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My name is Ann Fulmer. I hold a Bachelor of Arts in Mass Media/Communications and a law degree, both from the University of Akron. I have studied mortgage fraud[1] against lenders and how to detect it, and have worked diligently to prevent it since 1996, when criminals began to illegally "flip" houses in my neighborhood just outside Atlanta, Georgia. In this quest I have worked as a licensed private detective, a county tax assessor, as an expert witness, and briefly as a criminal prosecutor. I also co-founded the Georgia Real Estate Fraud Prevention and Awareness Coalition, whose mission includes raising public awareness of the crime and the damage it brings to communities. For the past five years I have been the Vice President of Business Relations at Interthinx, a leading provider of automated fraud detection and prevention technology to the residential mortgage lending industry. In that capacity, I frequently lecture on the topic at industry conferences and have been called upon to provide training and assistance to Federal law enforcement agencies including the FBI, the Secret Service, HUD's Office of Inspector General, and Federal prosecutors.

The variety of mortgage fraud schemes shift with market conditions and are limited only by the human imagination. I have focused my testimony on illegal flipping because it was the predominant scheme at the beginning of the last fraud cycle and, in my view, it was the precipitating factor in the current financial crisis. Flipping played a major role in the initial escalation of housing prices, which drew speculative investors and more fraud into the market, and eventually housing became unaffordable in many markets. This in turn led to the abuse of stated income and no document loan programs— particularly through the brokered mortgage channel— in order to qualify borrowers for mortgages that, if they had been fully amortized, they could not afford to repay. When the housing market began to cool in 2005, the riskiest borrowers began to default in large numbers in what came to be called the "subprime mortgage meltdown." Their defaults eventually became so pervasive that investors in

[1] Because predatory lending activities are frequently referred to by law enforcement and others outside the industry as "mortgage fraud," it is important to understand the distinction between the terms. In predatory lending cases, the borrower is the victim of the lender or broker's failure to make proper disclosure of the terms and fees associated with the loan or of a loan containing terms harmful to the borrower, including excessive rates or fees, or a failure to provide a tangible benefit to the borrower. The majority of these cases are pursued in the civil courts, most recently as a defense to foreclosure. In mortgage fraud cases, the victims are the lender, the communities in which it is perpetrated, and by virtue of the fact that more than 90% of loans originated today are purchased, insured or guaranteed by the Federal government directly or indirectly through Fannie Mae and Freddie Mac's conservatorship, US taxpayers. Violations are prosecuted as criminal matters.

residential mortgage backed securities began to demand that the originators repurchase entire pools of loans. Since most lenders were originating mortgages to sell on the secondary market, they did not have the funds available to meet investor demand. When these lenders began to fail, it created the liquidity crisis and, ultimately, led to the Great Recession.

Mortgage fraud is, essentially, bank robbery without a gun. It is a high-yield, low-risk crime that can, in a single transaction, net a perpetrator from $100,000 to $1 million or more in illicit profits.[2] It can, and does, happen anywhere — from run-down and gentrifying neighborhoods in the urban core to suburban neighborhoods and gated country club communities to newly constructed exurbs. It has been reported in all 50 states, Puerto Rico, Guam, and American Samoa.[3] Its perpetrators are equally diverse: Criminal prosecutions and news reports point to the involvement of organized rings,[4] street gangs,[5] persons with links to terrorists and terrorist organizations,[6] drug traffickers,[7] real estate agents,[8] closing attorneys,[9] appraisers,[10] mortgage brokers,[11] bank executives,[12] ministers,[13]

[2] In contrast, the Federal Bureau of Investigation reports that between FY 2003 and FY 2009 the average cash haul in a physical hold up of a lender was just over $10,000. Federal Bureau of Investigation, Lender Crime Statistics, http://www.fbi.gov/publications.htm.

[3] Financial Crimes Enforcement Network, "Mortgage Loan Fraud: An Industry Assessment Based on Suspicious Activity Report Analysis," November 2006 at 10. http://www.fincen.gov/news_room/rp/reports/pdf/mortgage_fraud112006.pdf.

[4] See, e.g., USA v. Bowens, 2:07-cr-00544 (D. Ariz. 2007) (defendants scheme perpetrated over five years and three states involving 19 properties and 10 vehicles).

[5] See, e.g., David Jackson, "Mortgage Fraud Is the Thing to Do Now," *Chicago Tribune*, Nov. 5, 2005.

[6] See, e.g., USA v. Omar, 2:06-cr-756, superseding indictment (D. Utah 2006) and Bianco, Katalina "Money Laundering and Mortgage Fraud: The Growth of a Merging Industry," pp. 6-9, http://www.cch.com/press/news/CCHWhitePaper_Fraud.pdf; Sheridan, Mary Beth, "Man Suspected of Bin Laden Link Accused of Fraud," *The Washington Post*, August 9, 2005 (the criminal case against Tarik Hamdi, the Ayatollah Khomeini's spokesman, is still open at USA v. Hamdi, 1:05-cr-00123 (E.D. Va. 2005), and Patrick Poole, "Mortgage Fraud Funding Jihad," FrontPageMag.com, April 11, 2007 http://www.frontpagemagazine.com/articles/Read.aspx?GUID=2FB5D093-D93D-404B-B4CD-AEEA3DB9CEBF.

[7] See, e.g., United States Immigration and Customs Enforcement press release, Nov. 19, 2008. http://www.ice.gov/pi/nr/0811/081119newyork.htm .

[8] See, e.g., USA v. Rice, 1:2002-cr-00691 (N.D. Ga. 2002).

[9] See, e.g., USA v. McFarland, 1:04-cr-224 (N.D. Ga. 2004) (superseding indictment); USA v. Sprouse, 3:07-cr-211, fourth superseding indictment (W.D. N.C. 2007).

[10] See, e.g., USA v. Ross, 5:06-cr-40068, first superseding indictment (Kan. 2006).

[11] See, e.g., USA v. Hooker, 2:05-cr-80897 (E.D. Mich. 2005).

[12] See, e.g., USA v. Gordon, 08-cr-21103 (S.D. Fla. 2008) (lender's managing director altered borrowers' credit scores and misrepresented property type in order to inflate the apparent quality and value of mortgage pools prior to their sale to investors); USA v. Levine, 1:09-cr-00554 (N.D. Ga. 2009) (executive vice president in charge of lender's community redevelopment lending department knowingly overvalued lender assets in reports to the OCC and the FDIC in order to hide fraudulent loans funded by his department).

[13] See, e.g., USA v. Sailor, 1:08-cr-105, superseding information (N.D. Ga. 2008).

teachers,[14] police officers,[15] former professional athletes,[16] and novice property investors.[17]

Mortgage fraud is cyclical, and, contrary to the belief of many, occurs in both rising *and* falling markets because manipulation of property values is the primary mechanism for extracting illicit profits, and it is easiest to disguise when house prices are changing. It is not a new phenomenon: A Google news archive search for the term between 1975 and 1996 yielded nearly 7,800 articles. What *is* new in this cycle is its breathtaking scope, its pervasiveness and the damage it inflicted on the communities in which it occurred. While there are a multitude of factors that in combination led to the financial crisis, the unchecked proliferation of mortgage fraud against lenders must be considered as one of the primary precipitating factors.

The Evolution of Mortgage Fraud

This latest fraud cycle began in the mid-1990s. Property values had been falling since 1989[18] and were ripe for a rebound. The economy was sluggish, consumer confidence was down, and 30-year mortgages were above 9% and rising. In February of 1996, the Federal Reserve cut the federal funds rate and the discount rate in an effort to boost the economy.[19] By autumn, mortgage rates had fallen by two points,

[14] See, e.g., USA v. Sprouts, 2:08-cr-0051 (W. D. Pa. 2008).

[15] See, e.g., USA v. Culp, 3:08-cr-00055 (N.D. Ind. 2005); USA v. Guaracino, et. al, 0:10-cr-60194 (S. D. Fl. 2010)

[16] See, e.g., USA v. Marshall, 1:09-cr-00078 (S.D. Ga. 2009).

[17] Novice investors are sought out by perpetrators because their inexperience can easily be exploited. Interviews with such investors reveal that they were lured into the schemes by perpetrators who presented themselves as experts offering passive "turnkey" programs that promised purchase prices below market value and cash back to the borrower/investor at closing. The perpetrators also promised to make renovations or repairs to the properties and to manage the rental of the properties at rates that would cover the mortgage and generate a few hundred dollars of income. They were told that after a year the property could be sold at a profit. But once the purchase was completed, the perpetrators disappeared and the investor, who typically had bought the property sight unseen, visited the property and discovered that the property had not been renovated, that there were no tenants, that market rents would not be sufficient to cover the mortgage payment, and that the actual value of the property was less than the mortgage balance. Some novice investors report that they fell for the perpetrator's claims because they had seen A&E's "Flip This House" and/or the Carleton Sheets "no money down, cash back at closing" infomercials on television, which gave them the impression that profitable real estate investing could be relatively effortless and which lent credibility and the appearance of legitimacy to the scheme as proposed by the perpetrator.

[18] A History of Home Values, *The New York Times*, August 26, 2006, http://www.nytimes.com/imagepages/2006/08/26/weekinreview/27leon_graph2.html (citing Shiller, Robert J., "Irrational Exuberance," 2nd Edition, 2006).

[19] Malkin, Lawrence, "Federal Reserve Cuts Borrowing Costs in Effort to Spur Growth: Lower Rates Give U.S. More Room to Breathe, February 1, 1996 http://www.nytimes.com/1996/02/01/news/01iht-fed.t.html.

real estate sales were surging, and the stage was set for fraud.

I was living in Atlanta, Georgia, in the summer of 1996, when I first became aware of mortgage fraud. Houses in my upscale neighborhood that had been sitting on the market for as much as two years finally began to sell, and I heard rumors that the purchasers were leaving the closing table with large amounts of cash. Neighbors began to complain to the homeowners' association that the new owners of these houses were not maintaining the yards or the properties and expressed concern because the new occupants were "different": They actively avoided contact with the neighbors, didn't seem to have jobs or furniture, were covering garage windows with paper, and had a lot of late-night visitors. Then a title attorney neighbor told me that he had been working with an IRS agent and an investigator from the state Department of Banking and Finance who were investigating these sales. Since he had a conflict of interest that prevented him from continuing that work, he asked me to get involved. I began to research the sales history of these properties and discovered that a handful of people were involved in all of the unusual sales in my neighborhood, that they were buying and re-selling these houses on the same day with price increases of up to $300,000, and that they were doing this in communities throughout metropolitan Atlanta. That's when I discovered illegal flipping.

In a typical illegal flip,[20] the perpetrator enters into a contract to purchase a property at or below the current asking price. Before the perpetrator closes on his purchase, and with no or only cosmetic improvements, he obtains an appraisal that shows a substantially higher value.[21] He then enters into a contract to resell the property to a "straw" buyer.[22] The straw, whose loan application may

[20] Not all flips are illegal. If, in a non-distressed, arm's-length transaction someone buys a property at less than market value and then resells it at market value to a willing buyer, it is not illegal. Nor is it illegal if someone buys a property in an arm's-length transaction and makes repairs, improvements, or renovations and then resells it in an arm's-length transaction that represents a fair value to a willing buyer.

