



Mortgage Fraud Assessment

Florida Department of Law Enforcement

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Prepared by
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MORTGAGE FRAUD ASSESSMENT

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MORTGAGE FRAUD ASSESSMENT 2005

SUMMARY

The Florida Department of Law Enforcement created this assessment in order to identify the types of crimes, trends, regulations and the potential scope of mortgage fraud. This assessment highlights the areas of concern. Additional information on methods to research, identify, investigate, and prevent mortgage frauds are provided as links in this assessment.

This assessment identifies various state and federal laws that might influence mortgage fraud investigations.

Additionally, this assessment uses examples of mortgage fraud case law to provide background for investigators and prosecutors.

SCOPE:

Regulators and investigators have targeted organized mortgage fraud for decades as an intended criminal violation or as a conduit for other crimes such as real estate fraud, bankruptcy fraud, and/or money laundering.

The current real estate boom began with the drop in interest rates following the September 11, 2001 tragedy. Lower rates provided the catalyst for buyers to move into the market for the first time and for investors to leverage cash to purchase multiple properties. The initial momentum of investing into a market backed by substantial, but fair price growth has turned into real estate speculation by the masses. Many of the market prices have risen to values that are unacceptable for risk by traditional, more conservative banking and financial institutions. In order to accommodate the desire to purchase properties at these escalating prices, many speculators have turned to the secondary loan market in order to obtain financing that may have been denied by more conservative or regulated banks. The ensuing frenzy to loan money has created a market for hybrid loans that match up tolerance, risk, and profit, often at the expense of proper due diligence on the part of the lender and the buyer.

Perpetrators of various mortgage fraud schemes can be divided into industry insiders against lenders, industry insiders against borrowers, borrowers against the industry, and individual borrowers against individual sellers and vice-versa.

Historically, significant price increases in a home were scrutinized by legitimate buyers and lenders agencies as red flags. Even regulatory and law enforcement authorities monitored such high profit sales for potential signs of money laundering, illegal kickbacks/bribes or frauds (such as mortgage flipping). However, the extreme price increases in the current market have made such criminal activities easier to conceal as fair market value and excuse as a legitimate sale for profit.

Less scrupulous brokers and buyers have tapped into the unconventional private mortgage markets using various fraudulent income adjustments techniques. Without proper due diligence and fact checking, borrowers obtain loans that should have been declined based on lack of proper assets and income. (For instance, cash is placed into the account of a family member long enough to be counted as an asset, then turned back to the owner for use by other family members). Mortgage brokers who know how to manipulate the system often coordinate such actions. This pattern may not necessarily turn into lender losses if the borrower is able to make the payments, however, since most of these loans are based on adjustable interest rates, every increase in loan rates leans the borrower toward failure. Should interest rates rise dramatically, loans will fail and researchers will point out the faults in the system and the failure of banks' due diligence. The Florida Department of Financial Services, Office of Financial Regulation (OFR), has received numerous complaints of this type of fraud, however, due to limited resources, they can only target the most egregious of offenses.

Many mortgage frauds target the borrower, especially the poor and their neighborhoods. Predatory lenders provide loans to homeowners who have significant equity in their homes, then eventually foreclose on the home when the owner cannot pay the exorbitant rates and fees. Additionally, mortgage flippers, bankruptcy fraud artists, and scammers target poor neighborhoods then leave the properties in civil limbo for years as the courts sort out true ownership.

The problem with mortgage frauds, predatory lending, and mortgage flipping has been examined for more than several decades. Congress had hearings and provided recommendations to correct the problem but the issue persists. *(For further information, refer to notation 8, pages 34-36.)*

State regulatory agencies and Attorneys General have conducted investigations into predatory lenders for more than a decade. Many of these lenders are large corporations or sell their loans to these well-known public companies. Though states have fined these companies who had promised corrective action, most continue the practices and see the fines as a cost of business. Some states' investigations are interfered with as corporations complain that state rules are inconsistent between states and that such audits are duplicative of federal efforts. States, however, recognize that even though federal authorities have such powers to conduct audits, they are rarely conducted.

The implications of mortgage fraud are substantial and could have more severe repercussions than those of the corporate frauds of the late 1990's.

Even with the new bankruptcy laws, in the years to come there will be a rise in fraudulently filed bankruptcies that are linked to speculative and fraudulent mortgages. For instance, falsely inflated properties are used as collateral to purchase more properties or as collateral for other

business investments. Should the fraudulently overvalued real estate assets be required to be liquidated to raise cash, the true value of the property is revealed causing a potential chain reaction to businesses that promised cash but cannot produce it, and bankruptcies occur. For instance, the insurance market may use some real estate as collateral for a percentage of its registered customers.

The total annual and long-term cost of various types of mortgage frauds is unknown. Over the past several years, more than one investigation in Florida has uncovered mortgage frauds with over one hundred million dollars in illegal land flips. These frauds include the following: foreclosures on loans that were based on fraud; equity skimming; predatory lending; bankruptcies as a product of or caused by mortgage fraud; various urban development grant and HUD frauds; illegal property acquisitions; and a myriad of other frauds, and even substantial loss of tax revenue and legal costs. The total annual value in the frauds easily reaches the tens of billions, if not hundreds of billions of dollars. Therefore, the total actual losses are difficult to calculate.

The real estate frenzy of the first part of the new century may turn out to be a natural price surge that can be legitimately accommodated by the economy; however, the criminal activities that are part of this cycle will manifest in the years to come. As with all boom cycles, and similar to the Savings and Loan Crisis of the past, this real estate frenzy will reveal billions in yet to be discovered frauds. The end of this cycle will result in the collapse of some private institutions and potentially some public banks. As such, federal, state, local and tribal agencies will be taxed with investigations into the various frauds, laundering, and corruptions that are highlighted in this assessment.

There is a perception on the part of industry insiders and the attorneys that represents them that the mortgage and real estate market is a business where taking advantage of others is permissible if contracts are signed and each party had the opportunity for due diligence. For instance, predatory lending is considered by many to be a business opportunity that permits experts in mortgage transactions to legally take advantage of the uninformed or misinformed. Though this argument has some measure of validity, if fees and interest become usurious then it becomes a crime. Additionally, in real estate transactions, if the buyer or seller engaged in an active effort of misrepresentation and deception to mislead the other party, then a crime was committed. Many insiders perceive that it should be "buyer beware" similar to any other business investment and that such activities should be argued in civil court and not criminal. However, the reason that the mortgage and real estate industry is heavily regulated is so that buyers have confidence that a home will be built for them to live in and they should not be taken advantage of by unscrupulous and manipulative schemers. In Florida, civil case law exists that advises that if both parties had the ability for proper due diligence, then they cannot sue. Other states, such as Georgia, have mandated that the terms of loans be advantageous to the buyer.

If there are purposeful misrepresentations, schemes to defraud and deception, then the state can unambiguously charge a crime. But, when victims come to the government, they find a knotty system of various state, local and federal agencies that have civil and/or criminal jurisdiction. Victims often find that federal, state and local regulatory and law enforcement agencies are constrained by a lack of resources. Agencies measure their resources against many factors, including competing requests for assistance by corporate victims of frauds and layman

constituents who have been victimized. Some agencies, especially federal, may be prone to work cases with corporations as victims leaving fewer resources for the victimization of constituents. The resource needs also extend to prosecutors and the courts since most of these cases are complicated and costly.

Due to the lack of resources, state and federal agencies tend to initiate investigations in which there is a social, economic, regulatory or political impact. Local law enforcement agencies take on smaller, but more numerous investigations. Taxpaying constituents often find themselves “shopping” for a police agency and a prosecutor to take their case.

Law enforcement has limited resources to choose among the requests from corporations, citizens, and even government agencies who have been victimized by mortgage and real estate scams.

WHAT IS MORTGAGE FRAUD?

There are many variations of mortgage fraud. Every mortgage fraud scheme involves some type of material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase or insure a loan. Industry insiders such as brokers, appraisers, agents, lenders, underwriters, and others often are conspirators in frauds. Additionally, buyers, investors, and speculators perpetrate user/consumer level frauds against the industry in order to obtain cash or property. Corrupt government insiders who have access to information and use contacts to divert money or misuse power conduct other frauds. The Department Of Housing And Urban Development explains mortgage fraud as: defined under § 1731.2 to mean a material misstatement, misrepresentation, or omission relied upon by an Enterprise to fund or purchase — or not to fund or purchase — a mortgage, mortgage backed security, or similar financial instrument. The term would include, but not be limited to, identification and employment documents, mortgagee or mortgagor identity, and appraisals that are fraudulent. The term “possible mortgage fraud” would be defined to mean that an Enterprise has cause to believe that mortgage fraud is occurring or has occurred. *(For further details from HUD, see notation 3, page 30.)*

According to the Mortgage Bankers Association: Mortgage fraud is a “material misrepresentation — the giving of false information [or documentations] that deceives or misleads a lender into extending credit beyond the limits of what would normally be extended if the facts were known.” “Appraisal fraud is a component of mortgage fraud and generally involves the falsification of a real estate appraisal often to justify a value that may not accurately represent the true market value of the property”.

Florida law defines mortgage fraud in Chapter 494, Mortgage Brokers & Lenders/Mortgage Fraud:

- Section (4) In any practice or transaction or course of business relating to the sale, purchase, negotiation, promotion, advertisement, or hypothecation of mortgage transactions, directly or indirectly:
 - (a) To knowingly or willingly employ any device, scheme, or artifice to defraud.

- (b) To engage in any transaction, practice, or course of business which operates as a fraud upon any person in connection with the purchase or sale of any mortgage loan.
- (c) To obtain property by fraud, willful misrepresentation of a future act, or false promise.
- (d) In any matter within the jurisdiction of the office, to knowingly and willfully falsify, conceal, or cover up by a trick, scheme, or device a material fact, make any false or fraudulent statement or representation, or make or use any false writing or document, knowing the same to contain any false or fraudulent statement or entry.
- (e) To violate s. 655.922(2), subject to ss. 494.001 - 494.0077.

