New Markets,

New Products,

New Territories…Same Old Fraud??

Mortgage Fraud Conference – December 11-12, 2006

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New Markets, New Products, New Territories…

- Education both Internal and External
- Embrace the opportunity to serve emerging markets by developing trust and awareness
- Know your market and develop a plan that best will serve that market
- Get involved in the communities and become a part of the communities you want to serve
- Understand the culture, be sure you are educated not only on the culture but also the differences
New Markets, New Products, New Territories…

- Develop products that meet specific needs and that are not one size fits all
- Determine what is important to each market and work to meet those needs
- Involve all departments when embarking on a new market, get all points of view
- Ensure staff understands what is necessary to be successful
- Update systems, websites, brochures, disclosures, etc.
New Markets, New Products, New Territories…

- Develop alternative methods for communication specific to your market

- Associates need to be bilingual including loan officers, product associates, customer service, etc.

- Documents should be written in the native languages

- Staff needs to embrace the culture, understand the customer needs, be versed in the product and communicate this effectively
New Markets, New Products, New Territories…

- Provide training to prospective customers on the mortgage experience in their native language

- Ensure there is an understanding of the requirements, employment, credit assets, etc.

- Ensure understanding of non-traditional income, asset and credit requirements

- Provide staff training on how to verify requirements, alternative methods and tools available
New Markets, New Products, New Territories…

Understand that the criminal element exists in all markets

- Conduct proper due diligence on all files
- Verify alternative or non-traditional income assets as required
- Know Your Customer and ensure that proper identity checks are conducted
- Associates should be bilingual to understand customers native language, read and understand documents
- Understand the immigration requirements to better serve the community
Criminal Element Current Trend – Home Equity Bust Out Scheme

- Taking place in counties in NY, NJ, IL and CA that are experiencing long recording delays
- Potential borrowers (victims) are solicited by fraudsters posing as trusted members of their community
- Borrowers are targeted based on available equity in their property
- Are promised large payouts and convinced they are doing nothing wrong as it is their property
- Coached to apply for several Home Equity loans all on the same day at various lenders
- Employment, Assets, credit history many times are enhanced
New Markets, New Products, New Territories…

Criminal Element Current Trend – Home Equity Bust Out Schemes (Cont’d)

- Coaches often contact the lenders to speed up the process

- Loans all simultaneously fund, lenders think they are in the right lien position

- Taking advantage of long recording delays, lenders lien eventually is recorded and lender is in 6th, 7th, 8th, etc. position

- Losses realized can be steep; consider for example a property worth $300,000 where 10 home equities were obtained, the total outstanding would be $3 million and the last lender is in 10th position
Criminal Element Red Flags – Home Equity Bust Out Scheme

- Credit reports contained numerous inquiries from other financial institutions within a short period of time
- Identity discrepancies, name, social security number, etc.
- Income not consistent with employment information provided
- Alerts on credit report
- Same phone number listed as “call back numbers” appeared on many different applicants applications
New Markets, New Products, New Territories…

Criminal Element Prevention – Home Equity Bust Out Scheme

- Investigate numerous inquiries, contact necessary individual, institutions, etc.
- Ensure you Know Your Customer and validate the borrower’s identity
- Conduct a reasonability test for income and employment
- Follow up and pursue all alerts on the credit report
- Question phone number similarities and discrepancies
New Markets, New Products, New Territories…

In Closing….

**Demonstrate trust and be visible in the community**

- Network with your peers in the industry and talk about what you are seeing, experiencing, etc.

- Keep current on market trends - not just mainstream publications - and disseminate information throughout your organization

- Have a robust up-front Fraud monitoring and Quality Control process to quickly identify issues

- Develop a partnership with Investors, GSE’s to collaborate and in turn share in the risk throughout the experience

- If an issue is identified engage law enforcement to ensure the fraudsters are stopped
Fraud Schemes and Emerging Issues

Case Study 1: One Transaction Flips
One Transaction Flip

Historically, to execute a property flip transactions required two transactions:

1. Purchase of the subject property for the true market value
2. Resale of the subject property at a significantly inflated value
New Scheme –
One Transaction Flip

• Middle man connects parties wishing to sell real estate with parties wishing to enter into the lucrative investment property business

• Of course for no money down on the part of the investor
How the One Transaction Flip Works

• Middle man enters into an agreement with property seller to bring them a contract that will net them out the proceeds needed
• Middleman and/or associates then hold Get Rich on Real Estate With No Money Down seminars at the local Marriott! (These guys are really good!)
The Loan Process – One Transaction Flip