[21] While the inflation may be as little as 50%, in extreme cases, the valuation can be as much as 300% above actual market value.

[22] A straw buyer is a person who allows the use of his or her financial identifiers and credit history in the mortgage application process, often in exchange for a fee of as little as $10,000 or as much as $100,000 or more. Perpetrators use straws, nominees, and stolen identities to hide their involvement in the transaction. While perpetrators sometimes use their own names when purchasing the property from the original owner, they frequently use limited-liability shell companies ("LLCs") to further obscure their participation because LLCs are not required to list their officers, managers, or owners in their incorporation documents. In many cases, the straw has no intention of either occupying the property or repaying the mortgage, especially if the perpetrator has promised to manage the property as a rental and to use the rents to make the mortgage payments on the straw's behalf. Thus, transactions involving straw buyers are likely to go into default and eventual foreclosure.

misrepresent income, employment, assets, and intended use of the property, obtains a loan to purchase the property at the higher price. Both transactions are closed simultaneously or only a short time apart,[23] which enables the proceeds from the straw's mortgage loan to be used by the perpetrator to close his purchase of the property at the lower price. The perpetrator's profit is the difference between the actual purchase price and the inflated price to the straw. The value of the property securing the lender's loan is its protection against loss. If a property is overvalued at origination, the lender will suffer a loss if it has to foreclose unless property values have risen enough in the interim to match the overvaluation.[24] But even without an eventual foreclosure, overvaluation can have a significant effect on a metropolitan region.

Potemkin Villages: Fraud's Effect on Metropolitan Housing Prices

Since the existence of mortgage fraud was not widely known in the mid-1990s, flip sales were not recognized as illegal transactions, and the inflated values were entered into county deed registries, multiple listings, and appraisal and tax assessment databases and published in the local paper's weekly real estate section. Once these fraudulent values became part of the public record, the perpetrators and complicit (or incompetent or inexperienced) appraisers were able to use them as comparable sales to facilitate additional flips in the immediate area and in ever-widening arcs throughout an entire region. For example, an investigation conducted by the *Sarasota Herald Tribune* into real estate sales in Florida between 2000 and 2009 identified more than 50,000

[23] In many cases, the perpetrators would enlist the services of a naïve or corrupt settlement agent to conduct a "reverse" closing in which the sale from the perpetrator to the straw buyer was closed first, even though the perpetrator did not yet actually own the property. The proceeds from that transaction were then used to pay for the sale from the original owner to the perpetrator. If the settlement agent was a corrupt actor, he might also cause the deeds to be recorded in the proper order (original owner to perpetrator to straw buyer) in order to obscure the illegal nature of the reverse closing.

[24] This was the case during the run up of property values in the early 2000s. The magnitude of the fraud that had been committed was masked by rapidly rising values that minimized or eliminated lender losses. Rising property values also masked the incidence of fraud committed by and on behalf of borrowers whose income was overstated in "liar loan" programs because they could sell their homes at par or better if they were in danger of default. Although a fraud "expert," quoted in August of 2005 in a leading mortgage publication, encouraged lenders to believe that fraud by borrowers was a mere technical compliance issue that could safely be ignored because those borrowers never defaulted, FinCEN statistics show that the vast majority of mortgage loan SARs filed between 1996 and 2006 referenced income and asset misrepresentation by the borrower. Statement of James H. Freis, Jr., Director, Financial Crimes Enforcement Network, Before the United States House of Representatives Committee on Financial Services Subcommittee on Housing and Community Opportunity, May 6, 2009 http://www.fincen.gov/news_room/testimony/html/20090506.html.

suspicious flips[25] — a number that one expert said wasn't "even close to the bare minimum"[26]— for which lenders granted mortgages worth $10 billion.[27] The *Herald Tribune* noted that these flips began in urban centers and then "radiated into the suburbs and surrounding communities."[28]

While flipping in single-family neighborhoods was immensely profitable for the crooks, flips involving condominium and condo conversion projects allowed them to take profits into the stratosphere. Why bother with the hassle of flipping one house at a time when you could buy an entire apartment project, convert it to condos (or just represent that they had been converted), or buy flip-ready units from developers of new projects, and then, through real estate investment clubs and hype, flip a hundred units at inflated prices and walk away with millions of dollars? That's what happened in a scheme that ran from 1997 through 2004 in Chicago. In that case, the perpetrators bought and "converted" at least 32 apartment buildings. They recruited an appraiser to inflate the units' values, recruited straw buyers with promises of cash back at closing, and, through their mortgage brokerage companies, prepared and submitted loan applications that materially overstated the buyers' income and assets. The defendants' obtained $27 million in loans and were ordered to pay restitution of $8 million.[29] While there is no way to ascertain the magnitude of illegal flipping and price speculation[30] in the condo market, Radian Guaranty, the number three mortgage insurer in the country, quit writing policies for attached condominiums in 2009.[31]

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[25] For the purposes of the study, the reporters adopted the mortgage industry's definition of a price increase of at least 30% or more within 90 days of the first purchase. Braga, Michael; Davis, Chris; and Doing, Matthew, "'Flip That House' Fraud Cost Billions," *Sarasota Herald Tribune*, July 19, 2009, http://www.heraldtribune.com/article/20090719/ARTICLE/907191031?p=all&tc=pgall&tc=ar# and chart at http://www.heraldtribune.com/assets/pdf/SH17326717.PDF.

[26] This is an accurate statement because some flips take more than 90 days to complete, not all fraudulently inflated prices exceed 30% of the original price, and flipping on preconstruction condominiums was conducted through serial contracts that are not recorded in the public record.

[27] Id.

[28] Id.

[29] USA v. Kakvand, 1:04-cr-00896-1 (N.D. Illinois 2004). See also USA v. Dossey, 1:08-cr-00246 (N.D. Ga. 2008) (similar scheme operating over 17 months netted more than $6 million).

[30] The intense interest in this market is reflected by the creation, in 2005, of an Internet exchange to allow purchasers of unbuilt Miami condo units to find buyers to which to flip them. Foust, Dean "Flipping in Florida," Bloomberg.com, July 27, 2005 http://www.businessweek.com/the_thread/hotproperty/archives/2005/07/flipping_in_florida.html .

[31] *National Mortgage News*, "Nation's #3 MI, Radian, Bans Condo Loans," March 10 2009 http://www.nationalmortgagenews.com/dailybriefing/2009_47/-416857-1.html.

Illegal flipping may have been given a boost in 2002 when HBO's wildly popular series "The Sopranos" featured a storyline based on an actual scheme in Harlem where corrupt realtors purchased run-down buildings, over-appraised them, and "flipped" them to local nonprofit groups that were eligible for HUD 203(k) rehabilitation grants.[32,33] In any event, rising prices, low interest rates, and the promise of a fast buck through "no money down and cash back at closing" programs hawked by late-night infomercial gurus[34] attracted the attention of "specuvestors,"[35] many of whom, especially those recruited by perpetrators at educational seminars for novice investors, were engaged in illegal flipping. Flipping became such a phenomenon that in 2005 the Arts and Entertainment channel debuted "Flip This House," which quickly became its most popular show, and TLC introduced "The Property Ladder" to showcase the legal riches to be had through this form of investing.[36] Even a hedge fund got involved.[37] While not all flipping is illegal, the rise in *illegal* flipping was dramatic and particularly intense in Florida, which the FBI in fiscal year 2009 ranked in the top ten for same-day, 30-day, and 60-day property flips.[38]

The effect of fraudulent flipping on a region's housing prices is magnified by the fact that these illicit sales tend to cluster geographically.[39] Clusters of flipped properties, whether in condo developments or single-family neighborhoods, push legitimate sale prices within a one-quarter mile radius by as much as 4%,[40] and can drive the market because:

[32] "Watching Too Much Television," Episode 47, October 27, 2002.

[33] Feldman, Cassi and Gray, Geoffrey, "Losing Bid: Harlem tenants face auction of 203(k) homes," *City Limit*, December 15, 2003. http://www.citylimits.org/news/articles/1392/losing-bid-harlem-tenants-face-auction-of-203-k-homes.

[34] The most widely promoted of these gurus was Carleton Sheets.

[35] A specuvestor is a person who engages in speculative real estate investments.

[36] A&E was forced to remove episodes from 2006 involving Sam Leccima of Atlanta when he was accused of running an investment scam, and it was discovered that his featured renovations were elaborate hoaxes. http://today.msnbc.msn.com/id/18985912

[37] Dutton, Geogg, "Flipping Frenzy: Wealthy Investors Profit from Run Down Houses," The Columbus Dispatch, September 20, 2005 http://www.dispatch.com/live/contentbe/dispatch/2005/09/20/20050920-A1-00.html. The article alleges that the houses the fund was buying and selling were illegally flipped.

[38] Federal Bureau of Investigation, "2009 Mortgage Fraud Report 'Year in Review'", http://www.fbi.gov/publications/fraud/mortgage_fraud09.htm. The activities investigated by the FBI come, in large part, through lender SARs. FinCEN reports that the majority of SARs are filed on frauds that are discovered post-foreclosure, and concern activities that occurred from one to five years or more prior to the filing.

[39] Clustering occurs because appraisers are required to use recent comparable sales within a one-mile radius of the subject property.

[40] Andrew T. Carswell, Ph.D., "Effects of Mortgage Fraud on Assessment Values and House Sales Prices," Journal of Property Tax Assessment and Administration, vol. 6 no. 2 pp. 5-17 (2009).

- Real estate agents rely on published listing and sales prices to help them determine the market value of their new listings. If they do not live in the area and do not recognize that the reported values were inflated, the listing prices they suggest to new clients will incorporate the fraudulent inflation.
- Appraisers also rely on published and recorded sales values to help determine the value of the properties they are analyzing. If they do not recognize that these previous sales were collusive and inflated, and they are selected for use as comparable properties,[41] the appraisal will incorporate the fraudulent inflation.
- Lenders rely on published and recorded sales data when evaluating the accuracy of the appraisals submitted in support of a loan application. If the published data supports the value, the price will be accepted, the mortgage will be approved, and another sale will be recorded.
- In Georgia, once a certain number of increased prices are recorded, the neighborhood will be reassessed for property tax purposes. If the assessors do not recognize the existence of a fraud cluster and accept the values as a sign of appreciating values, tax assessments will increase.[42] The difference in growth in tax assessments between areas with fraudulent transactions and those without increases over time.[43]
- Investors and lenders sometimes use tax assessments to help them judge whether a given property is worth the asking price.

[41] To increase the likelihood of that happening, perpetrators and corrupt real estate agents often supply the appraiser with information from the flips and suggest that they be used as comparable sales.