Further, Florida law Chapter 817.54: Obtaining of mortgage, mortgage note, promissory note, etc., by false representation. --Any person who, with intent to defraud, obtains any mortgage, mortgage note, promissory note or other instrument evidencing a debt from any person or obtains the signature of any person to any mortgage, mortgage note, promissory note or other instrument evidencing a debt by color or aid of fraudulent or false representation or pretenses, or obtains the signature of any person to a mortgage, mortgage note, promissory note, or other instrument evidencing a debt, the false making whereof would be punishable as forgery, shall be guilty of a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.

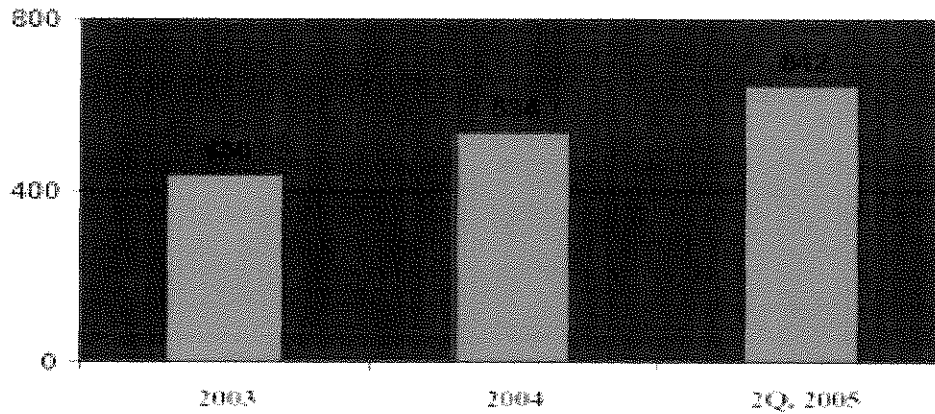
NATIONAL TRENDS, STATISTICS AND KEY FINDINGS:

"Concern about mortgage fraud against our home finance industry has reached such heightened levels that top management of every lender has to decide how they are going to address this growing threat and protect their company, their employees' jobs and the borrowers they serve," Regina Lowrie, president and chief executive of Gateway Funding Diversified Mortgage Services and incoming chairman of the bankers' group, said at a recent Mortgage Banker's Association conference held in coordination with the FBI.

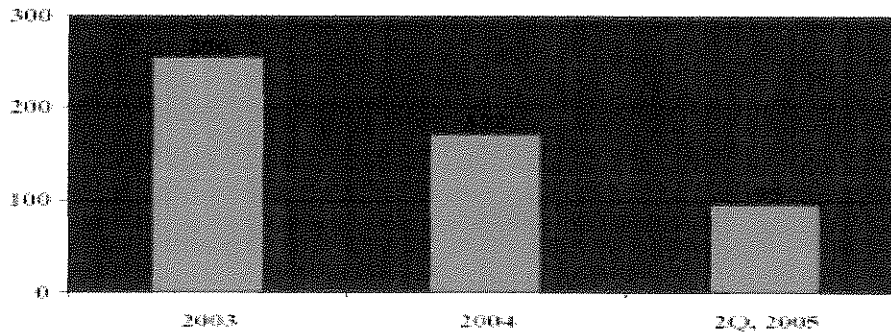
The number of FBI mortgage fraud investigations, including major undercover operations, rose from 102 in FY 2001 to approximately 550 in FY 2004. According to the FBI Report on Financial Crimes to the Public, May 2005, the number of federal mortgage fraud pending cases just within the first two quarters of 2005 is nearly double the total cases in 2003. However, this same report notes that the number of mortgage fraud convictions and pretrial diversions have diminished since 2003 by nearly 50%. While the filing of mortgage fraud indictments/informations and the collection of restitution have diminished since 2003, mortgage fraud recoveries rose to an all time high in 2004 as have the collection of mortgage fraud fines for the first two quarters of 2005.

(Source: <http://www.fbi.gov/congress/congress05/mueller021605.htm> 25feb2005) (For further information, refer to notation 7 on pages 33-34.)

MORTGAGE FRAUD PENDING CASES



MORTGAGE FRAUD CONVICTIONS/PRETRIAL DIVERSIONS

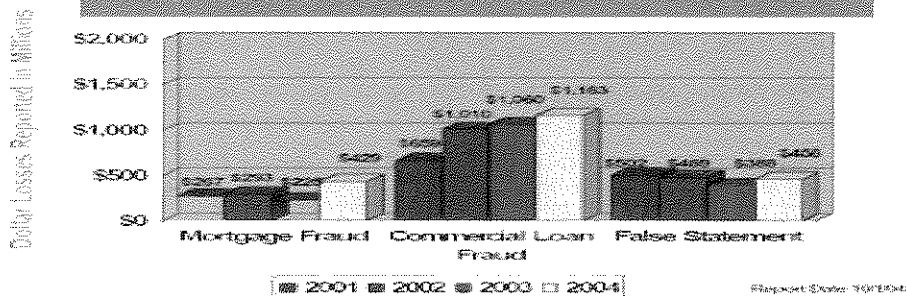


- 80% of all reported fraud losses involve collaboration or collusion by industry insiders. These schemes involve industry insiders to override lender controls.
- The average prison term handed out by federal judges to defendants in these schemes nearly doubled over the same period. FY2004 statistics reflect a three-year high in the number of cases recommended for prosecution as well as indicted, convicted and incarcerated. (Source: Internal Revenue Service)
<http://www.irs.gov/newsroom/article/0,,id=136208,00.html>
- There has been a 93% increase since 2004 in the Suspicious Activity Reports (SARs) filed by depository institutions citing mortgage loan fraud. According to the SAR Review, SARs citing mortgage loan fraud were doubled from 2003 to 2004, jumping from 9,500 to 18,300. (Source: FinCEN SAR Review May 2005 and Money Laundering Alert June 2005).

NUMBER OF VIOLATIONS OF MORTGAGE RELATED FRAUD SARs



DOLLAR LOSSES REPORTED OF MORTGAGE RELATED FRAUD SARs



- The Internal Revenue Service also reported the following four year statistics:

Statistical Information*	FY 2001	FY 2002	FY 2003	FY 2004
Case Initiations	107	166	215	194
Prosecution Recommendations	69	83	117	148
Indictment/Information Filed	67	71	94	102
Convictions	85	57	81	89
Sentenced	103	64	65	78
Incarceration Rate	71.8%	82.8%	87.7%	92.3%
Average Months to Serve	24	27	46	41

*How to Interpret Criminal Investigation Data

Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year. Therefore, in fiscal year 2004, the data should reflect an increase in convictions and sentenced due to the fiscal year 2003 increase in case initiations, prosecution recommendations and indictments.

- The following data was compiled from the *Seventh Periodic Mortgage Fraud Case Report To Mortgage Bankers Association May 2005: Mortgage Asset Research Institute, Inc. A ChoicePoint Service.*
 - a) Mortgage originations approached nearly \$3 trillion in 2004, down from a record \$4 trillion in 2003. Although the 2004 numbers on residential mortgage fraud and misrepresentation are still preliminary, it appears that problems are on the rise.
 - b) During the past four years, there has been a shift in the states that have the greatest problems. For the second year in a row, Georgia and South Carolina have had very high rates of reported fraud.
 - c) Florida continues to have a high fraud score, but is no longer entrenched in its historical second-place position on the national list of hot spots. Along with Georgia, the states of South Carolina, Florida, Utah and North Carolina comprise the top five states for fraud in the 2001-2004 time period. For most of the past decade, fraud rates from California and Florida have led the nation by substantial margins. In the past few years, Georgia has become the hottest spot in the country for incidents reported to the MIDEX database and recently South Carolina moved into second position by a substantial margin.
 - d) The types of problems found in loan fraud files seem to have been relatively stable throughout the last four years.
 - e) Over the last ten years, major mortgage lenders, agencies and insurers have been submitting information describing incidents of alleged fraud and material misrepresentation to a central database. The database is *MARI's Mortgage Industry Data Exchange (MIDEX®)*. MARI can mine the MIDEX database to obtain statistics on a wide range of mortgage fraud characteristics
 - According to MARI, the ramifications of mortgage fraud are:
 - To industry: Possible catastrophic monetary losses incurred by financial companies to destroyed professional reputations and criminal and administrative actions.
 - To consumers: Higher loan rates and fees, stolen identities and possibly impaired credit ratings.
 - To Neighborhoods: Higher property taxes, inability to sell homes, increased criminal activity and abandoned properties.

The below chart shows each type of fraud as a percentage of all fraud cases submitted to the MIDEX database. For instance, 56% of the fraud incidents reported to the database for mortgages originated in 2004 contained application fraud. *(Additional MIDEX charts are profiled at the end of this assessment as notation 6.)*

Mortgage Fraud Trends				
Fraud Classification	Mortgage Origination Year			
	2004	2003	2002	2001
Applications	56%	63%	64%	65%
Tax and Financial Statements	33%	27%	24%	23%
Verifications of Employment	12%	12%	14%	16%
Verifications of Deposit	16%	14%	16%	15%
Escrow/Closing	6%	10%	18%	17%
Appraisals/Valuations	10%	18%	28%	24%
Credit Reports	1%	1%	2%	2%

COMMON TYPES OF MORTGAGE SCAMS:

Mortgage frauds are as diverse as the perpetrators who cause them. The perpetrators are from traditional organized crime organizations as well as non-traditional such as Russian, Nigerian, and Israeli criminal groups.

