



**Fighting Fraud & Government Lending**

Government Housing Conference 2010

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FHA, Wells Fargo Home Mtg, & Rapid Reporting




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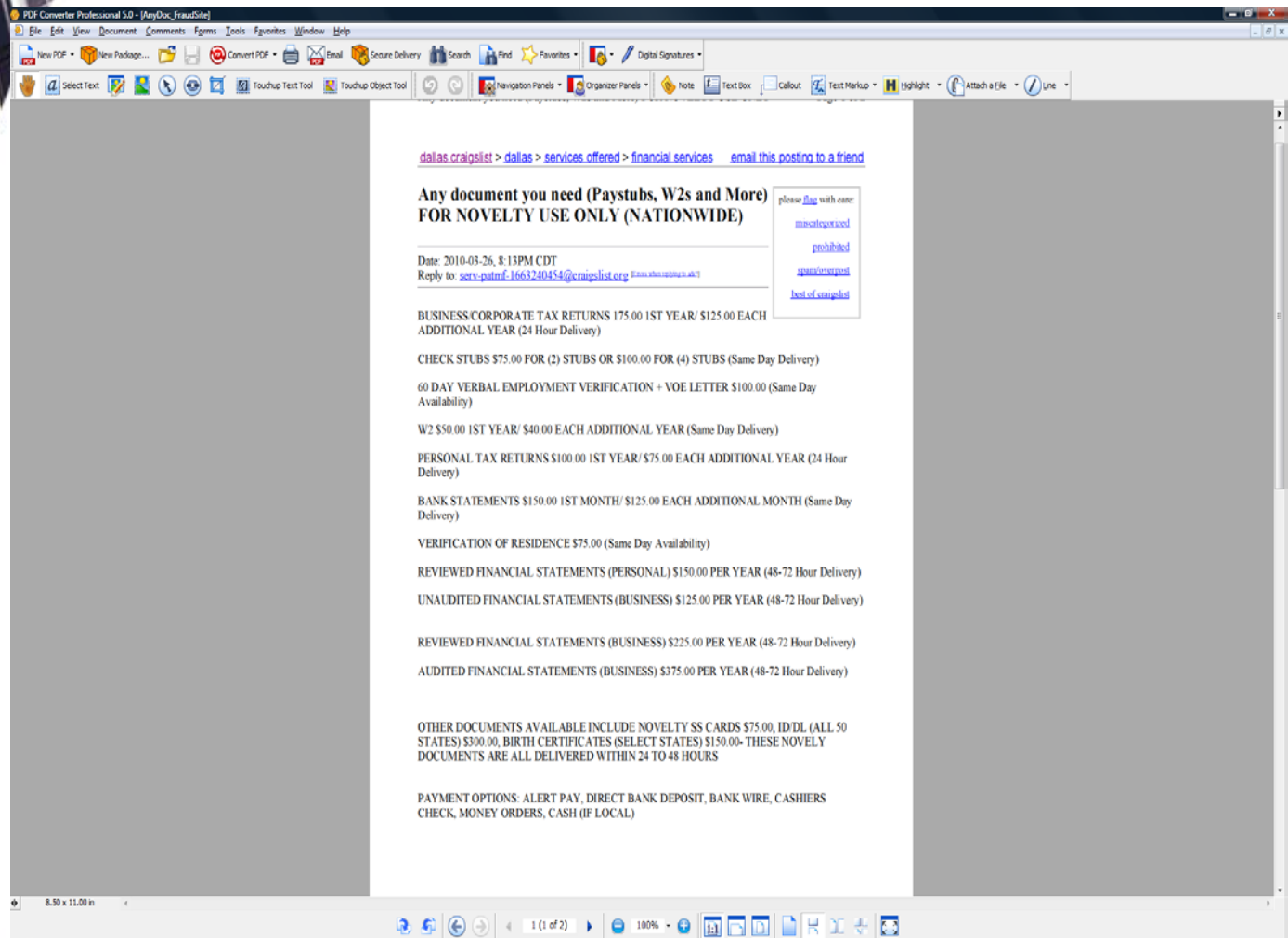
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# Franchising Fraud!