• Stated or no document program often selected
• Borrower has good credit score
• Often executed in markets where property valuation tools are minimally effective (i.e., Indiana)
The Closing – One Transaction Flip

- The seller receives the net $70,000 promised by the Middle Man
- A certified check is presented but the true source of the funds is the middle man
- The excess proceeds (total loan amount less the $70,000 to seller) is disbursed to the middle man (or related party) on the seller side of the HUD-1
The Control – One Transaction Flip

• The distribution on the seller side of the HUD-1 in of itself is not illegal.
• Additional controls around the availability of stated or no document loan programs for investment properties
• Added language to instructions to closing agents
Additional Language to Closing Instructions, Example

“Any disbursements in excess of $X,000 that are not related to normal closing cost or for lien related items, as identified in the title commitment binder, must be approved by Mortgage Company in advance of any disbursements”
Fraud Schemes and Emerging Issues

Case Study 1: Miami Mystery
Objectives

• Definition of Emerging Market
• Why serve Emerging Market
• How will New Immigration Laws affect Emerging Markets
• Current Products and what will future reveal
• Fraud Prevention Steps
• Loan Fraud Types and "Red Flags"
• Is Technology the Answer to Fraud?
Definition Of Emerging Markets

• The GSE’s define “Emerging Markets” as Minorities and New Immigrants. These groups offer huge growth opportunities.

• The Mortgage Industry should develop new credit underwriting tools to meet these specific needs of communities.

• This is the growth market and a great opportunity for everyone involved.

• Cultural sensitivity is the key to becoming successful.
Why Serve Emerging Markets?

• Previously emerging markets were centered in CA, TX, FL and New York
  – Today immigrant population is growing outside these states
• Home Ownership is the best way to fully embed immigrants into US society
  – Increased dependency, trust & interaction between cultures
  – Allow them to share in the “American Dream”
Immigration Laws

• How will the change in the US Congress play?
• Could there be any mass deportation effort or will a full amnesty be granted?
• How will either of these affect repayment of the Mortgage Loans?
• Is the Federal Tax Identification Number enough?
Products Now and in the Future?

- Interest Only
- Low Doc
- No Doc
- No Ratio
- 40 Year Mortgages
- 50 Year Mortgages
- Option Arms
- New “Exotic” Products in the Future?
- AVM’s or other web based market value services
- Back to 125% LTV's?
- Are we really changing or CYCLING?
Basic Steps . . .

- Know who you are doing business with
- Conduct background checks on your brokers and correspondents (criminal and civil, run news articles)
- Loan Level - watch out for ID Theft, biggest type of fraud in US today
- Pay attention to Credit Alerts
- If possible, use the Pre-funding Tools that are available today
Basic Steps . . .

• Call and verify job at least once during processing of loan

• Make sure someone checks borrower's ID at closing

• Immigrants are sometimes preyed upon by criminals
  – Immigrants not understand the mortgage process, are sometimes used as "straw buyers" and can become victims in pattern frauds.
Flipping Scenarios

• $100,000 property purchased at Real Market Value by Con Man A from seller

• Two seconds later Con Man A sells the same property to Con Man B (his Partner) for $500,000

• Con Man B applies to ABC Mortgage for an 80/20 for $400,000 and $100,000 (obviously Con Man A & B have an appraiser in their pocket)

• Con Man B gets approved by ABC Mortgage, the seller gets $100,000

• Con A & B split $400,000
Red Flags for Flipping

- Excessive down payment on 1003
- Seller not in title (refer to Title Commitment, Schedule B)
- Seller recently took title (refer to Title Commitment, Schd B)
- Recent sales with much lower amounts
  - HUD transfer (refer to Title Commitment, Schedule B and Appraisal Report, Page 2 - transfers in last 12 months)
- Large amounts for recent deposits on VODs or Bank Statements
Red Flags for Flipping

• Large gift funds or gifts of equity
• Large seller concessions
• Numerous loans to one borrower in same neighborhood
• Loans with same borrower, loan officer, realtor, appraiser, seller, closing agent/attorney
Straw Buy

• Straw Buy: to substitute a person's credentials for someone else's. Straw buy is not only used in mortgages but in stocks, corporate transfers and other financial transactions.