[42] This is especially true when the only transactions in a neighborhood are fraudulent. This occurred in my neighborhood, where assessments jumped 30% despite the fact that the legitimate sales that had occurred were sold for much lower prices. When presented with the evidence of flipping, the assessors removed the illicit sales values and reduced our assessments. Other neighborhoods in Atlanta, particularly those in the fraud-infested 30310 and 30315 zip codes, were not so fortunate. The 30310 Mortgage Fraud Task Force was formed, in part, to address what residents in the area believed were fraud-inflated tax assessments. While fraud was not the only reason assessments rose during the boom, the number of identified fraudulent transactions there were clearly an important factor. The fraud premium on tax assessments in those areas became particularly pronounced when the boom collapsed and foreclosures, which became the predominant sales in these neighborhoods, began to drive values down. A study conducted at the request of the Atlanta Neighborhood Development Partnership estimated that by 2008, every house in these areas was over-assessed by $1500, which represented a collective $20 million overpayment. Duffy, Kevin, "Study: Poor neighborhoods face unfair property taxes, The Atlanta Journal-Constitution, October 9, 2008.

[43] Andrew T. Carswell, Ph.D., "Effects of Mortgage Fraud on Assessment Values and House Sales Prices," *Journal of Property Tax Assessment and Administration*, vol. 6 no. 2 pp. 5-17 (2009).

The end result is that a fraud premium will be charged to subsequent purchasers[44] and all of the residents within the neighborhood.

While there were many reasons that housing prices rose so dramatically during the boom, years of fraudulently inflated values and their upward pressure on prices was certainly an important factor. Combined with low interest rates, and consumer and property investor demand, markets across the country experienced several years of sequential double-digit— and in some cities triple digit[45] — price appreciation in the early 2000s.[46] At some point, housing ceased to be viewed by the public primarily as a place of shelter and came to be viewed as an ATM for owners with increasing equity and as a means by which anyone could become wealthy. The latter attitude was reflected in the government's pressure on lenders and Fannie Mae and Freddie Mac to increase their lending to high-risk populations in order to boost their homeownership rates and enable them to achieve financial security. With housing prices apparently going nowhere but up, demand for residential mortgage-backed securities was intense, and trillions of dollars flooded into the market.

Demand from the secondary market drives underwriting standards because lenders must sell their loans to maintain their capital and reduce reserve requirements. To meet the government's directive to increase lending, to meet the demands of consumers and shareholders, and to stay competitive, the secondary market relaxed its underwriting requirements with respect to creditworthiness (as measured by FICO scores) and loan-to-value ratios which, in the 1990s, required a down payment of as much as 30% of the purchase price. Unfortunately, the statistics underlying the FICO scores did not have a sufficient history to provide valid statistics of borrower performance in declining economic

[44] This fraud premium will also include the price of lender-mandated property and casualty insurance, because the value and price for those policies is based on the amount of the mortgage. In some states, such as Georgia, the law requires that insurers pay policy limits in the event of a total casualty loss. Fraudulently inflated sales prices and values that are pushed by fraud in the area thus also increase the loss severity and cost to insurance companies.

[45] Prices increased by 127% in San Diego and 110% in Los Angeles; prices rose 110% in Boynton Beach, Fla., and housing payments consumed 30% or more of the average borrowers' gross compensation. "Housing Burden Rising Across America," October 9, 2006 http://money.cnn.com/2006/10/03/news/economy/housing_costs/index.htm

[46] A list of sources is available through a Google news archives search of 2001–2004 using query housing+prices+double+digit+appreciation.

environments, and few people thought that housing prices would collapse.

Since workers' median total compensation had risen by only 7.2% between 2000 and 2005 — and most of the rise was due to benefits, not wages,[47] — housing affordability was a serious issue for millions of potential borrowers. The relaxation of underwriting standards meant that products like stated-income loans, which had been developed for a niche market of high-net-worth and exceptionally creditworthy self-employed borrowers, were now available to W-2 employees. What no one realized at the time was that mortgage fraud, which was widely perceived to be negligible as a percentage of origination volume,[48] would skyrocket because fraud moved en masse from the realm of professional criminals and speculative investors who commit "hard fraud" (or fraud for profit) to the realm of "soft fraud" (or fraud for property).

Many lenders, some fraud experts, and the FBI make a distinction between fraud for profit and fraud for property. The industry makes this distinction because frauds for property are perceived to be "one-offs" that never default because the borrower is trying to buy a home and he fully intends to repay the mortgage.[49] While fraud for property looks like an isolated incident when viewed at the individual loan level, if you analyze loans involving the same broker, real estate agent, or appraiser, you may discover that they are all part of what Chris Swecker, former assistant director of the Criminal Division of the FBI, calls "the malignant network" of professional enablers who encourage borrowers to go along with the lie, or who commit it on their behalf, and who make a commission each time that a misrepresented loan closes. Seen from that perspective, it is all fraud for profit.

When the industry accepts "soft" fraud so long as the mortgage gets paid, it encourages people to

[47] Greenhouse, Steven and Leonhardt, David "Real Wages Failed to Match a Rise in Productivity," August 28, 2006 http://www.nytimes.com/2006/08/28/business/28wages.html

[48] The total incidence of fraud is immeasurable because it is not always recognized or looked for, because loan applications with material misrepresentations are usually declined but due to fear of libel and slander suits fraud is not cited as the reason, there is no mechanism by which to universally collect fraud data, and the majority of participants in the industry with information are not required to file SARs with FinCEN, which maintains the closest thing to it. Furthermore, rising property values greatly reduced lenders' losses on foreclosures due to fraud.

[49] See, e.g., Wisniowski, Charles, "Mark Fleming on Fraud Prevention," *Mortgage Banking*, August 2005.

lie. So the mortgage broker[50] tells the borrower that it's OK to exaggerate his income a bit because "the lender doesn't care what goes on the application so long as you keep the payments current." The borrower fudges his income, the loan closes, and the broker gets paid. But it's clear that the next borrower, who's a delivery guy, can't afford the payments on the house he wants. So, to get his commission, the broker tells the borrower he can afford it because he can get 100% financing and the interest rate is only 2%. What he doesn't make clear to the borrower is that the 2% rate is only good for the first three months. Then, knowing that investor guidelines prohibit the lender from verifying the borrower's income, he has the borrower sign a blank application and fills in the income for him. But instead of putting down an income that is reasonable given the borrower's employment and experience (which was the requirement for stated income loans), he puts down "manager" for the borrower's job and puts down whatever income it takes to get him qualified. The loan is fraudulent, and the broker profits because it closes anyway.

It's not just mortgage brokers who facilitate what only *appears* to be fraud for property. Take the real estate agent who sees that the borrower won't have enough money to bring to the closing table. To keep the deal alive, she asks the seller to give the borrower what he needs and says that if they increase the sale price on the contract he'll get his money back at closing because the higher price means a bigger loan. The agent rationalizes that the deal isn't fraud because nothing's really changed — moving money from column A to column B is just "creative financing," right? Wrong. Borrowers who make a financial investment in a property are less likely to walk away from their obligations or to let the property go into foreclosure, and this kind of structuring can take a loan from a 95% loan-to-value ratio to an undisclosed 110% loan-to-value ratio. The higher risk posed by this borrower was hidden from the lender, and the lender was deprived of the opportunity to increase the interest rate to account for the higher risk or to decline the loan altogether. That's fraud. And seeing that the agent structured

[50] The mortgage broker industry was largely unregulated. Some states did not require any specialized education, and only a small percentage performed criminal background checks on applicants or their employees. In Florida, an investigation by the *Miami Herald* found that nearly 10,000 mortgage brokers and originators working during the boom had felony convictions, including convictions for bank and other forms of fraud. Dolan, Jack; Barry, Rob; and Haggman, Matthew, "Ex-convicts active in mortgage fraud," http://www.miamiherald.com/static/multimedia/news/mortgage/brokers.html, and "Thousands with criminal backgrounds work unlicensed as loan originators," http://www.miamiherald.com/static/multimedia/news/mortgage/originators.html, 2008.

the deal to make sure she'd get her commission, it's clear that it's fraud for profit.

It all worked as long as housing prices kept rising. Borrowers could refinance with cash out if they needed to pay some bills; and if they got into real trouble, they could sell for at least what they owed. When they did go into default, those rising prices shielded lenders from most, if not all of the loss. People who had lived in their homes for years could tap their accumulated equity to pay for their children's college education or buy a new BMW or take a cruise. Housing drove the national economy and the "wealth effect" kept its engine running.

But in the second quarter of 2003, interest rates began to climb and mortgage origination volume peaked.[51] Although new housing starts jumped at a faster rate than at any time since 1986,[52] the growth in households was at its lowest point in 40 years, creating excess supply.[53] By 2005, housing prices were beginning to fall, foreclosure rates began to jump across the country, and the subprime mortgage meltdown began. Merit Financial, a large subprime lender, was the first of hundreds of mortgage banks to fail.[54] By August 2007, foreclosures were at record levels, the financial markets had seized up in the liquidity crisis, and the rest, as they say, is history.

Fallout at Ground Zero

Persistence over time

Some perpetrators who flip properties make no payments on the loan at all.[55] Some make only the first few payments.[56] More sophisticated perpetrators make some or all of the payments for the first

[51] Federal Reserve Bank of St. Louis, Mortgage Originations 2000 to 2006, August 2008. Twenty percent of the loans in that year were for 90% or more of the purchase price. "Housing Boom or Bubble?" http://www.pbs.org/now/politics/housingboom.html

[52] CNNMoney.com, "Housing Starts Jump," August 19, 2003 http://money.cnn.com/2003/08/19/news/economy/housing/index.htm.

[53] Housing Boom or Bubble?" http://www.pbs.org/now/politics/housingboom.html

[54] http://ml-implode.com/imploded/lender_MeritFinancial_2006-05-06.html

[55] These loans are called "first payment defaults" and are always investigated by lenders because they are so closely associated with fraud in the origination.

[56] Loans which default within the first 30 to 90 days are called "early payment defaults" and are also investigated by lenders because they are also closely associated with fraud in the origination.

12 months to "season" the loan before defaulting and allowing the property to be foreclosed.[57] Once the property has been foreclosed, it is often purchased again by the same group of perpetrators because they can resell it to a new straw buyer at or near whatever inflated value was established in the original flip. In other cases, a new group of fraudsters may purchase the property, sell it near the original inflated value and begin a new cycle of fraud with different participants.

The two houses on my street involved in fraud were a flipped a combined 7 times and foreclosed 7 times in a process that began in 1996 and continued until 2009, when I stopped counting. I have been told by residents of affected communities, appraisers and law enforcement agents from around the country that this is a typical pattern.

A more detailed examination of this pattern is shown in Figure 6, which concerns the property at 1318 Lucile Avenue. S.W. in Atlanta's notorious 30310 zip code. This zip code has been on industry lists of fraud hot spots for many years and is currently ranked 6th in Interthinx's quarterly Mortgage Fraud Risk Report.[58]

There were a number of unusual transactions involving this house in the four years prior its purchase by Kevin Wiggins, who pled guilty in October of 2007 to criminal bank fraud charges that included his purchase of 1318 Lucile Avenue. [59] The first sale occurred in October of 2000 when it was sold for $99,000, a price that is consistent with property values on the street at the time. It was re-sold the same day for $155,000, and sold again only 2 ½ months later, in January of 2001, for $300,000, in a transaction that was foreclosed in December of 2001. The short time lapse between the last sale and the foreclosure suggests an early payment default, which suggests that few if any mortgage payments were made. Early payment defaults are an indicator of fraudulent transactions.[60]

[57] Loans that perform for at least a year are considered "seasoned" and do not receive as much scrutiny from lenders upon default.