- What do you receive?
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**Any document you need (Paystubs, W2s and More)  
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BUSINESS CORPORATE TAX RETURNS 175.00 1ST YEAR/ \$125.00 EACH ADDITIONAL YEAR (24 Hour Delivery)

CHECK STUBS \$75.00 FOR (2) STUBS OR \$100.00 FOR (4) STUBS (Same Day Delivery)

60 DAY VERBAL EMPLOYMENT VERIFICATION + VOE LETTER \$100.00 (Same Day Availability)

W2 \$50.00 1ST YEAR/ \$40.00 EACH ADDITIONAL YEAR (Same Day Delivery)

PERSONAL TAX RETURNS \$100.00 1ST YEAR/ \$75.00 EACH ADDITIONAL YEAR (24 Hour Delivery)

BANK STATEMENTS \$150.00 1ST MONTH/ \$125.00 EACH ADDITIONAL MONTH (Same Day Delivery)

VERIFICATION OF RESIDENCE \$75.00 (Same Day Availability)

REVIEWED FINANCIAL STATEMENTS (PERSONAL) \$150.00 PER YEAR (48-72 Hour Delivery)

UNAUDITED FINANCIAL STATEMENTS (BUSINESS) \$125.00 PER YEAR (48-72 Hour Delivery)

REVIEWED FINANCIAL STATEMENTS (BUSINESS) \$225.00 PER YEAR (48-72 Hour Delivery)

AUDITED FINANCIAL STATEMENTS (BUSINESS) \$375.00 PER YEAR (48-72 Hour Delivery)

OTHER DOCUMENTS AVAILABLE INCLUDE NOVELTY SS CARDS \$75.00, ID/DL (ALL 50 STATES) \$300.00, BIRTH CERTIFICATES (SELECT STATES) \$150.00- THESE NOVELTY DOCUMENTS ARE ALL DELIVERED WITHIN 24 TO 48 HOURS

PAYMENT OPTIONS: ALERT PAY, DIRECT BANK DEPOSIT, BANK WIRE, CASHIERS CHECK, MONEY ORDERS, CASH (IF LOCAL)

# Fraud Prevention Objectives

- Global to the organization
  - » Create the culture
    - Buy in from bottom to top
    - Promote the benefits
      - › Origination through Sale or Servicing
      - › Understand the cost of repurchase fraud
    - Develop
      - › The process
      - › Definitions
      - › SLAs
      - › Notifications
      - › Reporting
      - › Actions
      - › Performance Metrics
    - Develop specific training
      - › How prevention fits with their job
      - › Red flag resolution
      - › Impact of fraud and repurchases

# Pre Funding Mission

- Quality loans benefit
  - » Underwriting
  - » Consumers
  - » Funding
  - » Investors
  - » Servicing
  - » US financial markets
- To review pipeline for those loans that represent
  - » Low risk
  - » High risk
  - » Fraud
  - » Inconsistencies/Exceptions
- Get a global view of the look and feel of the loans prior to investing FTE time
  - » Efficient work flows
  - » Verifications
  - » Fall out
  - » Broker/Loan Officer performance

# Pre Funding Process

- Define what will require pre funding review
  - » Entire pipeline through application scanning tool that correlates private and public records to the loan application
  - » Or base review reasons on other criteria or in addition to full pipeline review
    - › Under average loan officer or broker performance (delinquencies or pull through rates)
    - › Random selection - %
    - › New loan officer/broker, underwriter, etc.
    - › Layering of risk – max ltv, dti, credit scores
    - › Employment type
    - › Investment loans
  - » Develop SLAs – Unless fraud 24 hours is key
  - » Develop notification process for exceptions
  - » Develop action steps for adverse findings
  - » Align closely with Operations