1. The FBI public report on Financial Crimes identifies common mortgage fraud schemes as:
 - a) Property Flipping - Property is purchased, falsely appraised at a higher value, and then quickly sold. What makes property flipping illegal is that the appraisal information is fraudulent. The schemes typically involve one or more of the following: fraudulent appraisals, doctored loan documentation, inflating buyer income, etc. Kickbacks to buyers, investors, property/loan brokers, appraisers, title company employees are common in this scheme. A home worth \$20,000 may be appraised for \$80,000 or higher in this type of scheme.
 - b) Silent Second - The buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.
 - c) Nominee Loans/Straw Buyers - The identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.
 - d) Fictitious/Stolen Identity - A fictitious/stolen identity may be used on the loan application. The applicant may be involved in an identity theft scheme: the applicant's name, personal identifying information and credit history is used without the true person's knowledge.

- e) Inflated Appraisals - An appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender. The report inaccurately states an inflated property value.
 - f) Foreclosure Schemes - The perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. Perpetrators mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The perpetrator profits from these schemes by re-mortgaging the property or pocketing fees paid by the homeowner.
 - g) Equity Skimming - An investor may use a straw buyer, false income documents, and false credit reports, to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.
 - h) Air Loans - This is a non-existent property loan where there is usually no collateral. An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments, and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.
2. The following information regarding other types of schemes and how they can be combated was primarily derived from recognized Mortgage Fraud expert Vernon Martin, an Associate member of the ACFE, California State University, Los Angeles.

- a) TYPE: "Cash-out refinancing" is a method to bail out of a troubled property. In this type of fraud, perpetrators may purchase a troubled property and then apply for a cash-out refinance loan. (A cash-out refinance loan provides money needed to repay the first mortgage and additional cash that can be used for any purpose.) The loan is taken out on the pretext that the owners intend to obtain higher rent for the building by converting it. The conversion may be presented to the financial institution as a high rent medical building or other professional business. An in-house appraiser usually confirms the plan. Then, once funded, the loan would move into immediate default and the borrowers would disappear.

RESPONSE:

- The institution should have a written policy to conduct due diligence.
 - This type of loan default can be avoided if the appraiser or underwriter at the lending institution checks with the City to determine if the proposed conversion is allowable, i.e. under residential zoning and if permits had been issued for such space.
 - Research should be conducted to determine if the same subjects had conducted similar activities in the past, as most offenders will repeat their actions.
- b) TYPE: Falsified or Deceptive Business Plans
There are other types of mortgage fraud that are much more common, but less obvious, where the intention is to repay the lender if the property's performance and value increase, but to default if the property's performance and value decrease,

leaving the lender holding the bag. Such frauds, which are usually accomplished by either misleading or corrupting real estate appraisers, intend to trick the lender into lending more money than is adequately secured by the property and its cash flow. This minimizes the risk of equity loss to the borrower who may not even have any actual equity in the deal. In these cases, payment defaults occur years after the loan's origination, and lenders usually don't think to look for fraud at that time. This latter type of fraud is increasing now that more commercial properties are experiencing declining performance. A borrower will know he's in trouble long before would-be lenders and will use mortgage fraud to mitigate his risk and minimize his equity investment. These may be associated with:

- ❑ Illegal Building Improvements:
- ❑ In this scam, the owner makes illegal improvements to their building, some of which produce income. This is then used to obtain loans much higher than true appraisal.
- ❑ Bogus Offers to Purchase or Lease.
- ❑ One time cash infusions are listed as continuing income.

RESPONSE:

- ❑ Commissioned loan agents shouldn't be allowed to order appraisals. A neutral party, (having no stake in the outcome of the loan application), such as a chief appraiser or chief credit officer, should do the ordering.
- ❑ The bank should have insisted that only appraisers from its approved list be used. The lending institution's own due diligence should review the appraiser to determine if they have been involved in deceptive loans in the past.
- ❑ An examination of the date of the inspection, the date of the appraisal order, and the date of the report should be compared. In this case, the inspection had been done before the appraisal was ordered, which suggested that the appraisal had already been done for another party, possibly the developer. The delivery of the appraisal of such a complex property one week after ordering it also seemed suspect. Most commercial appraisals of much less complicated properties arrive in three to four weeks.

c) TYPE: Deceptive Purchase Contracts and Hidden Seller Concessions

Because so many appraisers and lenders think of the purchase price as prima facie (at first sight) evidence of market value, it has become quite common to see deceptive purchase agreements that inflate contract purchase prices. This is done with hidden or stated concessions, such as "allowances for repair" and "seller financing."

RESPONSE:

- ❑ A lending institution should always have its appraisers and underwriters review the purchase contract for red flags by checking:
- ❑ Seller financing: It's possible that such a loan could be "forgivable," particularly if there's a relationship between the seller and buyer

- Allowances for repairs: If the repairs aren't yet started, this amount should be deducted from the purchase price. All repairs should be verified by inspection before being assigned value.
- Some comparison of the buyer and seller: If they are individuals, do they share a surname? If the buyer or seller is a limited partnership, there should be some research into whom the principals are and whether one or more of the principals is on the opposite side of the transaction.
- Most of all, appraisers shouldn't be harassed by the lender for failing to appraise a property for its purchase price. Many lending institutions currently do so, with the effect of appraisers generally tending to "rubber stamp" the stated purchase price (said to occur 98 percent of the time).

d) TYPE: The 'Pocket-to-pocket' Lease

In this scam, the lender's own company or someone he conspires with will sign a high-lease agreement for a property that the lender wants a loan on. The lender is actually not profiting from these high lease payments since it is actually moving from one "pocket" to another "pocket" of the same owner. The appraisal is done on these stated higher rents.

RESPONSE:

- An appraiser should have to report standard market rents to the lending institution in addition to the reported rent from the lender. The lender should question discrepancies in values. The lending institution should always instruct the appraiser to alert it to any borrower dishonesty immediately.

e) TYPE: Theft of Revenue Through Property Takeovers

In general, these frauds occur when perpetrators organize limited partnerships to purchase properties at inflated prices, skim the revenues, and then default on the loans. Since many of these borrowers leave a track record, some use stolen identities to obtain the loan and property. Others may use straw buyers. This is accomplished when the perpetrator uses deceptive tactics to build the credit of an accomplice that becomes the "fall" person when the loan turns into a foreclosure. The perpetrator's credit is not scarred by the transaction. The perpetrators can usually tie up the lender in civil court for long periods of time while still collecting rents. *(End Vernon Martin contribution.)*

3. One other type of scheme is Lapping: A fraud that involves stealing one customer's payment and then crediting that customer's account with a subsequent customer's payment. (Source: Federal Financial Institutions Examination Council White Paper) *(For further information, refer to notation 1, page 29.)*

OTHER EXAMPLES OF MORTGAGE FRAUDS:

Investigations have revealed varying types of frauds in which people are solicited to prevent foreclosure, bankruptcy or methods to vacate a mortgage. These are scams that either prey on unwitting, uneducated mortgagees or they are knowledgeable and willing participants in the

scheme. The scheme starts with either an active solicitation by contacting people who are listed as pending foreclosure or through advertisements on roads, newspapers and on television. The solicitation advises that they will help people get out of the financial predicament in which they could lose their homes. The perpetrator typically files petitions on behalf of the homeowner that will eventually be vacated in court. However, the filings slow the process of foreclosure. Non-attorneys or "Pro-se" litigants typically conduct the filings. The filings purposefully contain errors. When foreclosure is close, the perpetrator advises the homeowner to quit claim the property to a straw buyer and manipulated values. Then more pro-se filings are conducted on behalf of a "straw owner", again slowing down the legal process. During this time, the property owner is told they can live on the property rent free, tax free and cost free and the foreclosure will be in the name of a straw buyer, not the real owner (sparing their credit). In scams in which the mortgagee is not unwitting, they pay a fee for filings that are quickly vacated and the business does not return their phone calls.

An investigation into deed fraud on the Florida Southwest Coast resulted in Florida Senator Aronberg to propose potential new laws on this issue. In the investigation, some deed scammers forged signatures using dead owners and fake witnesses and have hijacked the stamps and seals of notaries. Records show dozens of stolen lots in Lee and Charlotte counties that belonged to deceased owners remain listed in the names of new owners even though the fraudulent deeds have been exposed. State and county officials say they are not sure whether they will ever be able to stop con artists from using forged deeds to steal property and they are not sure what to do about property records in Lee and Charlotte counties. The scam apparently worked as follows:

- a) Scammers use tax rolls to seek out vacant lots with overdue taxes.
- b) The Internet is used to locate death notices, death certificates or obituaries on dead property owners.
- c) A fake deed with the dead owner's signature is forged.
- d) It must be notarized and witnessed by two people.
- e) Sometimes the notary and witness signatures are forged, too.
- f) The deed is recorded at the clerk of court's office.
- g) A DR-219 form is filed with the Florida Department of Revenue and the county property appraiser's office to transfer the property to the new owner.
- h) The lot is then sold at 100 percent profit.

(Source: Multiple reports from *The News-Press* Date: 08/01/2005 Edition: Fort Myers).

In 2005, agencies in 25 states, including Florida, acknowledged investigations into one of the nation's largest sub-prime lenders, Ameriquest Mortgage Co. A synopsis of the allegations against Ameriquest lending practices included:

- a) The accuracy of its appraisals and how loan terms are described in spoken statements to borrowers.
- b) Complaints and suits alleging a pattern of fraud, falsification of documents and bait-and-switch sales tactics.
- c) Former Ameriquest loan agents around the country had complained that pressure to write loans caused some employees to forge documents and push appraisers to inflate home values so that hard-pressed borrowers could qualify for mortgages.
- d) Allegations that it charged excessive fees when it refinanced loans for existing customers.