[58] Q2 2010 Mortgage Fraud Risk Report p. 5 http://www.interthinx.com/pdf/10_Q2MFRI_080910_FNL.pdf

[59] Wiggins was sentenced to 100 months imprisonment and ordered to pay joint and several restitution of $6,477,164. USA v. Wiggins, 1:07-cr-053 (N.D. Ga. 2007).

[60] FBI, 2006 Mortgage Fraud Report http://www.fbi.gov/publications/fraud/mortgage_fraud06.htm.

The next set of transactions show Kevin Wiggins' purchase of 1318 Lucile. Wiggins sold the property in May of 2002 for $95,000 five days *before* he actually closed on his purchase at $72,000. These prices were in line with prevailing values at the time but his buyer, most likely because of the January 2001 sale at $300,000, was able to obtain a $220,000 mortgage on the property. That mortgage was foreclosed 13 months later, which suggests that it may have been intentionally "seasoned."

The property was next bought out of foreclosure in January 2005 for $150,000, which was consistent with actual market values at the time of the transaction. It was re-sold two months later for $320,000, and sold again in October of 2006 for $220,000. The property was foreclosed three months later, in January of 2007, and remained vacant for over 2 years before it was bought for $21,000.

This persistence is also apparent when viewed from the metropolitan statistical area and state level. That fraud persists in a specific geography over time is supported by the fact that six of the top ten[61] metropolitan statistical areas in Interthinx's Q2 2010 Mortgage Fraud Risk Report were in the top ten a year ago, and all of them were in the top 20 one year ago.[62] At the state level, California, Arizona, and Nevada have been the top three states in the Fraud Risk Index since the report was first published in Q2 2009; Florida has been in the top ten during that same time and has occupied fourth place since Q3 2009.

Contagion

The process by which mortgage fraud spreads over time, described above, is shown in Exhibit A, and again concerns Lucile Avenue S.W.. In 2000, when its saga began, there were 16 owner occupied single

[61] These are: Modesto, Stockton, Fairfield-Vallejo, Riverside-San Bernardino-Ontario, Fresno and Bakersfield, CA; and Las Vegas, NV. Mortgage Fraud Risk Index Q2 2010 p. 4 http://www.interthinx.com/pdf/10_Q2MFRI_080910_FNL.pdf

[62] The other MSAs are: Cape Coral-Fort Myers, FL; Phoenix-Mesa-Scottsdale, AZ; and Visalia-Porterville, CA. Id.

family homes, three rental homes, three multifamily dwellings, four duplexes and only two properties that had been purchased and/or refinanced in known or suspected[63] fraudulent transactions. By 2008 only three homes were owner occupied; 19 properties were suspect (including one multifamily and one duplex), and 16 properties were vacant.

Exhibit B shows how Wiggins's purchases grew in number and the geographic spread over time throughout the 30310 zip code. Neighborhood activists identified five Wiggins properties in the West End in 2000. By 2008, he had acquired 83 additional properties. But Wiggins was not the only actor on this area and fraud became so rampant in the 30310 that during the boom it regularly appeared on "top ten" lists of high-fraud zip codes. It remains a hot spot to this day and currently ranks sixth in the latest Interthinx Mortgage Fraud Risk Report's top ten fraud risk zip codes. The nearby 30315 zip code, which was also hit hard by fraud during the boom, currently occupies tenth place in the list.[64]

Quality of Life Issues in Affected Neighborhoods

Houses involved in fraudulent mortgage transactions have a destabilizing effect of neighborhoods. Prior to its invasion by the mortgage fraud rings, my upscale neighborhood was a peaceful, crime-free area of large, well-kept homes. Once the fraud perpetrators began buying and flipping houses, everything changed. Several of the homes they bought became hubs of suspicious late night activity that appeared to be drug trafficking; one was occupied by an attorney, now a convicted money launderer, who primarily represented drug dealers and for a time conducted his law practice from his home; one of the homes had an apparent methamphetamine lab running in the basement; one of the two flipped homes on my street was occupied by a convicted arsonist while the other one was used as an apparent drug drop; and at another, only ¼ mile from my

[63] The suspect properties were identified by residents of the area working with the 30310 Mortgage Fraud Task Force, which is working with state and local regulators and law enforcement in an effort to address the effects of fraud on their communities. It is not known whether the persons involved in those transactions have ever been charged or convicted of mortgage fraud.

[64] Q2 2010 Mortgage Fraud Risk Report p. 5 http://www.interthinx.com/pdf/10_Q2MFRI_080910_FNL.pdf

children's elementary school, there was a shooting. Most of these homes were physically neglected and the residents and owners rarely did yard work. Other homes were left vacant and became even more deteriorated, especially after they were stripped of their fixtures and copper piping. Another home that became vacant was rendered uninhabitable after vagrants set it on fire and that house remained in its damaged condition until we finally convinced the county to raze it some two years later. All of these houses were eventually foreclosed.

Long time residents began to sell, but real estate agents were reluctant to bring in potential buyers because of the problems we were having. When they did find buyers, due to the appearance of these eyesores, and the number of foreclosures among the flipped properties, the sellers had to accept a lower price. Before the flipping started, we were a community that eagerly welcomed new neighbors. Afterwards, we became suspicious of everyone who moved in because there was no way to tell if they were going to be new neighbors, or whether they were involved with the flippers.

There is a clear connection between mortgage fraud and foreclosures. A study by researchers at Florida State University found that foreclosure rates in Florida between 2006 and 2008 were highest in the counties where there were high levels of fraud risk as identified by the Interthinx Mortgage Fraud Risk Index in the years prior to the measurement of foreclosure activity, and in states with higher mortgage fraud rates as measured by Suspicious Activity Reports, even when accounting for changes in unemployment rates.[65] There is also a well established link between foreclosures and crime.[66] Figure 4 shows that Interthinx Fraud Risk Indicators are leading indicators of future foreclosure activity in the United States, in Florida and in Miami. Since preventing fraud prior to funding will reduce foreclosures, preventing mortgage fraud is essential to stabilizing housing prices and reducing the incidence of both financial and other crimes.

[65] Wolff, Kevin; Arnio, Ashley; and Baumer, Eric, "Mortgage Fraud, Foreclosures and Crime: The Consequences of Lending Behaviors Across U.S. Counties," May 19 2010, Predictive Methods Conference, Laguna Beach California.

[66] Wilson, Ronald E. and Paulson, Derek J., "A Theoretical Underpinning of Neighborhood Deterioration and the Onset of Long-Term Crime Problems from Foreclosure", May 2010 (working paper) http://www.ncjrs.gov/pdffiles1/nij/grants/230450.pdf; Bureau of Justice Assistance Center for Court Innovation, "A Full Response to an Empty House: Public Safety Strategies for Addressing Mortgage Fraud and the Foreclosure Crisis," May 2010 http://www.ojp.usdoj.gov/BJA/pdf/CCI_Foreclosure_Crisis.pdf

Mortgage Fraud Trends

Historical: Property valuation fraud risk peaked in Q2 2004, well before the sharpest pre-crisis increase in house prices in 2005. Prices continued to climb, although at a slower rate, through early 2006. Occupancy fraud risk (the representation of an investment property as a primary residence) peaked in late 2006, which suggests that inflated property values helped draw investors into the market, and that they began to withdraw once prices started to decline. Income/employment fraud risk did not peak until 2007, suggesting that additional property value inflation by investors contributed to affordability issues and to the risk of misrepresentation of borrower qualifications.
Current: The national index value for property valuation fraud risk has been increasing steadily since Q1 2007, likely associated with short sale fraud and the resale of foreclosed properties. While it is too early to draw any conclusions, all three indices bear watching since the increase in property valuation fraud risk may represent the initial stages of the next fraud cycle. (Figure 3)

Current Fraud Schemes

Mortgage fraud schemes evolve to take advantage of opportunities presented by current market conditions. The primary schemes observed by Interthinx investigators and clients today include:

Flopping: Real estate agents, who are generally responsible for preparing broker price opinions for short sales, are increasingly reported to be artificially *deflating* the values being submitted to lenders in short sale negotiations in collusion with the purchaser of the short sale or on their own behalf. After the sale is completed, the property is re-sold at a higher price to a pre-arranged but undisclosed buyer. Lenders who unknowingly accept a deflated value suffer a larger loss on the mortgage, and the seller/borrower may face an increased deficiency judgment and tax liability on these sales.

Real Estate Owned/Foreclosed property flipping: Foreclosed properties owned by lenders, Fannie Mae, Freddie Mac and the FDIC are being purchased, sometimes in bulk, and flipped to new buyers at higher prices which in some markets may approach values that were inflated during the boom. It has been reported that some foreclosing lenders are unknowingly selling these properties to straw buyers associated with the persons whose flipping during the boom resulted in the foreclosure. It has also been reported that there is an increase in the number of first payment defaults where the perpetrators buy the properties out of foreclosure, sell it to a straw buyer at a higher price, the straw borrower defaults again, and the property is serially churned.

Foreclosure Rescue: Because the direct victims of foreclosure rescue schemes are desperate borrowers, foreclosure rescue schemes do not constitute mortgage fraud per se. However, perpetrators sometimes use such rescues as the "pitch" in order to gain control of the property, often via a land trust. Once this control is achieved, the property is then sold to a straw buyer who intentionally defaults on the new loan. The perpetrator's profits come from receiving the accumulated equity upon the "sale" to the straw buyer.

Loan Modifications: Lenders report an increase in the manipulation of real estate values and reported income by borrowers attempting to obtain a modification under the federal Making Home Affordable program, the filing of false tax returns to show hardship (the returns are later amended) and the receipt of forged documentation to support the application.

Refinancing: Lenders are reporting that borrowers with impaired equity are inflating property values in an attempt to refinance existing mortgages. The Q2 2010 Mortgage Fraud Risk Report shows that the states with the highest risk in refinance transactions are (in order): Nevada, Arizona, California, Rhode Island, and Florida.

Reverse Mortgages (Home Equity Conversion Mortgages): Federal prosecutors in Atlanta report a large number of fraud cases involving reverse mortgages. They note the involvement of convicted

felons in the brokering of these loans, the recruitment of seniors from public housing and the homeless who are promised "free" houses and who do not have the funds to pay taxes, insurance, homeowner association assessments and maintenance on the properties, the "gifting" or a false sale of the properties at grossly inflated prices to the seniors followed by a cash-out refinance, falsified down payments, and false representations that the properties have been repaired and that they meet HUD's habitability and suitability requirements (i.e., in good condition and with handrails and ramps for the disabled, etc).