# Getting started – Alerts/Scores

- Document, document, document
- Tie back to the 4 C's (culture and knowledge)
  - » Credit, Capacity, Character, Collateral
  - » 5<sup>th</sup> C = Cash
- Stay true to your organization culture
  - » Alerts or Scores should be categorized and normalized for your system
    - Good idea to classify & categorize
    - Finding Type = Capacity=Employment
    - Finding Type = Character = Occupancy
  - » Suggest you add Fraud finding types too
    - Work flow needs to be identified if you want loans to flow through finding types
    - If alert = Employment Fraud classify as Fraud Capacity = Fraud Employment

# Getting started

- » Develop understanding of the system, process and results delivered if using an application screening product
  - Are alerts easy to customize
  - Are alerts pertinent to your culture
  
- » Understand what false positives may fire and how they will be identified and resolved
- » Overlay findings to your systems, process and results
- » Define what alerts will be triggered and what process will kick in next
- » Example: alerts triggered for identity, employment, income, assets, occupancy, collateral, credit
- » Establish swim lanes or work flows from the pipeline review
  - Automated or Subjective Human
  - Needs to be transparent to the user if manual
- » Establish reporting from results
  - Weekly reports that summarize the pipeline – X number of alerts for Occupancy, etc.

# Verifications

- Third party verifications keep you doing lending processes, not verifications – Base your decisions on the facts
  - » Identity – FACTA & ID Theft Red Flag Rules
  - » Employment – standardized process
  - » Income – IRS records fulfill the gaps for type of income, other income, deductions, self employed, etc
  - » Assets – are bank statements good enough
  - » Undisclosed debt – double apps, additional properties, installment debt
  - » Collateral
- Third party verifications provide
  - » Safety from fraud
  - » Actionable data and results
  - » Standardized process
  - » Objective process
  - » ROI metrics