• Two types of Straw Buy: relative/friend/employer who is trying to help someone and the paid straw buy who is normally associated with "flips," builder bailouts, and schemes.
Red Flags for Straw Buy

• Down payment from someone other than borrower
• Borrower buying down
• No realtor involved in transaction
• Other party on purchase agreement but not on 1003
Red Flags for Straw Buy

- Additional name to be added on legal documents
- Credit Bureau in file for someone other than borrower
- Unrealistic distance for commute to job
Red Flags for Straw Buy Refinance

- Related parties
- No realtor involved in transaction
- Delinquent taxes (refer to Title Commitment)
- Lis Pendens, borrower in foreclosure (refer to Title Commitment)
Red Flags for Straw Buy Refinance

• Borrower buying down

• Purchasing at market value even though related parties

• Questionable down payment (e.g. gifts, notes, etc.)
Market has slowed and the builder has a construction loan on a condo project:

• Builder either goes into default or comes up with “ingenious financing”
Builder Bailout

• Advertises “buy a unit, no money down, get rental income”

• The builder is also the seller, so the appraiser uses other units in the development as comps and increases values
Builder Bailout

- The “no money down” becomes a silent 2\textsuperscript{nd} (normally a 3 or 5 year balloon)
- Borrowers go to refinance the balloon at a later date
  - Value not supported
  - Project defaults
Red Flags for Builder Bailout

- Excessive down-payment
- Sometimes owner occupied in investment market
- Gifts
- Condo sales in slow to medium market
Red Flags for Builder Bailout

• Usually all 80% LTVs
• Inflated values
• All comps are in same condo project
• Numerous loans to one borrower
• Sometimes loans to builder’s employees
Is Technology the Answer?

• Yes it is!!
• There is a new product almost every month in every facet of our industry
• Background checks are conducted on companies/officers we do business with
• Front end systems
• In Pre-funding
• Automated Underwriting
Is Technology the Answer?

- Servicing
- Quality Control
- Internal Audit
- Legal
- Compliance
- So on and so on and so…
The Real Estate Contract – One Transaction Flip

- Middle man brings the seller and the buyer together.
- Although the seller only needs to net $70,000 in proceeds, the sales price is listed at $130,000.
- Often the buyer enters into the contract site unseen, and may be out of state borrower.
Miami Mystery

- A loan application for a purchase transaction was presented to a lender by a mortgage broker.
- The applicant was shown as a financial executive earning $15,000 per month.
- The file included a bank statement indicating assets in excess of $100,000.
Miami Mystery, continued

• The borrower had a credit score of 800
• The broker ordered an appraisal in the normal course of business
• An appropriate appraisal was completed and a proper estimate of fair value was ascertained
Miami Mystery, continued

• The lender performed a successful independent verbal verification of employment using a reverse telephone search on the internet
• The lender also performed a verbal verification of assets confirming the bank statement in file was an active account
Miami Mystery, continued

- The borrower selected the settlement agent to handle the closing

- Both the lender and the settlement agent followed standard protocol in the approval of the preliminary HUD-1 Settlement Statement
Miami Mystery, continued

• The settlement agent did provide a closing protection to the lender from the major title underwriting company who they were agents for.

• All appropriate due diligence steps appeared to be completed and the lender wired monies to the closing agent’s account for closing.
Miami Mystery, continued

• A few days after the closing the broker called the lender complaining that he had not received his commission from the closing and was having difficulty in trying to contact the settlement agent.

• Oh, no...... Here is what really happened
Miami Mystery, continued

- The lender wired the funds to the settlement agents account in Orlando.
- Those funds were then automatically wired to an account in another state.
- Via telephone, the owner of second bank account depleted the funds by ordering 620 stored value cards each with a face value of $500.
Miami Mystery, continued

• The stored value cards were sent by overnight mail to an address in Boston which turned out to be a drop box
• The stored value cards were then converted to cash at two ATMs in Boston
• No one ever met the borrower as all activity was by phone or mail
Miami Mystery, continued

Once the case was investigated the lender found that:

- The supposed borrower had stolen the identity of another person to qualify for the loan.
- The true identity of the person whose identity was stolen was a janitor at a high school in Charleston earning only $2,700 per month.
Miami Mystery, continued

• The criminals actually applied for credit in Miami using in order to make it appear the borrower did reside in Miami and not Charleston

• The criminals also established telephone numbers with the local telephone company for the employer and the bank. This allowed for the lender to perform the reverse lookup.
Miami Mystery, continued

• The appraisal was completed appropriately, but the appraiser and the real estate agent for the seller had different “expectations”
• When all the dust settled the entire wire amount had to be written off as there was no substance to the transaction.
Miami Mystery, The Million Dollar Question

What could have been done to prevent this from happening?