Reverse mortgages are an area of great concern because the perpetrators have already figured out how to game the system, and lenders who are new to this segment are not yet able to recognize fraudulent transactions when they see them. Their origination processes and forms, developed for use in forward mortgage originations, do not directly translate into the reverse space and so do not adequately address some of the unique issues, nor take adequate steps to protect the lender or the borrower. Since the aging of the population portends major growth in this market it is very attractive to the criminally minded, and they can be expected to further exploit lenders' inexperience.

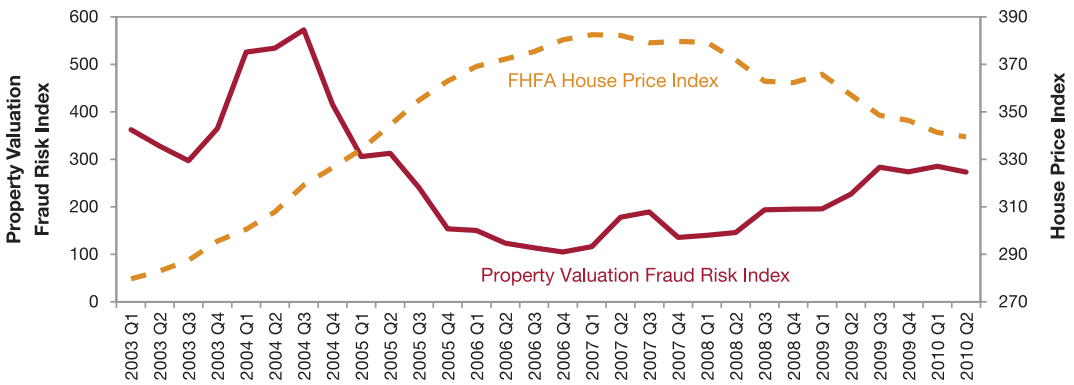
Document Fraud: Lenders now require that all loans have full documentation, so it's no surprise that they're seeing a substantial increase in forged and fabricated documents. With inexpensive, high quality printers widely available, "picture perfect" forgeries are easy to produce. Furthermore, there are numerous websites that will, for a price, produce items such as W-2s, Social Security cards, bank and utility records, tax returns (individual and corporate), audited profit and loss statements, and Proof of Funds letters (required by banks for cash purchases, which is often the case with short sales).

Acceleration: There are numerous websites that provide extremely questionable and misleading advice on property investment techniques for making quick riches from short sales and foreclosed properties. Furthermore, the vast majority of perpetrators and straw buyers who operated during the boom were never caught and they are likely adapting to today's market conditions with in-depth knowledge of lender operations and process weaknesses.

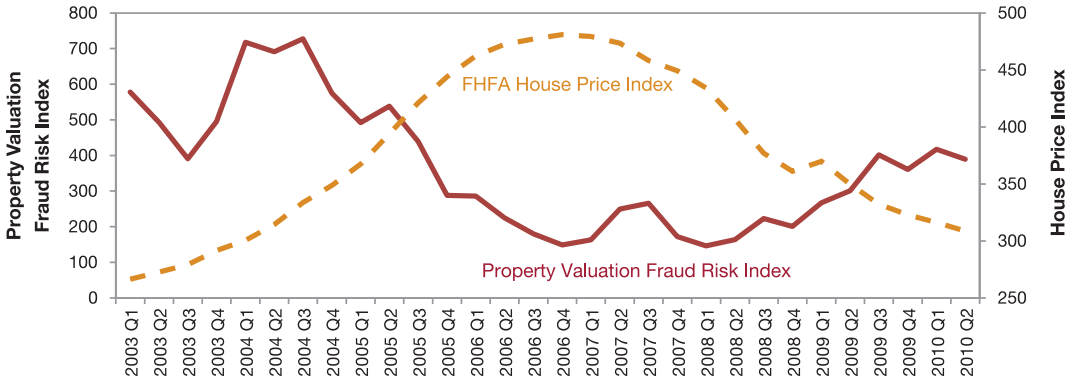
I would like to thank the Commission members for their dedication and efforts to determine the causes of our current economic difficulties. I also thank you for giving me the opportunity to testify on mortgage fraud's critical but hidden role in the financial crisis, and to expose the damages it causes to communities around the country. The truth is that we are all victims of this crime. As the country moves forward toward recovery, it is important that we learn from the lessons of the past, and that we strive to effect positive change in order to prevent it from happening again. I have included as Exhibit D a list of recommendations that reflect the collective wisdom of experts who work daily to prevent fraud in the hopes that it will help us move in that direction. Thank you for your time and attention.

Figure 1

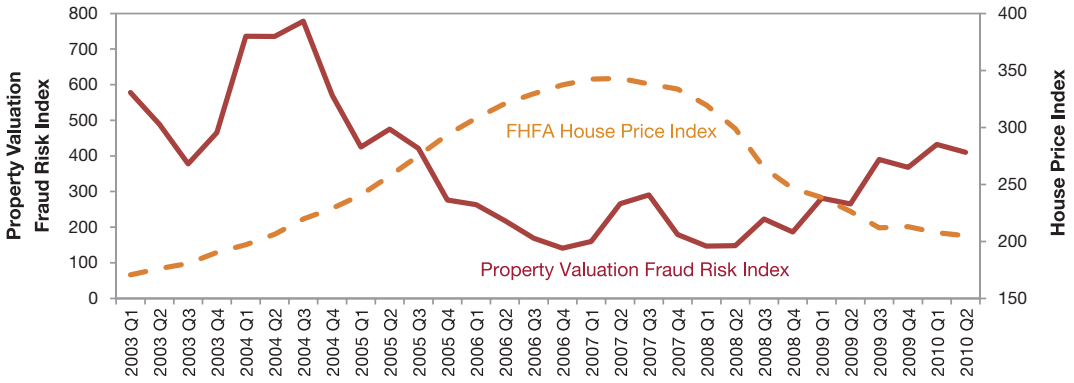
US Property Valuation FRI and HPI



FLORIDA Property Valuation FRI and HPI

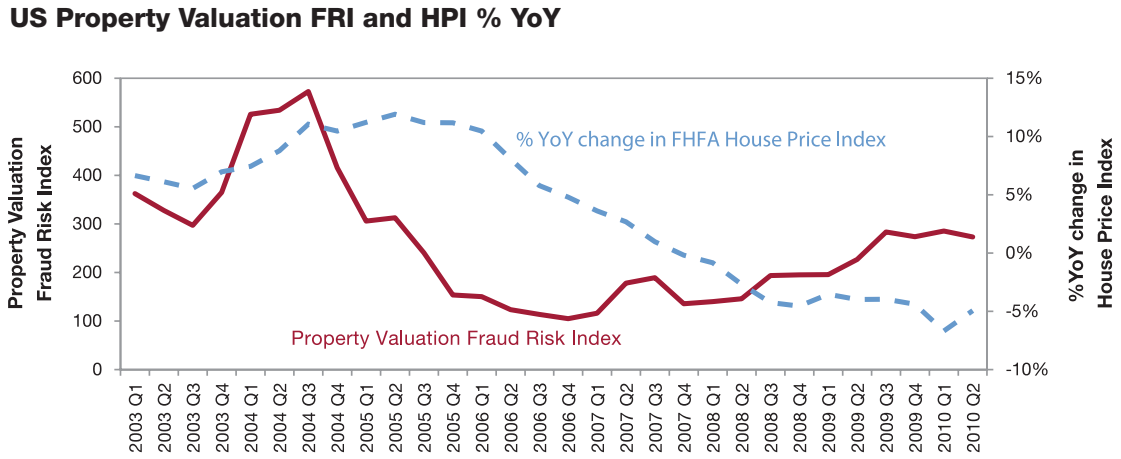


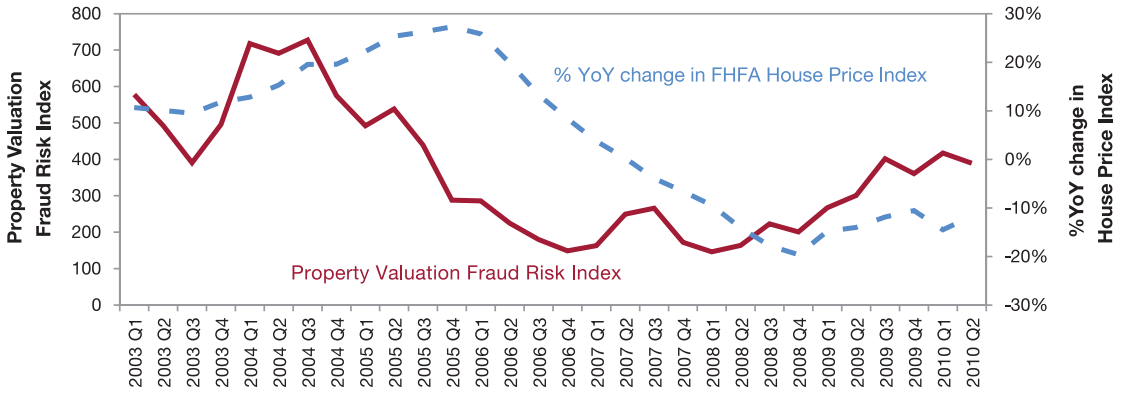
MIAMI Property Valuation FRI and HPI



Key: 100 or less = low fraud risk
100-125 = moderate
125-150 = high
150+ = very high