- e) States accused Ameriquest employees of surprising borrowers at loan closings with high fees and interest rates that often were markedly higher than had been promised in good-faith estimates of the loan costs.
- f) Employees used ruses such as telling the borrowers their old loans had already been paid off to pressure them into accepting new loans, the lawsuit says.
- g) The Orange County-based company also said it had agreed to pay up to \$50 million to settle a class-action lawsuit that alleges it defrauded thousands of borrowers in four states, including California.
- h) Ameriquest, who has donated money to both political parties, blamed a computer glitch.
- i) Ameriquest blames rogue offices. In the Tampa case, the office allegedly had an "art department" that would create any document needed to get a loan through. The office would allegedly create a Quit Claim deed then title a loan as a re-finance. In order to accomplish this, a Title company would have to be involved. An interesting point to this fraud, Ameriquest is its own lender (not re-selling loans) and therefore would be victims of their own negligence.
- j) Ameriquest is not a licensed mortgage brokerage and, therefore, does not fall under most regulatory requirements. Its' "account executives" who solicit and market loans are not licensed brokers.
- k) Ameriquest has been accused of being a "serial settler", whose "best practices," adopted over the last five years, have not changed the way it does business. Examples, such as:
 - The Connecticut Attorney General stated, "Ameriquest has violated not only the letter of our law," he said, "but also the spirit of our agreement that gave them a second chance" (due to Ameriquest prior promises to cease and desist such practices).
 - In 1996, the company, then known as Long Beach Mortgage Co., paid \$4 million to settle U.S. Justice Department charges that its lending practices cheated minorities, women and elderly people.
 - The Federal Trade Commission suspended an investigation into Ameriquest lending in 2001, after the company promised to adopt "best practices" that would set a standard for sub-prime lenders and pledged to make \$360 million in low-cost loans to borrowers identified by ACORN, a national grass-roots group.

(For additional information on "willful blindness", see case law number (5) in this report.)

Studies by the Mortgage Asset Research Institute noted examples of cases where mortgage brokers submitted applications on behalf of clients that the broker knew to contain fraudulent information. When confronted with the fraud, the broker acknowledged knowledge of the fraud on the application but continued to search for less vigilant companies. Samples of large-scale investigations into this fraud by mortgage brokers include the following:

- In August 2002, the Cleveland FBI Office culminated two-year undercover operation (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 North Carolina State Bureau of Investigation initiated the investigation due to numerous complaints 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.
- A joint investigation by the Los Angeles FBI Office and HUD Office of the Inspector General (OIG) illustrated an extensive scheme in which fraudulent identification and employment documents were used to perpetrate mortgage frauds. An individual who regularly manufactured false identity and income documents for a profit largely assisted the scheme. This document forger created W-2s, pay stubs, credit letters and social security printouts over an eight-year period. Real estate professionals who knowingly submitted the falsified information to lending institutions used these documents. The loans were then insured by HUD and caused a loss to that agency of more than \$18 million. The investigation revealed more than 100 real estate professionals had ordered false documents in the past.

“Mortgage Elimination” schemes have been in existence for many years but have recently become more popular. Many of these schemes use a homeowner as a co-conspirator, especially if the mortgagee could lose the home to foreclosure. The scheme is designed to tie the home up in legal challenges while the owner ceases paying. In 2005, the Better Business Bureau conducted a review of websites and located several “mortgage elimination” schemes. Most create documents that attempt to release mortgages then take out second loans on the properties in order to pay perpetrators. These companies often proclaim the entire U.S. banking system is flawed and use these claims to persuade homeowners that mortgage elimination is legal and ethical.

- The Greater Cleveland Better Business Bureau uncovered a mortgage elimination scheme in which the homeowner pays a \$3,000 fee to a dishonest broker. The homeowner agrees to place the title to their home in a family trust. The homeowner then presents the lender a document that contains 40-50 “legal” challenges to the loan. Dubbed the “CPA Report”, this document outlined 40-50 claimed “violations” of federal laws committed by the lender. The lender must

respond with proof of the validity of the loan. When the lender fails to respond, a power of attorney is filed which gives the trustees authority to act on behalf of the lender. Using the power of attorney, a "Discharge of Mortgage" is filed certifying that the loan has been fully paid. The next step is to apply for refinancing on the home. Once obtained, the homeowner and the dishonest broker share the proceeds. This new loan is then "eliminated" using the same technique. The BBB believes that homeowners who sign onto Broker's program likely face several potentially serious legal problems – default on their original mortgage, foreclosure, difficulty selling the home due to the irrevocable trust and the title issues it creates, potential liability for failure to pay any additional loans procured by the trust, and a possibility of being an accessory to criminal activity. (Based on source material from the Better Business Bureau of Cleveland).

Also of interest are the "anti-government" individuals that target the real estate and associated mortgage, foreclosure and bankruptcy system. These subjects advertise and solicit for people who are pending bankruptcy or foreclosure and provide them with an erroneous advice in which to avoid paying their mortgages yet avoid foreclosure. To accomplish this, the homeowner is typically either ignorant of basic law or an accomplice in the scheme. There are many variations of this scheme, however, it typically involves filing pro-se petitions against foreclosure or bankruptcy that are always dismissed but delay the legitimate legal process. In variations, a straw buyer takes ownership of the home through Quit Claim, however, the original homeowner does not move out until the legal process is finished. The homeowner then lives in the property rent free, tax free, mortgage free, etc, for that period of time.

Many mortgage fraud cases showcase a lack of communication among federal agencies and semi-private loan institutions Fannie Mae and Ginnie Mae. Recently the HUD responded with a proposed declaration to correct this problem. *(For further detail, refer to notation 3, page 30.)*

- A recent investigation revealed a fraud scheme committed by insiders of First Beneficial Mortgage Corporation against Fannie Mae and the Government National Mortgage Association (Ginnie Mae). First Beneficial Mortgage Corporation sold fraudulent loans to Fannie Mae. When Fannie Mae discovered that the mortgages were fraudulent, it forced First Beneficial to repurchase the loans. To raise the money to repurchase the loans, First Beneficial sold fraudulent mortgages to Ginnie Mae. Fannie Mae did not inform Ginnie Mae that First Beneficial had made fraudulent loans. Fannie Mae agreed to a consent order to forfeit approximately \$7.5 million to the Federal government, which represents the amount, plus interest, that the First Beneficial principals obtained through fraud. This and other frauds in the mortgage industry reflect the need to deter and, if necessary, detect and remedy fraud.

MORTGAGE FRAUD IN FLORIDA:

Several entities in Florida have responsibility for various aspects of mortgage fraud investigations. One of the primary investigating entities, The Florida Department of Financial Services, Office of Financial Regulation (OFR), reported the following statistics regarding mortgage fraud investigations conducted by their office:

- FY 03/04: 68 involving a total of \$149 million
- FY 04/05: 83 involving a total of \$75 million

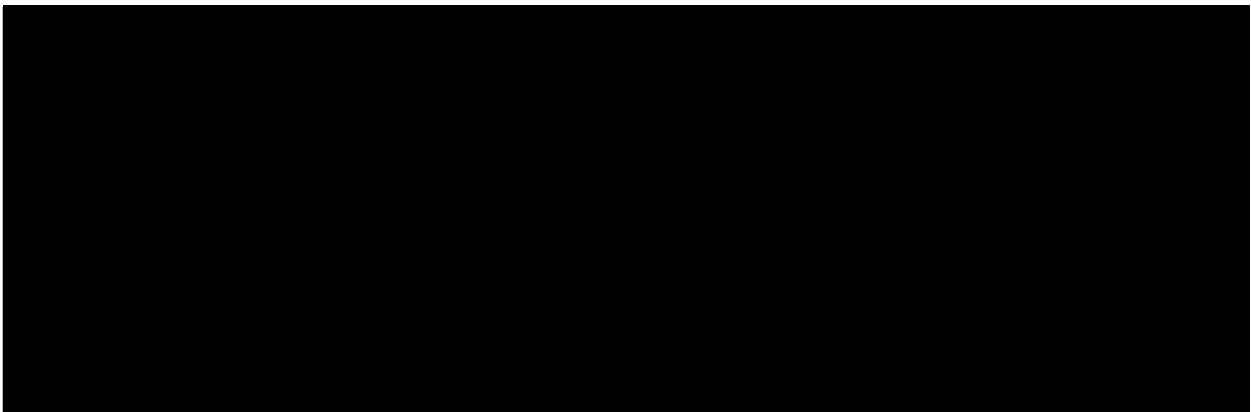
Additionally, the OFR reported that investigation initiated in 2005 primarily involved the areas of: Ft. Myers, Miami, Plantation, Jacksonville, Orlando, Tampa, Pinellas County, Sarasota, and West Palm Beach. The OFR has also observed Mortgage foreclosure scams, and reselling of rehabbed properties in Miami-Dade County. (Source: Chris Hancock, OFR).

The Florida Department of Financial Services, Division of Insurance Fraud (DIF), investigates title insurance fraud, another component of mortgage fraud. The DIF provided the following information reference title insurance fraud investigations:

- 2003: 17
- 2004: 44
- 2005: 20

Additionally, investigations by the DIF in 2005 involved the areas of: Ft. Myers, Miami, Plantation, Jacksonville, Orlando, Tampa, and West Palm Beach. (Source: Carolyn Ingram, Florida DIF).

A search of Florida data from the Financial Crimes Enforcement Network (FinCEN) was conducted by the Florida Department of Law Enforcement, Financial Crime Analysis Center. The data revealed the following information:



One other Florida trend to note surfaced during a survey by FDLE of local law enforcement agencies in the Miami area. Many agencies reported an increased usage of high quality false driver licenses by perpetrators of mortgage frauds. The false identifications appear to be of such a good quality that it is believed they are being obtained through the DMV or produced with a very sophisticated PC. The information on the licenses is legitimate but the photograph of the subject is false. (Source: FDLE Miami Regional Operations Center Economic Crime Unit).

INDUSTRY RESPONSE:

The mortgage and finance industry tend to focus on the mitigation of problems with fraud and reluctantly spend resources for prevention or turning to law enforcement for criminal action.