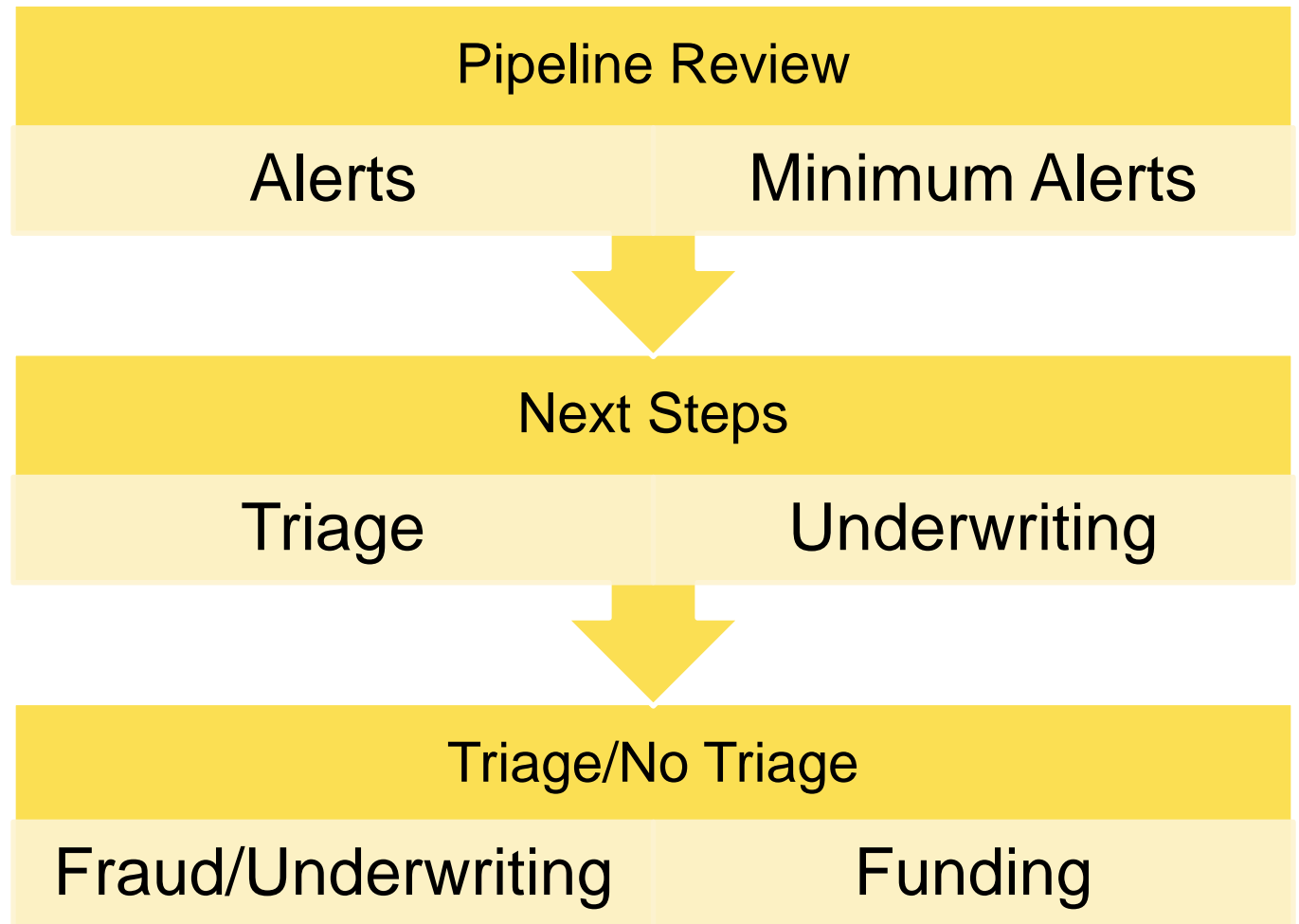
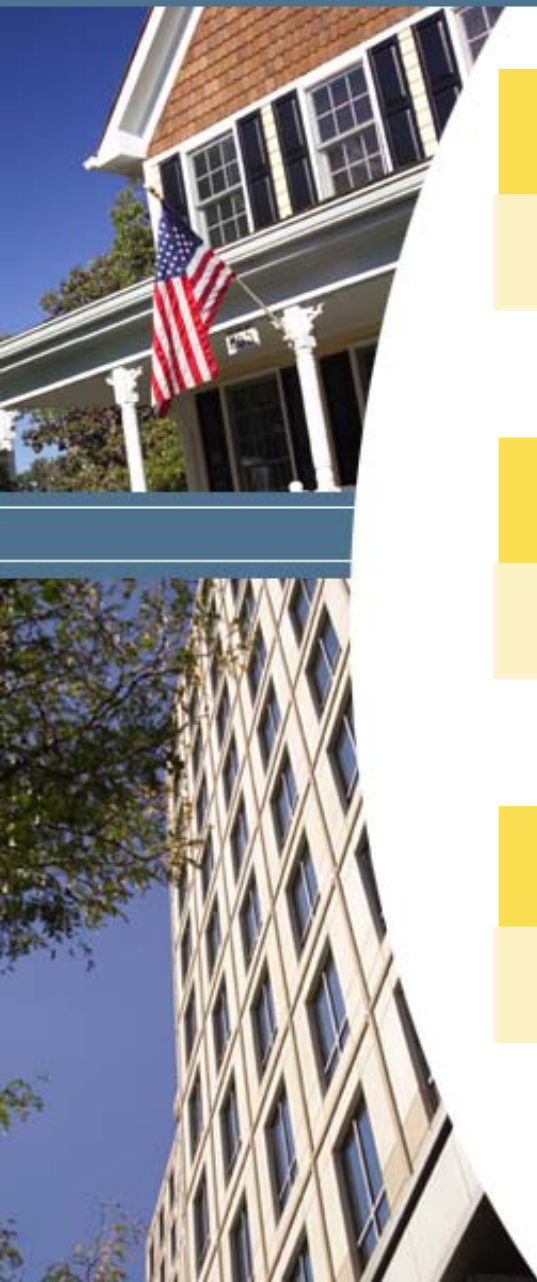
# Getting started – Alerts/Scores