Figure 2





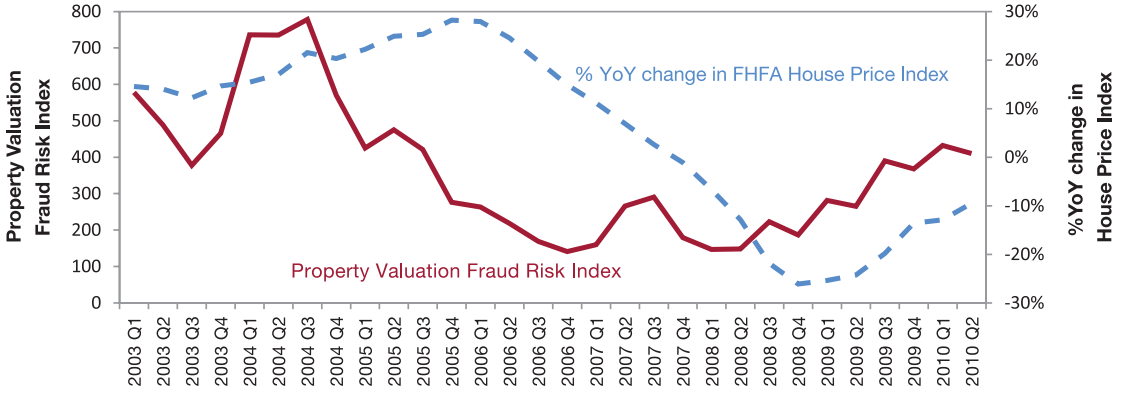


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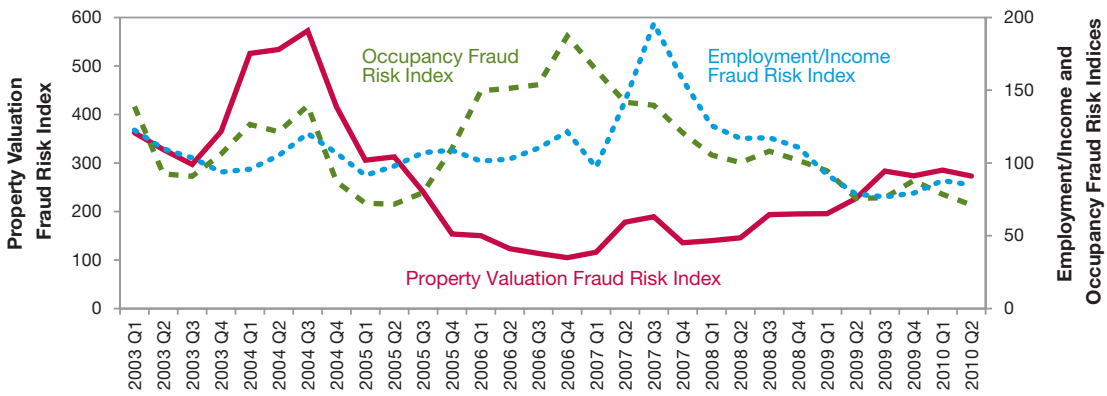
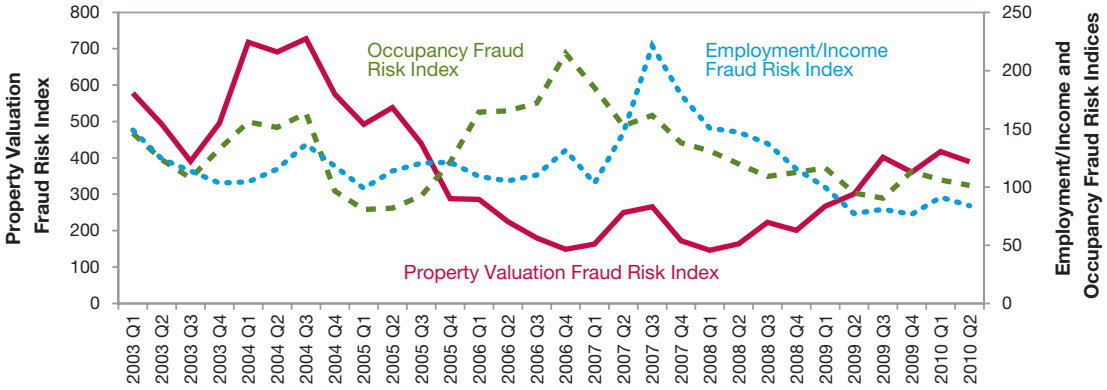
Figure 3

US Property Valuation Occupancy, and Employment/Income FRI



FLORIDA Property Valuation Occupancy, and Employment/Income FRI



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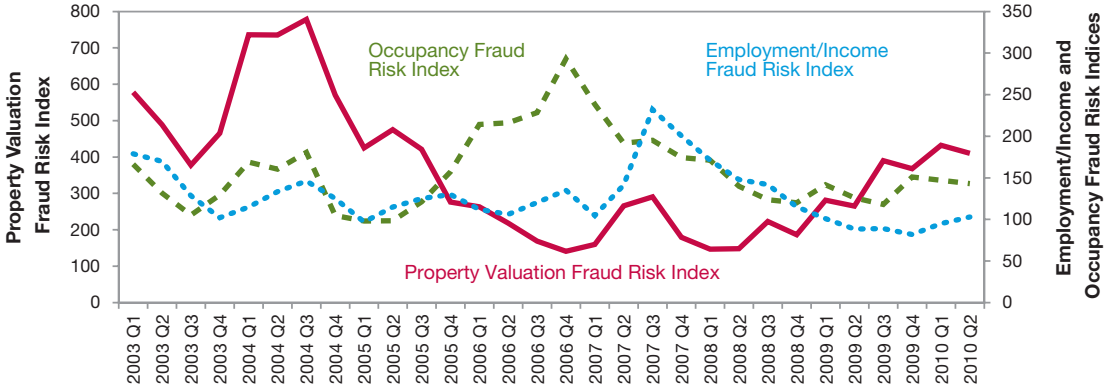