These mitigation programs are designed to accept that fraud will occur but it is up to the institution on how to deal with losses. Some financial institutions see fraud as a cost of business and often choose to overlook some losses in exchange for continuing financial relationships with big lenders or brokers who may have either deceived them for personal gain or in sold mortgages that they knew to be fraudulent in order to dispose of them.

The decision to proceed civilly is examined as a cost/return decision for the institution. Many choose not to proceed criminally due to the financial cost of working with the government, especially when it is perceived that the government will keep any assets that are seized and little, if any, is returned to the victim institution. Many institutions do not conduct proper due diligence prior to engaging in financial relationships, and then turn to the government to fix the problem. Law enforcement agencies are often incredulous at the blatant real estate frauds that could have been easily identified through even minor due diligence.

THE GOVERNMENT'S RESPONSE:

A significant portion of the mortgage industry is void of any mandatory fraud reporting; therefore government oversight of mortgage fraud is limited. Currently only about one-third of the institutions that make mortgage loans are federally chartered and thus covered by federal reporting requirements. Currently 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 Mortgage Banker's Association. FinCEN is studying the concept and has leaned toward expanding the current SAR form instead of creating a new form.

FinCEN has also issued several rulings regarding customer identification that have an impact on mortgage fraud. FinCEN has ruled that loan participations purchased from third parties and loans purchased from mortgage brokers are within the exclusion from the definition of "account" for loans acquired through an acquisition, merger, purchase of assets, or assumption of liabilities. However, if the bank is extending credit to the borrower using a mortgage broker as its agent, then it must ensure that the dealer or broker is performing the bank's Customer Identification Program. (January 2004). If the bank uses a subsidiary for various financial activities, then that subsidiary is bound to implement a customer identification program. If the loan is transferred to a new person, the bank is obligated to fully identify the person who assumed the loan. A bank will not be required to look through trust, escrow, or similar accounts to verify the identities of beneficiaries and instead will only be required to verify the identity of the named account holder. The agencies wish to emphasize that a bank's CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable

Other government agencies have already taken steps to mitigate frauds from speculative investments. In 2000, Congress held hearings on Mortgage Flipping frauds called "PERMANENT SUBCOMMITTEE ON INVESTIGATIONS HUD'S GOVERNMENT INSURED MORTGAGES". The committee was troubled by the problem of mortgage flipping, calling it a "crisis" and noted they were "appalled" that "the federal government has essentially subsidized much of this fraud. HUD, through FHA, insures many of the mortgages that finance these fraudulent transactions, but the Department has been slow to act to curtail this fraud. A series of audits and reports over several years warned HUD repeatedly of the vulnerability of its

mortgage programs to fraud. When a lender forecloses on ...flipping victims, it is fully compensated for underwriting the bad loan because FHA paid the insurance claims. Therefore, these flipping schemes often result not only in financial ruin for the buyers and their families, but also undermine the integrity of the FHA insurance fund by passing the tab for the fraud on to the federal government". (Source:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_senate_hearings&docid=f:66088.pdf).

Most likely, in response to the above-mentioned hearings, various new rules have been proposed. For example, in February 2005, HUD proposed the following rule under § 1731.3, an Enterprise (Fannie Mae, Freddie Mac, Ginnie Mae) would not be permitted to require the repurchase of or decline to purchase a mortgage, mortgage backed security, or similar instrument if it has notice of fraud or possible mortgage fraud until it promptly reports such fraud to the Director. OFHEO solicits comments on this proposed section. Section 1731.4 would set forth the procedures for reporting fraud and possible mortgage fraud to OFHEO. As noted above, OFHEO would issue guidance and instructions with respect to format and content of mortgage fraud reports. Section 1731.4 also would provide that if the situation requires the immediate attention of OFHEO, an Enterprise would report immediately by telephone or electronic communication. Section 1731.5 of the proposed regulation would provide that an Enterprise must establish adequate and efficient internal controls and procedures and an operational training program to assure an effective system to detect and report mortgage fraud.

(Source: <http://www.ofheo.gov/media/pdf/mortfraudregproposed.pdf>)

The Federal Housing Authority (FHA) is another significant entity in regulating mortgage fraud. The FHA is the major lending source for first-time, low income, and minority homebuyers. For example, one-quarter to one-third of all low-income and minority homebuyers got their homes through FHA insurance, and three-quarters of FHA's portfolio is devoted to first-time homebuyers. FHA relies on about 10,000 lenders to carry out its mission. About 2,900 of these lenders are granted what is called direct endorsement authority. That means these lenders can gather and process the information, underwrite loans, make eligibility determinations, and they do this with no prior review from HUD. The remainder of the lenders are called loan originators. Loan originators can gather such information as mortgage applications, employment verification, credit histories, but then they must go to one of the 2,900 approved lenders for underwriting and eligibility determinations. Given HUD's reliance on private lenders, oversight is essential. Such oversight is the primary responsibility of four homeownership centers that HUD has in Atlanta, Denver, Philadelphia, and other cities (Source: FHA Statement to Congress Subcommittee in 2000: congress docid=66088). In mid 2003, the Federal Housing Authority instituted the "90 Rule of Loan Flipping". A nationwide campaign designed to crack down on mortgage fraud and predatory lending has spilled over into the home-rehab industry in the past few years, placing many entrepreneurs in "time out" for up to six months before they can cash in on their latest fixer-upper opportunity. During this time, the Federal Housing Administration also tightened restrictions on re-sales occurring within 180 days and stopped insuring mortgages altogether on property sold more than once in 90 days. Other lenders have followed suit, toughening underwriting standards for "quick-turns," more commonly known as "flips." Other stipulations are aimed primarily at the quick resale of new homes by preventing the sale or assignment of a sales contract on a property. For example, if the home price rose by more than 50 percent within a five-month period, the FHA could ask for a new, independent appraisal. Still, there are several

ways around the rules, including seller financing, lease options and non-conforming loans. (Source: Steve McLinden, Scripps Howard News Service. Saturday, August 20, 2005).

The Government National Mortgage Association (“GNMA”) is yet another agency of the federal government that has responsibilities regarding mortgage fraud. It has primary responsibility for regulating mortgages based on federally established criteria. As part of its responsibilities, GNMA underwrites mortgage loans meeting certain standards. If loans do not meet these standards, including eligibility for and attainment of a Mortgage Insurance Certificate (“MIC”), such loans are not accepted into the GNMA program. Consequently, the entity that has purchased the right to service the loans is responsible for repayment of their full value if the borrower defaults.

The Federal Reserve Bank (FRB) amended the Home Mortgage Disclosure Act in order to force the disclosure of pricing. The FRB was concerned that “the growth of the subprime market has also raised public policy concerns. Among the concerns is whether consumers who obtain higher-priced loans are sufficiently informed about their options to make the market work as efficiently as it could and to protect themselves from unfair or deceptive lending practices. Those concerns have played into ongoing debates about the adequacy and efficacy of proposed or existing disclosures and limitations on mortgage lending intended to protect consumers from abuse. (*Additional information can be reviewed at notation 9, pages 35-36.*)

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. Associates of the “flipper” then repurchase the artificially valued properties several times for a higher price. After three or four sham sales, victim lenders foreclose on the properties. Often flipped properties are ultimately repurchased for 50-100% of their original value. (Congressional Testimony Statement of AD Chris Swecker, FBI, 10/2004 <http://financialservices.house.gov/media/pdf/100704cs.pdf>).

Some states have passed or proposed legislation to protect consumers and punish mortgage fraud perpetrators. The State of Georgia has proposed new legislation on mortgage scams and filing false deeds. (*Additional information can be reviewed at notation 5, pages 31-32*). The State of Ohio proposed SB162 for 2005-2006 which states the following: If the advertisement indicates that special terms, reduced rates, guaranteed rates, particular rates, or other special features are available:

- i. The advertisement clearly shall disclose any applicable limitations to the availability of these terms, rates, or special features.

- ii. The advertisement shall comply with 12 C.F.R. 226.16, as amended, promulgated by the federal reserve board pursuant to the "Truth in Lending Act" 84 Stat. 146, 15 U.S.C. 1601 (1968).
- iii. No registrant shall fail to do any of the following: Make reasonable efforts to secure a loan the terms of which are reasonably advantageous to the buyer, considering all circumstances applicable to the buyer, including rates, charges, repayment terms of the loan, and available loan options.

MORTGAGE FRAUD INVESTIGATIVE TIPS:

The following information should be kept in mind when conducting investigations of mortgage fraud schemes:

- ❑ The trustee in Bankruptcy can waive attorney client privilege and provide all of the records they receive from the bankruptcy court.
- ❑ It is important to maintain all envelopes and mailings. This will assist in charges for mail fraud. Case law on this subject is referenced later in this report.
- ❑ Complete a comprehensive prosecutive summary that identifies each misrepresentation, who provided that misrepresentation, and who was deceived. The summary should break down the investigation into comprehensive points based on existing jury instructions for each accused charge.
- ❑ Ensure that a prosecutor is brought in from the beginning of an investigation, however, an investigator should also search on their own for existing case law for the type of investigation they are conducting and ensure that they follow cases that have been tried successfully while avoiding the mistakes of those prior cases (if any). Do not assume the prosecutor is an expert in the area of mortgage fraud or kept up with case law in the area.
- ❑ The investigator should be cognizant of any state law that might have been constructed to suit their type of investigation (i.e. statutes that provides for harsher penalties and/or ease the constraints of victims and witnesses – such as the Aggravated White Collar Crime statute). The investigator should review each misrepresentation to determine if that lie is a violation of a specific law, especially if it is a predicate for the RICO statute (i.e. cases where there is representation of state or federal insurance to back up an investment when there is none).