- » Alerts or Scores should be classified as underwriting deficiencies or red flag concerns
  - Finding type = Collateral = Value
  - Finding type = DTI = Exceeds guidelines
- » Examples of Credit Alerts
  - Finding type = Credit Score = <650
  - Finding type = Credit History = Accounts less than 2 years
  - Finding type = Credit Accounts = Authorized User present
- » Examples of Character Alerts.
  - Finding type = Fraud Identity SSN = SSN invalid
  - Finding type = Fraud Identity = SSN reported deceased

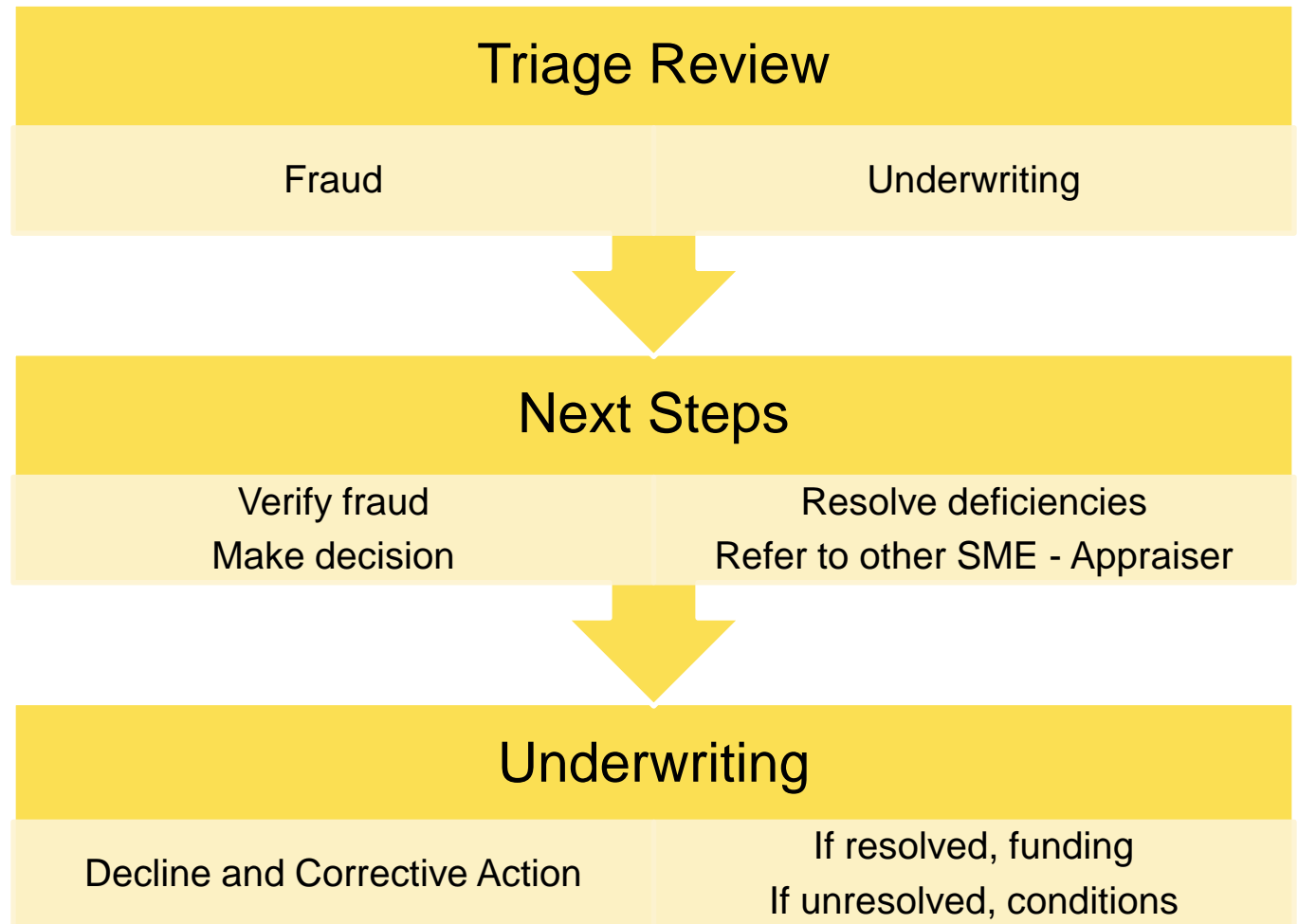
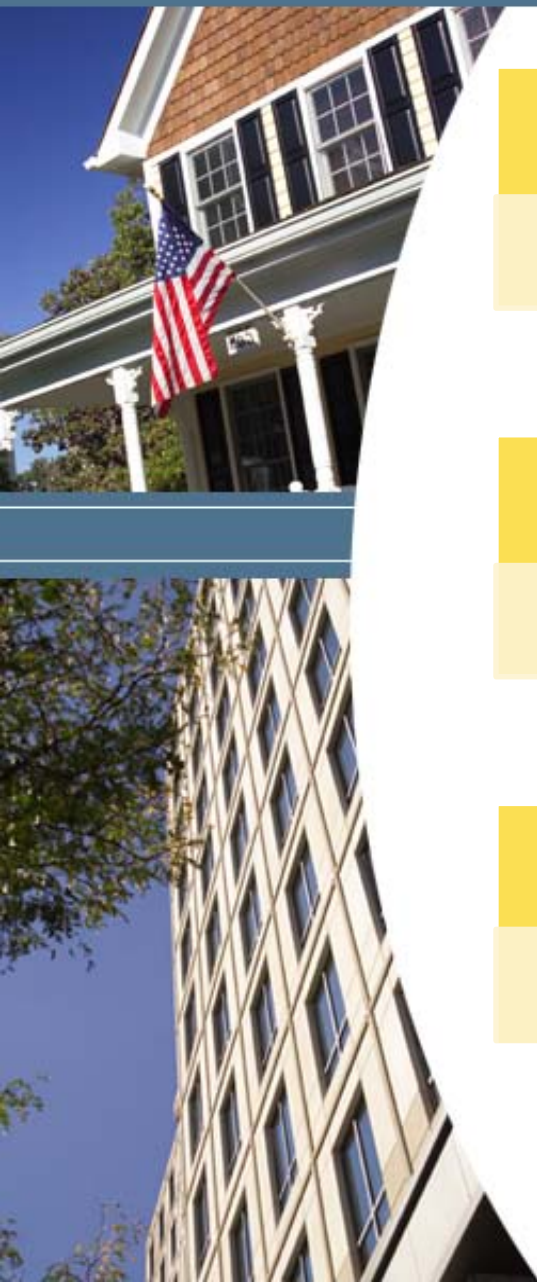
# Triage Unit