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Figure 4

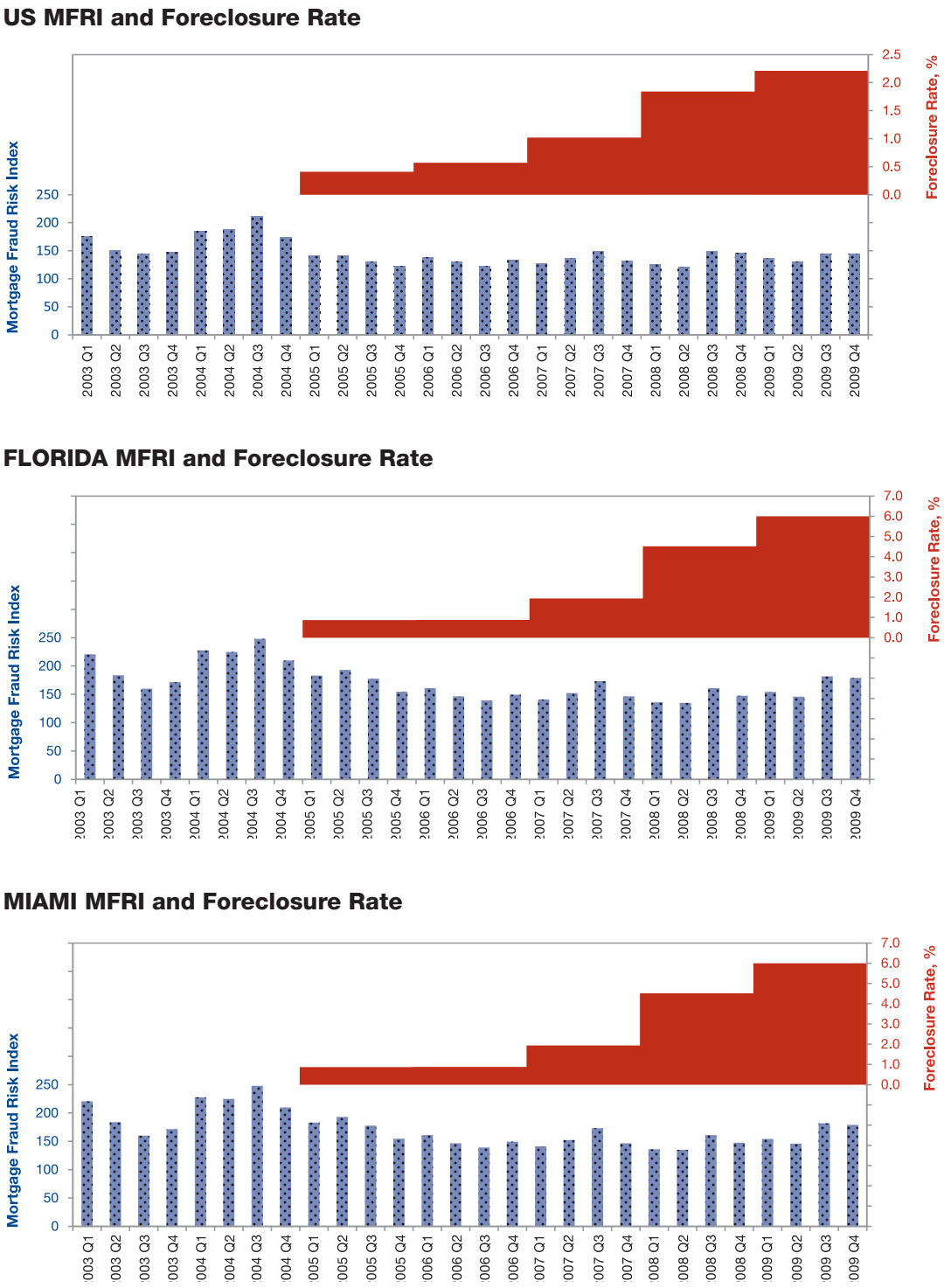

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Figure 5

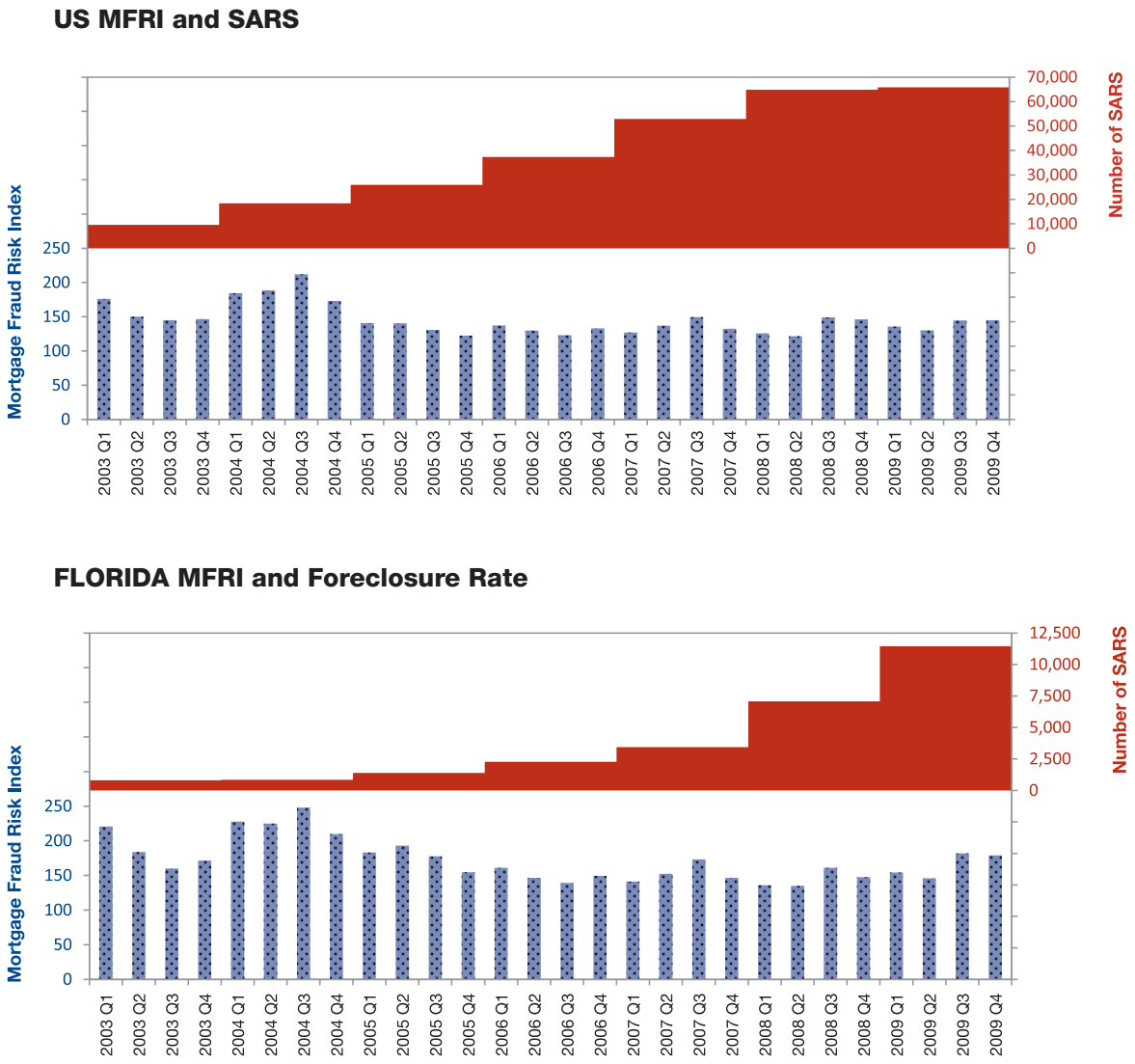

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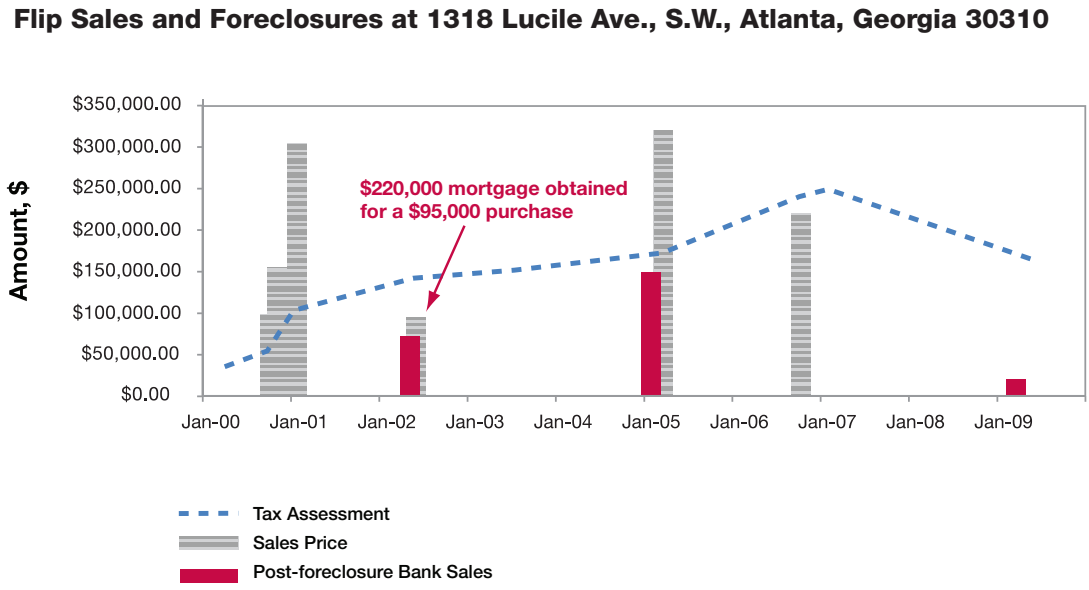
Figure 6



This chart shows the effect of flipping and foreclosures at 1318 Lucile Ave. SW, Atlanta Georgia.

The first sale was in October of 2000 at $99,000, which was consistent with property values on the street at the time. It was re-sold the same day for $155,000, and sold again for $300,000 in January of 2001. That sale ended in foreclosure in December of 2001. The short time lapse between the last sale and the foreclosure suggests an early payment default, which suggests that few if any mortgage payments were made. Early payment defaults are closely associated with fraudulent transactions.

The next set of transactions involve a reverse closing. Kevin Wiggins, who was convicted of bank fraud in this transaction, sold the property for $95,000 five days before he actually closed on his purchase at $72,000. These prices were in line with prevailing values at the time but his buyer, most likely because of the January 2001 sale for $300,000, was able to obtain a $220,000 mortgage on the property. That mortgage was foreclosed 13 months later. Loans which perform for 12 months are considered "seasoned" and do not receive as much scrutiny when they foreclose.

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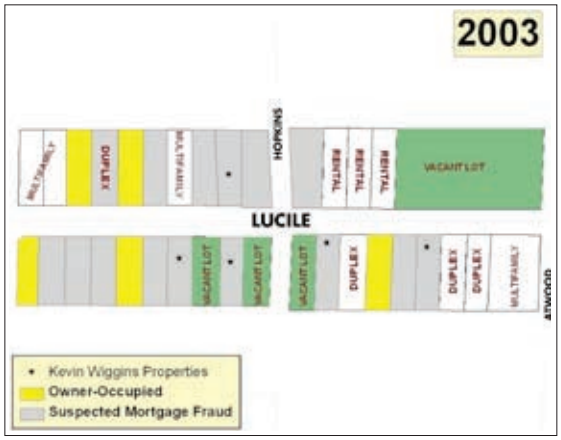
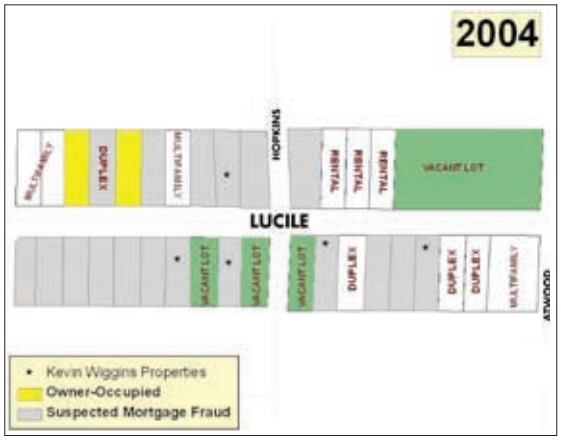
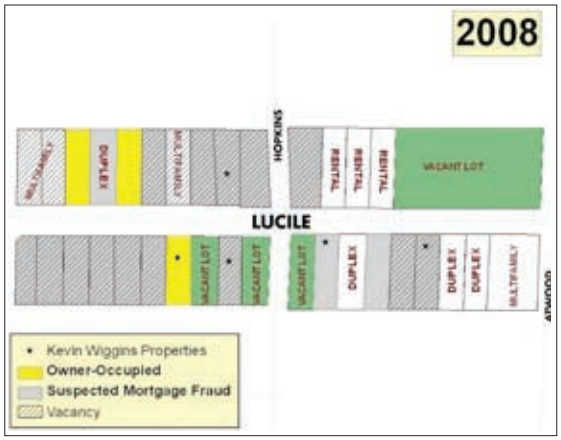


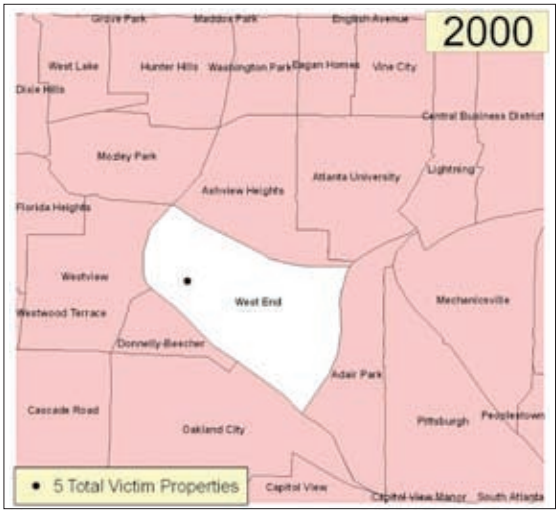


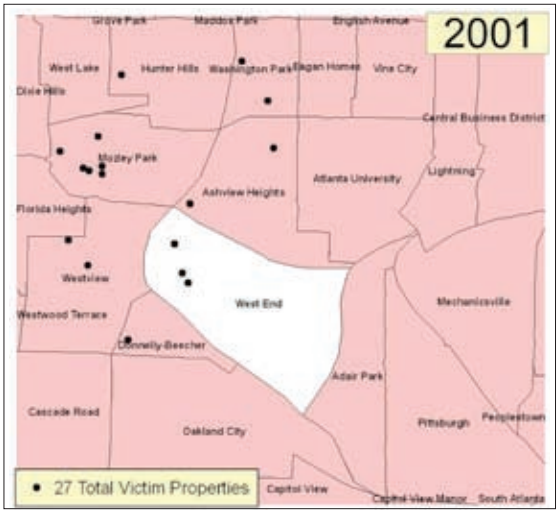


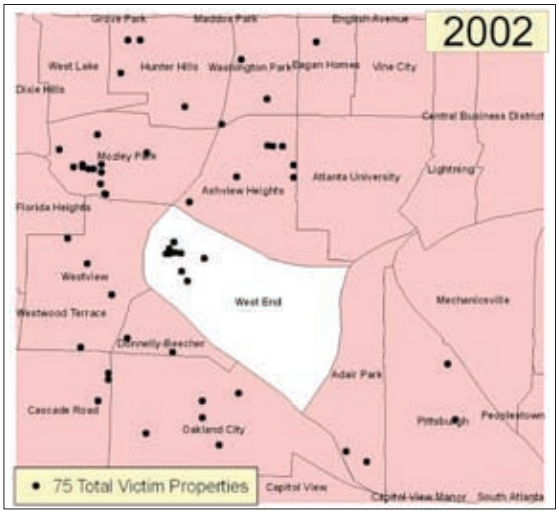
These charts show the proliferation of properties involved in known and suspected fraudulent mortgage transactions on Lucile Ave. SW, Atlanta, Georgia. Note that in 2000, there was only 1 known and 1 suspected fraud on Lucile Avenue, and its character was predominantly owner-occupied. By 2008, there were 18 suspect transactions, 17 of those properties were vacant, and only 3 were owner occupied.