RECOMMENDATIONS AND SUMMARY:

In reviewing assessments from universities, the mortgage and real estate industry, federal and state government agencies as well as the experiences of investigations within the Florida Department of Law Enforcement, it is clear that diligence stops most frauds before financial losses occur. It is also clear, that investors rely too much on the very industry that may be defrauding them to conduct due diligence. Proper due diligence should be conducted by independent specialists and not solely by the parties involved. Though there is a cost involved with hiring specialists, many of these reviews can be done easily and cheaply. For instance, a basic review of courthouse documents to ensure proper filings is a productive method to identify and stop some frauds (such as taking on multiple investors for the same property) and can be

done for free on the Internet. Additionally, reviewing the buyer or seller's past practices is available through courthouse and other research. Federal and state regulatory agencies could provide a "laundry list" of methods to conduct due diligence for real estate and mortgage transactions that any layman could use. These agencies could also force such a list to be provided for every transaction involving real estate and mortgages along with the other truth in lending requirements. These mandates should include all transactions, including prime lenders in the private market.

Law enforcement agencies, regulatory agencies, prosecutors and the courts must become more creative to identify resources for the growing number of frauds that have been outlined in this report. There are potential resources on the part of retired accountants, attorneys, judges, investigators, and other citizens who may be able to assist in putting these cases together under the umbrella of the government.

Enhanced civil penalties and injunctions against repeat offenders is an important tool and may require legislative review of existing laws.

Courthouses should post warnings on criminal action if false filings are performed and the filer should initial a form that identifies this as a crime.

These efforts along with proactive efforts to identify frauds before victimization are essential to mitigating the mortgage fraud problem.

ADDITIONAL STATE OF FLORIDA LAWS:

□ Liability in case of unlawful transaction.

(1) If a mortgage transaction is made in violation of any provision of ss. 494.001 - 494.0077, the person making the transaction and every licensee, director, or officer who participated in making the transaction are jointly and severally liable to every party to the transaction in an action for damages incurred by the party or parties.

(2) A person is not liable under this section upon a showing that such person's licensees, officers, and directors who participated in making the transaction, if any, acted in good faith and without knowledge and, with the exercise of due diligence, could not have known of the act committed in violation of ss. 494.001 - 494.0077.

□ Injunction to restrain violations.

(1) The office may bring action through its own counsel in the name and on behalf of the state against any person who has violated or is about to violate any provision of ss. 494.001 - 494.0077 or any rule of the commission or order of the office issued under ss. 494.001 - 494.0077 to enjoin the person from continuing in or engaging in any act in furtherance of the violation.

FEDERAL CRIMINAL LAWS AND VIOLATIONS:

- 18 U.S.C. Section 1344: A person who fraudulently obtains a mortgage for property or other asset - Bank Fraud submission of false or forged statements on loan applications.
- 12 U.S.C. § 1709-2: Equity Skimming
- 18 U.S.C. §§ 1341 and 1343: Mail Fraud And Wire Fraud
- 18 U.S.C. Section 656/657: Theft, Embezzlement, or Misapplication of Funds
- 18 U.S.C. § 1621: Perjury
- 18 U.S.C. § 1001(a)(1): Fraudulent concealment

CASE LAW HIGHLIGHTS:

1) United States of America, plaintiff-appellee, v. Tricia Lin Beckley, defendant-appellant. Oct. 16, 1996.

- An example of a criminal investigation into **equity skimming**: "[T]he language of 12 U.S.C. 1709-2 does not require that a defendant know (or should know) that properties are insured by the FHA or VA; nor does it require that he act with the intent to defraud those federal insurers."

<http://caselaw.lp.findlaw.com/scripts/getcase.pl?navby=search&case=/data2/circs/11th/943513opa.html>

- 2) USA v Kenneth S. Alexander plaintiff-appellee, U.S. 7th circuit court of Appeals Argued June 6, 1997--decided January 30, 1998
- In this mortgage fraud investigation, mail fraud was charged and the defendant challenged that he did not conduct the mailing. The Appeals court ruled that, “such evidence of a standard office or business practice is sufficient circumstantial proof to take the mailing issue to the jury” and “It is instead sufficient if he caused the mails to be used, which he would do by acting “with the knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen”.
- 3) United States of America, Appellee, v. William H. Walsh, Defendant, Appellant.
- An example in which a property developer directed his employees to obtain loans through the use of deception so that customers would be able to purchase his properties. Additionally, the suspect concealed other financing he had for the properties.
- <http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=1st&navby=case&no=951139>
- 4). U.S. 11th Circuit Court of Appeals, United States of America, Plaintiff-Appellee vs. Ellis E. the Defendant, Jr., Defendant-Appellant. No. 92-2929. United States Court of Appeals, Eleventh Circuit. Dec. 10, 1999.
- An example of a mortgage flipping investigation in which a developer sold properties among a group of companies also owned by him in order to inflate the properties and defraud the lender. The developer also conducted a fraud in which he needed to “pre-sell” a certain number of units in order to obtain financing. The developer used his own companies for this as well. The developer also provided false invoices in order to obtain early financial draws of the loans. At the developer’s trial, the district court decided as a matter of law that the evidence established beyond a reasonable doubt the materiality of the developer’s false or fraudulent representations for purposes of the bank, mail, wire, and tax fraud charges. Accordingly, over the developer’s objection, the court instructed the jury that it need not consider the element of materiality for these charges. After he was convicted of these offenses, the developer appealed, arguing, inter alia, that the district court erred in refusing to sub. The Appeals Court found that, “because the issue is whether a statement has a tendency to influence or is capable of influencing a decision, and not whether the statement exerted actual influence, a false statement can be material even if the decision maker did not actually rely on the statement. See Gregg, 179 F.3d at 1315”.

<http://caselaw.lp.findlaw.com/scripts/getcase.pl?navby=search&case=/data2/circs/11th/922929ma2.html>

- 5) 94-1222 United States of America v William J. Camuti, Appeal from the United States District Court for the District of Massachusetts
- Mail fraud--does not require that the victims be pure of heart or even that they have been effectively deceived by the charged misrepresentations. Materiality

issues aside, all that matters is that the defendant deliberately made the representations. *United States v. Allard*, 926 F.2d 1237, 1242 (1st Cir. 1991).

- Willful blindness instruction, it was amply justified in this case. *United States v. Gabriele*, 63 F.3d 61, 66-67 (1st Cir. 1995). A jury could reasonably find that ...the warning signs were ample to have alerted (the defendant) to the fraud unless he deliberately chose to close his eyes to them; (Awareness such as through contacts with investigators or through newspapers on the issue that were discussed with investors). The usual formula for willful blindness, see E. Devitt, et al., *Federal Jury Practice and Instructions* § 17.09 (4th ed. 1992); *Gabriele*, 63 F.3d at 66 n.6, The judge can advise the jury that it could not find that the defendant acted knowingly if he "was simply careless."

- 6) U.S. 11th Circuit Court of Appeals, In *The United States Court of Appeals for the Eleventh Circuit no. 92-2929, United States Of America V Ellis E. The Defendant, Jr.*, appeal from the United States District Court for the Middle District of Florida (December 10, 1999) on remand from the Supreme Court of the United States.
 - In this case, it is important to emphasize the fact that a defendant cannot claim that, even though false statements were made, it was a typical course of business and that the victims knew or should have known these statements were false. The defendant was charged with defrauding lenders in obtaining land acquisition loans by (1) submitting inflated appraisals; (2) submitting sales contracts between his nominee corporations and limited partnerships that falsely stated that down payments had been made to the corporations; (3) concealing that the land was being purchased from the original landowners at prices lower than the inflated prices being paid by the limited partnerships; (4) misrepresenting or failing to disclose the nature of his interest in the nominee corporations; and (5) failing to disclose that he was depositing in his personal account the excess loan proceeds his corporations received from the sales to his limited partnerships. The defendant's main argument that these representations were not material is that the lenders either knew or should have inquired about what the defendant was doing but did not care that the defendant was using the corporations as nominees in a "land-flipping" transaction, "netting" the down payment, and depositing the excess loan proceeds in his personal account. The defendant introduced evidence that these practices were common in the 1980s and argued that the lenders had a duty to inquire about whether the defendant was engaging in them. The defendant also claims that these falsehoods were not material because he personally guaranteed the loans and, as a result, the lenders were fully secured.

➤ Noted Facts from case that will influence similar cases:

- The Government elicited testimony from all of the lenders that if they had known the truth, they would not have approved the defendant's land acquisition loans on the same terms and conditions.
- "False statements can be material even if a decision maker was not actually influenced by those statements and knew they were false. See *Johnson*, 139

F.3d at 1364. Again, what is relevant to the materiality inquiry is whether the defendant's representations have "a natural tendency to influence, or [are] capable of influencing, the decision of the decision making body to which [they are] addressed"-here, the Union's decision to pay. The defendant's draw requests. See Gaudin, 515 U.S. at 509 115 S. Ct. at 2313.

