged, the information is provided to the respective FBI field office for further investigation. Property flipping is best described as purchasing properties and artificially inflating their value through false appraisals.The artificially valued properties are then repurchased several times for a higher price by associates of the ?flipper.?After three or four sham sales, the properties are foreclosed on by victim lenders. Often flipped properties are ultimately repurchased for 50-100% of their original value.

Other methods employed by the FBI include sophisticated investigative techniques, such as undercover operations (UCO's) and Title III wire taps. These investigative measures often result in collecting valuable evidence and provide an opportunity to apprehend criminals in the commission of their crimes and reduce losses to financial institutions. These proactive methods do not preclude historical investigations; however, they provide the FBI with additional tools to conduct large scale investigations through operational efficiencies.

In August 2002, the Cleveland FBI Office culminated a two-year UCO targeting industry insiders. The UCO focused on mortgages settled by American Home Loans employees and corrupt professionals including appraisers, accountants, mortgage brokers and loan originators. Representatives of American Home Loans were able to orchestrate the scheme by fabricating loan applications and the supporting documentation (W-2s, tax returns, employment/income and bank verifications). As a result, industry insiders were able to circumvent the safeguards of numerous finance companies. The pervasive loan fraud caused property values to be artificially inflated in the greater Cleveland area. Through this UCO, more than 150 targets were identified, 23 search warrants were executed, and 94 targets were indicted, including two accountants, four title company employees, five appraisers, eight underwriters and forty loan brokers.

On September 16, 2004 an undercover mortgage fraud investigation conducted by the FBI Charlotte Division resulted in the identification of more than 35 industry insiders, and more than 380 fraudulent loans exceeding $70 million. In November 2002, the investigation was initiated due to numerous complaints by the North Carolina State Bureau of Investigation and lenders regarding high loan default rates within a short period of time. The FBI identified a pattern of pervasive mortgage fraud in the greater Charlotte area. The investigators determined the most efficient and effective approach to this investigation was an UCO. This not only resulted in the identification of a large number of corrupt industry insiders, but also prevented further fraudulent mortgages. Seven plea agreements have been signed to date; the investigation is ongoing.

Fraud Trends:
Although there are many mortgage fraud schemes, the FBI is focusing its efforts on those perpetrated by industry insiders. The FBI is engaged with the mortgage industry

in identifying fraud trends and educating the public. Some of the current rising mortgage fraud trends include: equity skimming, property flipping and mortgage identity related theft. Equity skimming is a tried and true method of committing mortgage fraud and criminals continue to devise new schemes. Today's common equity skimming schemes involve the use of corporate shell companies, corporate identity theft and the use or threat of bankruptcy/foreclosure to dupe homeowners and investors. Property flipping is nothing new; however, once again law enforcement is faced with an educated criminal element that is using identity theft, straw borrowers and shell companies, along with industry insiders to conceal their methods and override lender controls. It should also be noted that identity theft in its many forms is a growing problem and is manifested in many ways, including mortgage documents. The mortgage industry has indicated that personal, corporate and professional identity theft in the mortgage industry is on the rise. Computer technology advances and the use of online sources have also assisted the criminal in committing mortgage fraud. However, the FBI and its law enforcement and industry partners are working together to identify trends and develop techniques to thwart illegal activities in this arena.

Law Enforcement Partnerships:

In 1999, the FBI joined forces with HUD-OIG to establish the Housing Fraud Initiative (HFI)Task Force. As a result, numerous successful joint investigations were conducted in New York, Baltimore, Washington D.C., Chicago, Los Angeles, and Dallas. The FBI is actively investigating mortgage fraud in those cities and continues to promote joint investigations with HUD-OIG and other federal, state and local law enforcement and regulatory agencies wherever mortgage fraud is prevalent.

With regard to the HFI initiative the following serve as examples of successful joint investigations:

A two-year joint investigation by the FBI , the IRS, and HUD-OIG revealed a fraud for profit scheme committed by several insiders of First Beneficial Mortgage Corporation. This two year fraud was perpetrated against Fannie Mae and Ginnie Mae home loan programs resulting in losses exceeding $30 million. Recently, the president of First Beneficial Mortgage Corporation and six others were convicted on conspiracy, bank fraud, wire fraud, and money laundering charges. The president was sentenced to 21 years in prison, ordered to pay $23 million in restitution and forfeited about $8 million in property.