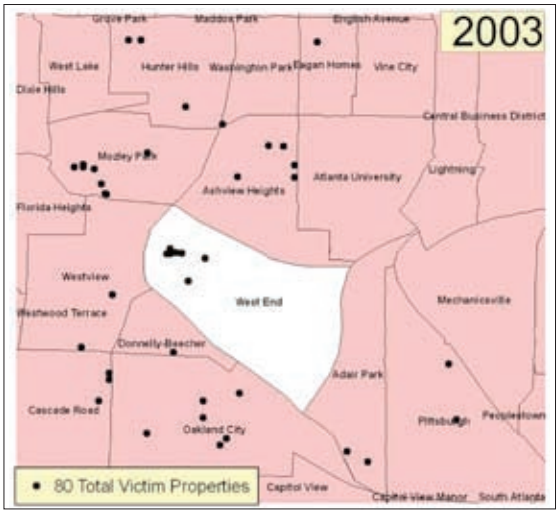
Source: Courtesy Brett Brewer

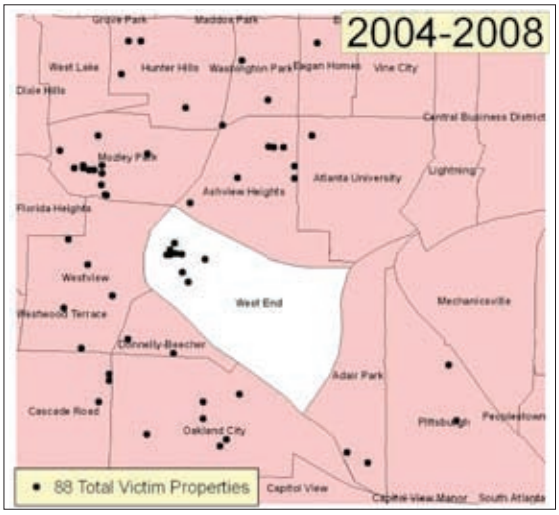
Exhibit B







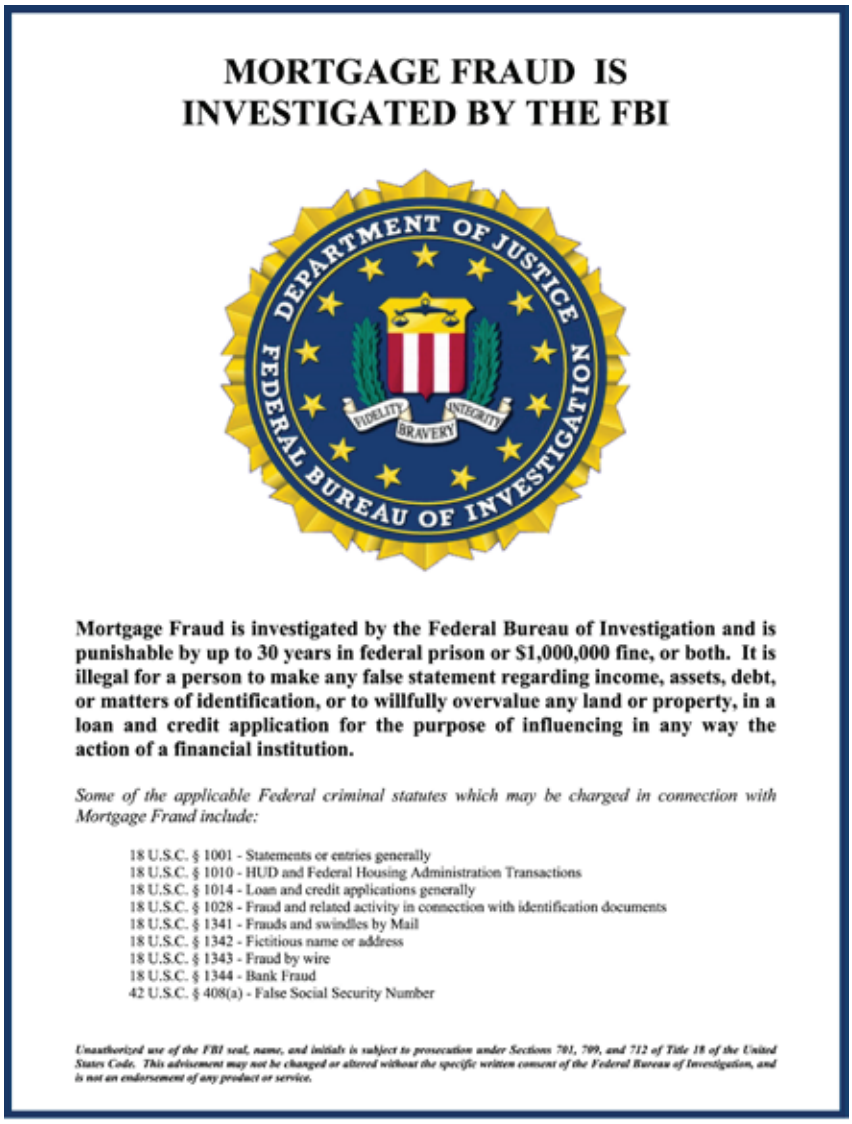




These charts show the proliferation and clustering of properties acquired by Kevin Wiggins throughout the 30310 zip code in Atlanta, Georgia. In October of 2007 in Federal court, Wiggins pled guilty to three criminal counts of bank fraud.

Source: Courtesy Brett Brewer

Exhibit C



MORTGAGE FRAUD IS INVESTIGATED BY THE FBI

Mortgage Fraud is investigated by the Federal Bureau of Investigation and is punishable by up to 30 years in federal prison or $1,000,000 fine, or both. It is illegal for a person to make any false statement regarding income, assets, debt, or matters of identification, or to willfully overvalue any land or property, in a loan and credit application for the purpose of influencing in any way the action of a financial institution.

Some of the applicable Federal criminal statutes which may be charged in connection with Mortgage Fraud include:

18 U.S.C. § 1001 - Statements or entries generally
18 U.S.C. § 1010 - HUD and Federal Housing Administration Transactions
18 U.S.C. § 1014 - Loan and credit applications generally
18 U.S.C. § 1028 - Fraud and related activity in connection with identification documents
18 U.S.C. § 1341 - Frauds and swindles by Mail
18 U.S.C. § 1342 - Fictitious name or address
18 U.S.C. § 1343 - Fraud by wire
18 U.S.C. § 1344 - Bank Fraud
42 U.S.C. § 408(a) - False Social Security Number

Unauthorized use of the FBI seal, name, and initials is subject to prosecution under Sections 701, 709, and 712 of Title 18 of the United States Code. This advisement may not be changed or altered without the specific written consent of the Federal Bureau of Investigation, and is not an endorsement of any product or service.

Signature Date

Signature Date

RECOMMENDATIONS:

Proactive risk mitigation is essential for the recovery of the mortgage market and the U.S. economy. The items listed below are recommendations from professionals across the spectrum of mortgage lending and mortgage service providers that, if enacted, would reduce the risk of fraud.

1) Enact a federal law that defines and criminalizes mortgage fraud. A well-crafted law would help prevent fraud by:
   a) increasing the awareness of the licensed professionals who are best positioned to prevent fraud at the earliest opportunity, such as real estate agents, appraisers, closing attorneys, and loan originators required to register under the SAFE Act as to acceptable and unacceptable conduct and practices
   b) increasing awareness of fraud among buyers and sellers
   c) streamlining prosecutions by allowing prosecution of the fraud without also having to prove wire fraud or mail fraud

2) Federal law enforcement agencies should have permanently staffed mortgage fraud groups to maintain a continuous source of expertise, industry contacts, and familiarity with prevalent and emerging schemes; to prevent delays in the investigation of active cases caused by the rotation of agents; and to reduce the resources invested in training agents in the complexities and specialized knowledge required to investigate mortgage-origination frauds.

3) A standardized and state-specific National Mortgage Fraud Training Program should be developed by the mortgage industry and made available to local federal and state agents, officers, and prosecutors.

4) FinCEN should:
   a) adopt and implement the Suspicious Mortgage Activity Report Form (SMARt) to develop more accurate and actionable intelligence for law enforcement use
   b) promptly and regularly report back to the industry any significant scheme characteristics and general locations derived from the analysis of SAR/SMARt reports filed on frauds discovered during prefunding
   c) develop standardized training in filing requirements and incorporate that training as part of the training mandated under the SAFE Act

5) Expand SAFE Act registration requirements to include all regulated mortgage loan originators (banks, savings and loan associations, and credit unions).

6) Expand BSA Safe Harbor to cover voluntary filing of SARs by mortgage brokers, title and mortgage insurers, real estate agents, settlement agents, appraisers, mortgage servicers, and investors.

7) Lenders and market participants are reluctant to share their knowledge of persons involved in attempted and completed (but not adjudicated) frauds because of concern about running afoul of laws protecting consumer information and fear of libel and slander suits. Enactment of a universal safe-harbor law that explicitly protects lenders and other market participants who, for the purpose of detecting and preventing fraud, wish to share confidential loan transaction data would encourage the sharing of critical data and deprive the criminals of a tremendous advantage that they exploit at great expense to the industry and American neighborhoods.

8) Require that the FBI Mortgage Fraud Warning (Exhibit C) be acknowledged/signed by the parties at closing, who must also state their role (buyer/seller/real estate agent, etc.).

9) Require that all participants in a residential mortgage transaction — including buyers, sellers, real estate agents, appraisers, title and settlement/escrow agents — execute an Affiliated Parties/Business Arrangements Disclosure prior to closing and provide copies of the disclosure to lenders, note holders, and investors.

10) Require that borrowers at risk of default who seek a loan concession (short sale or loan modification) under a federal program:
    a) sign an affidavit attesting that no misrepresentations were made by them, or on their behalf, during the origination of their loan
    b) execute a new IRS Form 4506-T (authorization to release tax transcripts)

    In the event that the borrower seeks approval for a short sale, the seller should also be compelled to sign an affidavit attesting that there was no misrepresentation of value or collusion with any other party to the transaction and that there are no undisclosed relationships with of any participants.

11) The following recommendations seek to address frauds that occur at settlement:
    a) Require buyers, sellers and settlement/escrow agents to sign and date an attestation as to the completeness and accuracy of each page.
    b) Require the title officer or settlement/escrow agent to sign a document attesting that, at the time of settlement, he or she was not aware of:
        i) any liabilities that had not been disclosed to the lender
        ii) any information that indicated that the buyer's intended occupancy or use of the property was not consistent with that which had been represented to the lender
        iii) concurrent closings on the same property
        iv) any undisclosed relationships between the parties
    c) Closing Protection Letters with strong requirements regarding compliance with the lender's instructions should be required to prevent deviation from those instructions.

d) The disbursement/escrow ledger from settlement should be provided to the lender and the investor within ten business days of origination so that any misrepresentations could be identified prior to loan default.

12) Underwriting and processing functions must be insulated from, and independent of, sales and production and report to different managers to prevent undue influence and pressure to originate faulty loans.

13) Quality-control and quality-assurance/audit departments must be independent and report directly to the CEO.

14) All loans must be screened with automated fraud detection technology prior to funding to identify and stratify loans by level of risk. Experienced/expert in-house personnel must subject loans with high risk to in-depth review.

15) Since some real estate speculators and subprime originators/brokers who engaged in illicit practices during the boom have rebranded themselves and migrated into other business segments since the market collapsed, it is strongly recommended that licensing and criminal background checks be conducted on all production and sales staff.

16) To encourage quality loan production, loan officers should receive a salary. Incentives to brokers and loan officers should be tied to loan performance. Investors and the GSEs should insist that this be made a feature of any conduit purchase agreements and should limit or discontinue the purchase of loans in shops that compensate only on, or tie incentives to, origination volume.

17) To reduce the incidence of fraudulently deflated distress sales involving GSE and FHA loans, the use of broker price opinions prepared by real estate agents/brokers should be discontinued in markets that have experienced a high level of foreclosures, deeds-in-lieu, and/or short sales.
    a) All mortgage loan originations staff (processors, underwriters, closers) should receive ongoing mandatory training in fraud recognition and detection (to stay current on new schemes), SAR filing requirements, and the functions and purpose of quality control and quality assurance. Senior managers and stakeholders should be required to attend fraud awareness programs and learn the importance of prevention and trending analysis.