- The Supreme Court has instructed, "[i]n general, a false statement is material if it has 'a natural tendency to influence, or [is] capable of influencing, the decision of the decision making body to which it was addressed.'" The defendant, - U.S. at -, 119 S. Ct. at 1837 (quoting United States v. Gaudin, 515 U.S. 506, 509, 115 S. Ct. 2310, 2313 (1995) (quoting Kungys v. United States, 485 U.S. 759, 770, 108 S. Ct. 1537, 1546 (1988))); see also United States v. Gregg, 179 F.3d 1312, 1315 (11 th Cir. 1999) (using this definition to determine the materiality of a false statement in a bank fraud case). Because the issue is whether a statement has a tendency to influence or is capable of influencing a decision, and not whether the statement exerted actual influence, a false statement can be material even if the decision maker did not actually rely on the statement. See Gregg, 179 F.3d at 1315. Indeed, a false statement can be material even if the decision maker actually knew or should have known that the statement was false. See United States v. Johnson, 139 F.3d 1359, 1364 (11 th Cir. 1998) (stating that actual knowledge "is not a defense to the 'materiality' requirement" in the context of discussing whether a false statement is material under 18 U.S.C. § 1001), cert. denied, - U.S. -, 119 S. Ct. 2365 (1999); United States v. Johnson, 530 F.2d 52, 55 (5 th Cir. 1976) 4 ("The natural and probable tendency of the affidavit to influence the decision to be made must be judged by the content of the document itself and not by any special knowledge possessed or acquired by the [Internal Revenue] Service."). 5
7. Nos. 04-1038/222 Appeals from the United States v. District Court for the * District of Minnesota. Olusoji Michael Agboola, February 14, 2005 This case had several appeals. Of interest to investigators might be the appeal on total losses from the frauds and the formula used to reach that number by the Internal Revenue Service. The court affirmed the formula. Also noted was an appeal that described the IRS agent as a layman or expert witness.
- "As recognized by the Guidelines, the damage wrought by fraud is sometimes difficult to calculate, so a district court is charged with the difficult task of making a reasonable estimate of the damages or loss. Because the district court need only make a reasonable estimate of loss rather than a precise determination, United States v. French, 46 F.3d 710, 715 (8th Cir. 1995). Application note 9 instructs, "The loss need not be determined with precision. The court need only make a reasonable estimate of the loss, given the available information." U.S.S.G. § 2F1.1 cmt. n.9. This estimate "may be based on the approximate number of victims and an estimate of the average loss to each victim, or on more general factors, such as the nature and duration of the fraud and the revenues generated by similar operations. The offender's gain from committing the fraud is an alternative estimate that ordinarily will underestimate the loss." Id. "The amount of fraud loss for sentencing purposes

is the greater of the loss defendants intended to inflict at the time of the fraud, or the actual loss.” United States v. Coon, 187 F.3d 888, 899 (8th Cir. 1999).

- In this investigation, the perpetrators’ companies would hold title to real estate for as little as one day before selling to a client for substantially higher prices, based on the fraudulent appraisals. The perpetrator encouraged his employees to set up their own companies to purchase and sell real estate, as well as use “seller carry-back” loans to pay off a client’s down payment to help the client qualify for a mortgage. The perpetrator provided the funds for these transactions. The normal practice at the perpetrator’s company was to forgive the carry-back loans so clients would not have to repay them, but institutional lenders were not informed of the practice. The perpetrator then directed employees to submit fraudulent loan documents, deposit verifications, employment records, income records, and tax returns to mislead lenders into funding transactions brokered by the perpetrator.

REFERENCES FOR FURTHER INFORMATION ON MORTGAGE FRAUD:

1. Federal Financial Institutions Examination Council, The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper Produced by the October 27 – November 7, 2003 FFIEC Fraud Investigations Symposium.
 - This White Paper is an excellent resource for the review of residential mortgage frauds that are associated with industry insiders. This 69 page document includes glossaries of terms, various types of frauds described in detail, the examination of motives, and the mortgage loan process and its participants. Additionally, the report provides a list of best practices for industry and methods to identify fraud by appraisers; see Notes (1).
2. <http://www.mortgagedaily.com>
3. <http://www.mortgagenewsdaily.com>
4. <http://www.mari-inc.com> (Mortgage Asset Research Institute – a Choicepoint service, in conjunction with the Mortgage Banker’s Association publishes annual reports on mortgage frauds including white papers).

Hearings before the permanent subcommittee on investigations of the Committee on Governmental Affairs United States Senate, 106th Congress, Second Session, June 29-30, 2000.

NOTATIONS:

- (1) The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper: Federal Financial Institutions Examination Council, http://www.ffiec.gov/exam/3P_Mtg_Fraud_wp_oct04.pdf
- (2) U.S. Title 12: Banks and Banking
 - PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

- <http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=126705d1d7674b34c1edae36bca78bc5&rgn=div6&view=text&node=12:2.0.1.1.8.5&idno=12>

Subpart E—Real Estate Lending and Appraisal Standards

Source: 63 FR 37655, July 13, 1998, unless otherwise noted.

§ 208.50 Authority, purpose, and scope.

(a) *Authority.* Subpart E of Regulation H (12 CFR part 208, subpart E) is issued by the Board of Governors of the Federal Reserve System under section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o) and Title 11 of the Financial Institutions Reform, Recovery, and Enforcement Act (12 U.S.C. 3331–3351).

(b) *Purpose and scope.* This subpart E prescribes standards for real estate lending to be used by member banks in adopting internal real estate lending policies. The standards applicable to appraisals rendered in connection with federally related transactions entered into by member banks are set forth in 12 CFR part 225, subpart G (Regulation Y).

§ 208.51 Real estate lending standards.

(a) *Adoption of written policies.* Each state bank that is a member of the Federal Reserve System shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing.

(3) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

12 CFR Part 1731

RIN 2550-AA31

Mortgage Fraud Reporting

4220-01P

Proposed Rule: 2/18/2005

<http://www.ofheo.gov/media/pdf/mortfraudregproposed.pdf>

<http://www.ofheo.gov/media/pdf/MortFraudReporting72805.pdf>

Analysis of Proposed Regulation

In light of the impact of mortgage fraud on the safe and sound operations of the Enterprises (Freddie Mac, Fannie Mae), the proposed regulation sets forth safety and soundness requirements with respect to mortgage fraud reporting. OFHEO solicits comment on the purpose of the proposed regulation.

- The term “mortgage fraud” would be defined under § 1731.2.
- Under § 1731.3, an Enterprise would not be permitted to require the repurchase of or decline to purchase a mortgage, mortgage backed security, or similar instrument if it has notice of fraud or possible mortgage fraud until it promptly reports such fraud to the Director. OFHEO solicits comments on this proposed section.
- Section 1731.4 would set forth the procedures for reporting fraud and possible mortgage fraud to OFHEO. As noted above, OFHEO would issue guidance and instructions with respect to format and content of mortgage fraud reports.

- Section 1731.4 also would provide that if the situation requires the immediate attention of OFHEO, an Enterprise would report immediately by telephone or electronic communication. This requirement would not prevent an Enterprise from disclosing or reporting such fraud pursuant to legal requirement, including to appropriate law enforcement authorities.
 - Section 1731.5 of the proposed regulation would provide that an Enterprise must establish adequate and efficient internal controls and procedures and an operational training program to assure an effective system to detect and report mortgage fraud. OFHEO solicits comments on this proposed requirement.
 - Section 1731.6 expressly would state that failure to comply with the requirements of the regulation may subject the Enterprise or the board members, officers, or employees of the Enterprise to supervisory action by OFHEO under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.
- (4) 818.02 Executing mortgage on personally without notifying mortgagee of prior mortgages.-- Whoever executes a second or subsequent mortgage of personal property and receives money or thing of value therein without first notifying the second or subsequent mortgagee of the existence of the prior mortgage or mortgages, whether the same be recorded or not, and of the amount of such prior indebtedness, shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 or s. 775.083.

Senate Bill 1056 (Ch. 2005-267): Business Entities; Department of State; False Acts; False Statements; False Documents; Fraud; Repeals; Corporations; Partnerships; Registered Agents; Crimes and Penalties

This 210-page bill concerns a number of topics affecting business entities, including matters involving the Florida Department of State. On the last page of the bill it amends F.S. 817.155 by increasing the penalty from a second degree misdemeanor to a third degree felony when a person, in a matter within the Department of State's jurisdiction, knowingly and willfully falsifies or conceals a material fact, or makes a false, fictitious, or fraudulent statement or representation, or makes or uses a false document, knowing that it contains a false, fictitious, or fraudulent statement or entry. Also repeals offenses in F.S.S. 607.0129, 617.0129, and 620.192 concerning false documents, corporations, and registered agents as they relate to partnerships. Effective Date: January 1, 2006, except as the bill provides otherwise.

- (5) Title 16 of the Official Code of Georgia Annotated, relating to offenses involving theft, so as to provide for the "Georgia Residential Mortgage Fraud Act"; person commits the offense of residential mortgage fraud when, with the intent to defraud, such person:
- Knowingly makes any deliberate misstatement, misrepresentation, or omission during the mortgage lending process with the intention that it be relied on by a mortgage lender, borrower, or any other party to the mortgage lending process;
 - Knowingly uses or facilitates the use of any deliberate misstatement, misrepresentation, or omission, knowing the same to contain a misstatement, misrepresentation, or omission, during the mortgage lending process with the intention that it be relied on by a mortgage lender, borrower, or any other party to the mortgage lending process;

- Receives any proceeds or any other funds in connection with a residential mortgage closing that such person knew resulted from a violation of paragraph (1) or (2) of this Code section;
- Conspires to violate any of the provisions of paragraph (1), (2), or (3) of this Code section; or
- Files or causes to be filed with the official registrar of deeds of any county of this state any document such person knows to contain a deliberate misstatement, misrepresentation, or omission.
- **An offense of residential mortgage fraud shall not be predicated solely upon information lawfully disclosed under federal disclosure laws, regulations, and interpretations related to the mortgage lending process.**

(6) Charts from the *Seventh Periodic Mortgage Fraud Case Report to Mortgage Bankers Association, May 2005: Mortgage Asset Research Institute, Inc. (midex):*

MARI Fraud Index (MFI) All MIDEX Contributors by State 2001 through 2004		
Rank	State	MFI
1	Georgia	297
2	South Carolina	250
3	Florida	194
4	Utah	160
5	North Carolina	159
6	Missouri	140
7	Nevada	129
8	Texas	127
9	Illinois	126
10	Michigan	121