A joint investigation conducted by the Los Angeles FBI Office and HUD-OIG illustrated an extensive scheme in which fraudulent identification and employment documents were used to perpetrate mortgage frauds. The scheme was largely assisted by an individual who regularly manufactured false identity and income documents for a profit. This document forger created W-2s, pay stubs, credit letters and social security printouts over an eight-year period. These documents were used by real estate professionals who knowingly submitted the falsified information to lending institutions. The loans were then insured by HUD and caused a loss to that agency of more than $18 million. A search warrant executed during the investigation revealed more than 100 real estate professionals had ordered false documents in the past. To date, the document forger and six associates have been convicted in the scheme, as well as fourteen real estate professionals.

A two-year joint investigation conducted by the Kansas City FBI Office, IRS, and HUD-OIG culminated on August 13, 2004 with the arrest of a local real estate investor. The real estate investor and three business associates were charged in U.S. District court for their alleged roles in purchasing run-down properties, securing fraudulent appraisals and obtaining mortgages in the names of straw purchasers. The straw purchasers were allegedly paid $2,000 for their role in the scheme whereby they placed properties in foreclosure, leaving the real estate investor and his associates with the mortgage proceeds. This scenario was repeated approximately 300 times, resulting in losses to lending and financial institutions in excess of $15 million.

Industry Liaison:

The FBI focuses on fostering relationships and partnerships with the mortgage industry to promote mortgage fraud awareness. Over the past two years, the FBI has spoken at and participated in various mortgage industry conferences and seminars, including those sponsored by the MBA. This year the FBI will be speaking at and participating in the MBA's 91st Annual Convention and Expo. The MBA estimates that six thousand industry leaders will attend this conference.

To raise awareness of this issue and provide easy accessibility to investigative personnel, the FBI has provided contact information for all FBI Mortgage Fraud Supervisors to relevant groups including the MBA, Mortgage Asset Research Institute, Fannie Mae, Freddie Mac and others. Additionally, the FBI is collaborating with industry to develop a more efficient mortgage fraud reporting mechanism for those not mandated to report such activity. This Suspicious Mortgage Activity Report (SMARt Form) concept is under consideration by the MBA. The FBI supports providing a "safe harbor" for lending institutions, appraisers, brokers and other mortgage professionals similar to the provisions afforded to financial institutions providing SAR information. The "Safe Harbor" provision would provide necessary protections to the mortgage industry under a mandatory reporting mechanism. This will also better enable the FBI to provide reliable mortgage fraud information based on a more representative population in the mortgage industry.

A recent analysis of mortgage industry fraud surveys identified 26 different states as having significant mortgage fraud problems. Although every survey identified Georgia and Florida as having significant mortgage fraud related investigations, the survey also identified nine other states in the South and Southwest, seven states in the West and five states in the Midwest as having mortgage fraud problems. Once again, these studies illustrate the need for increased coordination among industry and law enforcement on mortgage fraud.

Lenders are increasingly aware that fraud is affecting their bottom line. Through routine interaction with FBI personnel, industry representatives are aware of our commitment to address this crime problem. The FBI frequently participates in industry sponsored fraud deterrence seminars, conferences and meetings which include topics such as quality control and industry best practices to detect, stop and prevent mortgage fraud. These meetings play a significant role in training and educating industry professionals. Companies share current and common fraud trends, loan underwriting weaknesses and best practices for fraud avoidance. These meetings also increase the interaction between industry and FBI personnel.

Additionally, the FBI continues to train its personnel and conduct joint training with HUD-OIG and industry on mortgage fraud. As a training model, the FBI seeks industry experts to assist in its internal training programs. In this past year, industry has assisted training FBI personnel on mortgage industry practices, documentation, laws and regulations. Industry partners have offered to assist the FBI in developing advanced mortgage fraud investigative training material and fraud detection tools.

Conclusion:

In conclusion, the FBI is committed to increasing liaison and education efforts and partnering with federal, state, and local law enforcement, and private industry to combat mortgage fraud. The FBI supports new approaches to address mortgage fraud and its effects on the U.S. financial system, to include:

a mechanism to require the mortgage industry to report fraudulent activity,

and

the creation of ?Safe Harbor? provisions to protect the mortgage industry under a mandatory reporting mechanism.

Mr. Chairman, the FBI looks forward to working with you and other members of this committee on solving this problem. Thank you for allowing me the opportunity to testify before you today. I will be happy to entertain any questions you may have.