Source: Case submissions to the MIDEX system

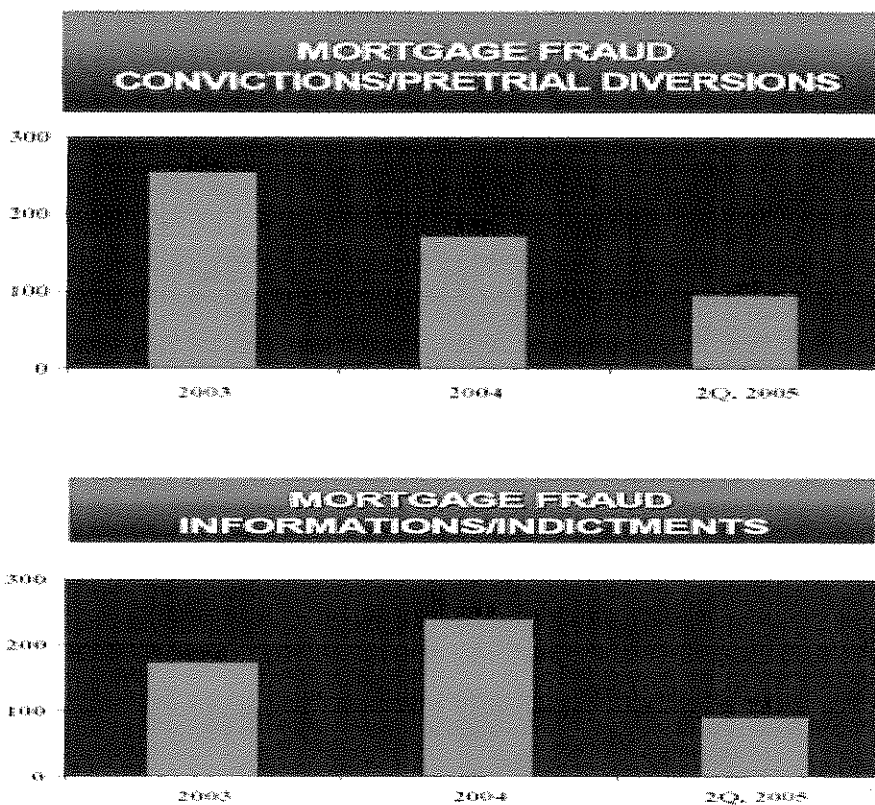
MARI Fraud Index (MFI) for MIDEX Reports from <u>Prime</u> Lenders by State 2001 through 2004		
Rank	State	MFI
1	South Carolina	303
2	Georgia	296
3	North Carolina	188
4	Missouri	171
5	Florida	166
6	Texas	160
7	Utah	159
8	Illinois	134
9	Michigan	112
10	Indiana	108

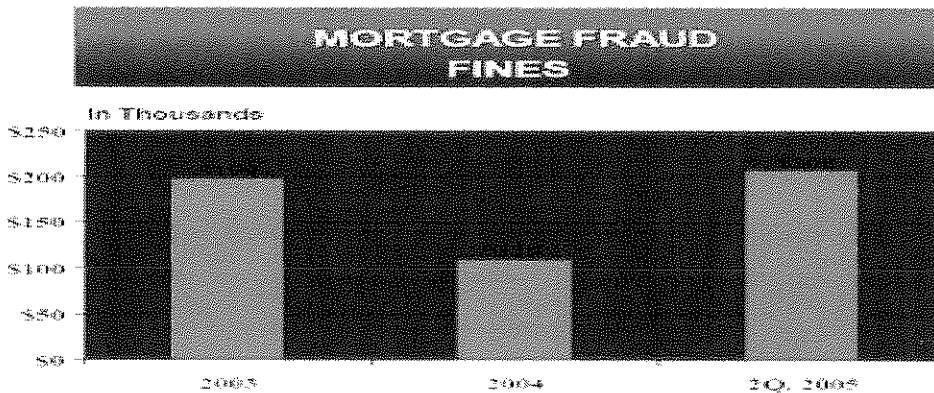
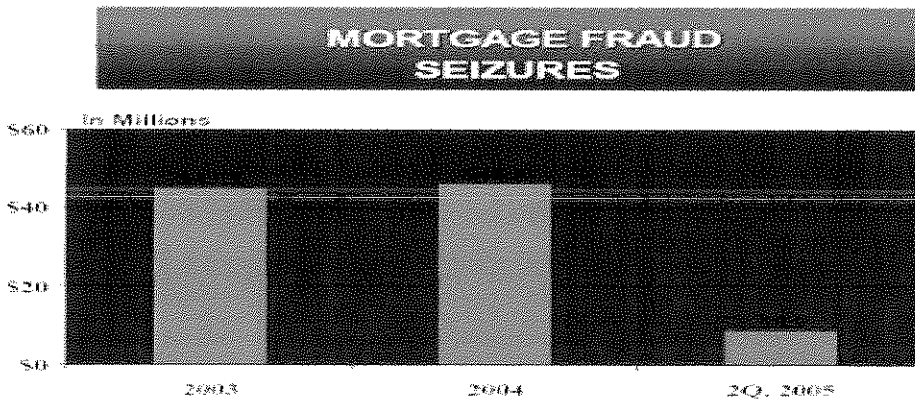
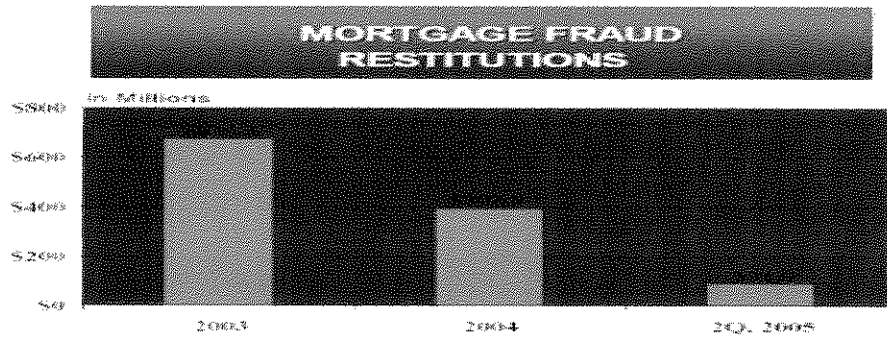
Source: Case submissions to the MIDEX system

**MARI Fraud Index (MFI)
for MIDEX Reports from Subprime Lenders
by State
2001 through 2004**

Rank	State	MFI
1	Georgia ³	297
2	Florida	237
3	South Carolina	172
4	Nevada	166
5	Utah	162
6	Michigan	136
7	New York	132
8	Arizona	123
9	Mississippi	119
10	North Carolina	116

(7) FBI Report on Financial Crimes to the Public May 2005:





(8) The following excerpts were derived from U.S. Senate Hearings on Mortgage Flipping and Predatory Lenders in 2000. The excerpts were recommendations to correct the problem. (Source: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_senate_hearings&docid=f:66088.pdf).

The National Task Force and HUD announced a series of recommendations to address the problem of predatory lending on June 19.

These fifty recommendations to stop predatory lending are based on a four-point plan that gets to the heart of the problem.

First, because education is so important when it comes to homeownership, the plan calls for improved consumer literacy and counseling.

The Task Force recommends requiring counseling for certain types of mortgages and would amend the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) to give people more timely and accurate information on loan costs and terms.

In their second recommendation, the Task Force zeroes in on harmful sales practices. They suggest imposing new requirements on mortgage brokers, which would prohibit abusive lending and loan flipping.

The third recommendation of the Task Force is to restrict the abusive conditions of high-cost loans. To do this, they suggest imposing new restrictions on points and fees for subprime loans and the reduction of prepayment penalties.

In addition, they also suggest expanding the scope of the Home Equity Protection Act (HOEPA) to cover the subprime market and restricting balloon payments on high-cost loans.

Finally, the Task Force recommends a general improvement for improving the way the market is structured. They suggest prohibiting Fannie Mae, Freddie Mac, and Federal Home Loan Banks from purchasing loans with predatory features.

They also recommend using the Community Reinvestment Act (CRA) to encourage lenders to move people from the subprime market to the conventional market.

First, it calls for early detection of problem loans and problem lenders.

Second, it provides help to the victims of flipping and helps them avoid foreclosure so they can keep their homes.

Third, it identifies and prosecutes the predatory lenders and flippers so they will no longer prey upon innocent people.

This is the kind of Federal commitment I want--a commitment to stabilizing and saving communities.

Yesterday, I joined my colleague Senator Sarbanes in introducing legislation to authorize HUD's Credit Watch Program.

This legislation will formally authorize HUD's Credit Watch program. The legislation is needed to close a loophole that has allowed some flippers and predatory lenders to escape punishment.

Our bill will give HUD the power to prosecute the bums and scum with the power of law behind them. This legislation was the direct result of the Baltimore Task Force.

In the coming weeks, it will be critical for FHA to make sure that promises made are promises kept.

I believe we are already making a difference- thanks to the work of the FBI, U.S. Attorney and the hearings that have been held on this subject, we have sent a chill down the spine of flippers and predatory lenders. In Baltimore, the word is out on the street. If you are a flipper, you will be caught.

While I am proud of the work of the Baltimore Task Force, it goes hand in hand with the National Predatory Lending Task Force chaired by HUD and the Treasury Department.

The Baltimore Task Force gave us a blueprint to stop flipping, while the National Task Force gave us a blueprint to stop predatory lending.

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Finally, the Task Force recommends a general improvement for improving the way the market is structured. They suggest prohibiting Fannie Mae, Freddie Mac, and Federal Home Loan Banks from purchasing loans with predatory features.

- (9) In addition, the wider range of prices available in the marketplace has raised concerns about whether price variations reflect, even in part, unlawful discrimination rather than legitimate risk- and cost-related factors. "A lender may also want to determine if the HMDA data reflect price disparities that are not adequately explained by other information in the HMDA data set--such as income, loan size, and lien status--and, if so, to analyze those disparities in light of price variables known to the lender. The analysis could include a review of pricing discretion provided to loan officers. It also could include, where applicable, a review of the pricing patterns of mortgage brokers through which the lender has originated loans. Should a lender discover risks in its HMDA data, it goes without saying that the lender should manage those risks. As with other risks, those related to the HMDA disclosures should be managed with an eye to the entire enterprise, including the bank and the non-depository affiliates." (Remarks by FRB Governor Susan Schmidt Bies at the Financial Services Roundtable Annual Meeting, Palm Beach, Florida, March 31, 2005)