- Goal is to keep underwriters underwriting, processors processing
- Develop minimum and maximum alert levels or scores
- Identify which alerts can be handled during underwriting
  - » Develop swim lanes/work flows for these alerts
  - » Automated conditions to resolve would be a plus
- Identify which alerts need specialized review of the Triage team
  - » Triage underwriting team deals with underwriting issues regarding guidelines, collateral,
  - » Triage fraud team deals with fraud issues

# Potential Work Flow



# Potential Work Flow



# Start with the end in mind

- Monitor processes
  - » What is working
  - » What is not
- Keep FTEs on lending tasks
- Create efficient work flows
- Make a bible – understand why you do what you do
- Know the who, what and where of fraud
- Keep your organization information bottom to top



## **Fighting Fraud in Government Lending**

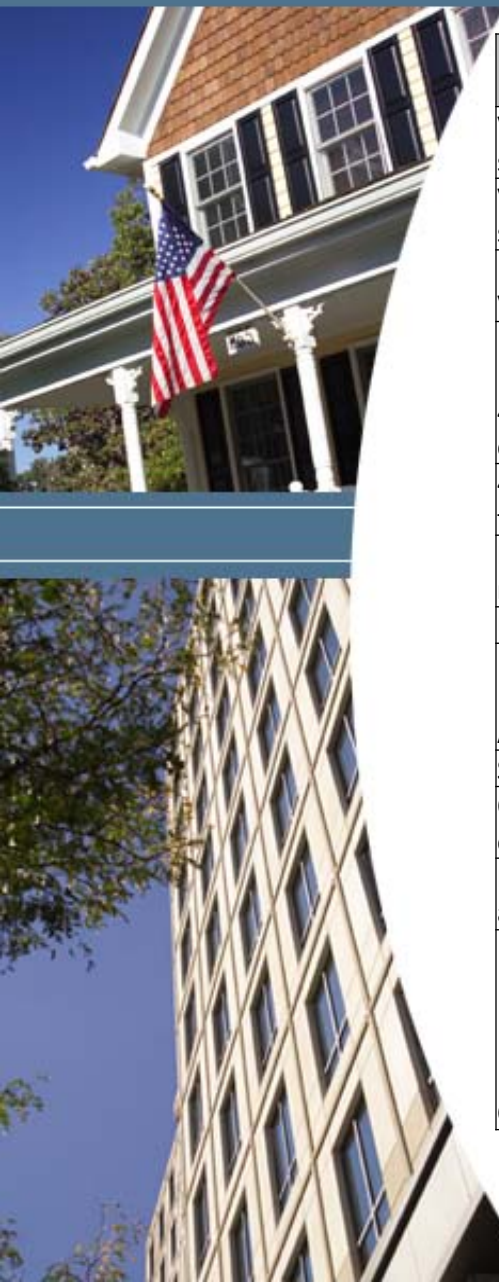
Government Housing Finance Conference 2010

Presented by – Mary Dee LeMaire

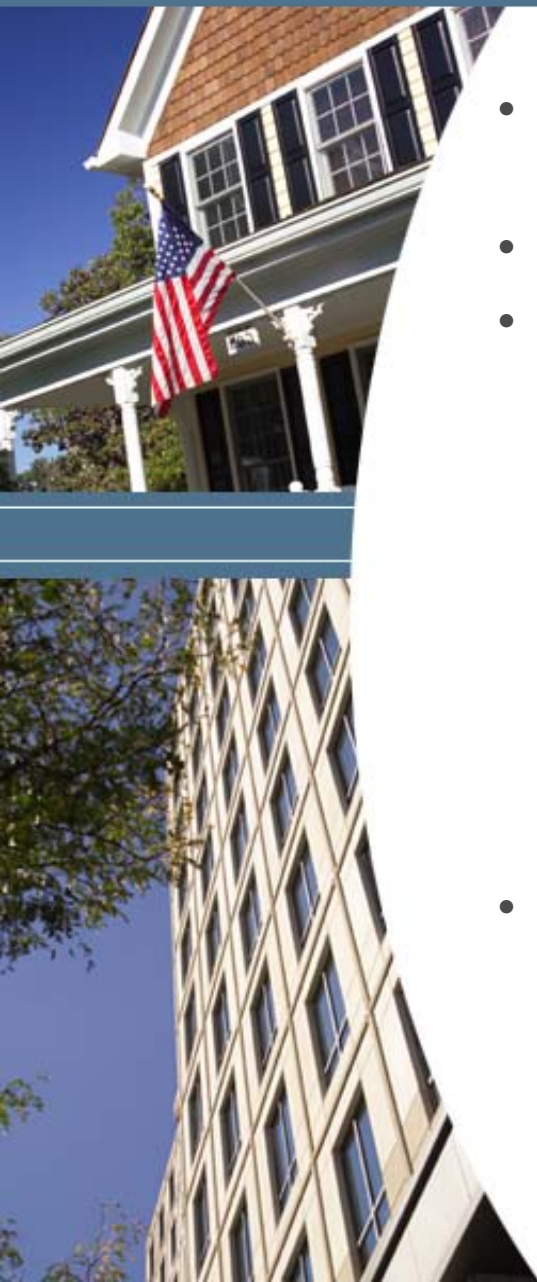
Wells Fargo Home Mortgage



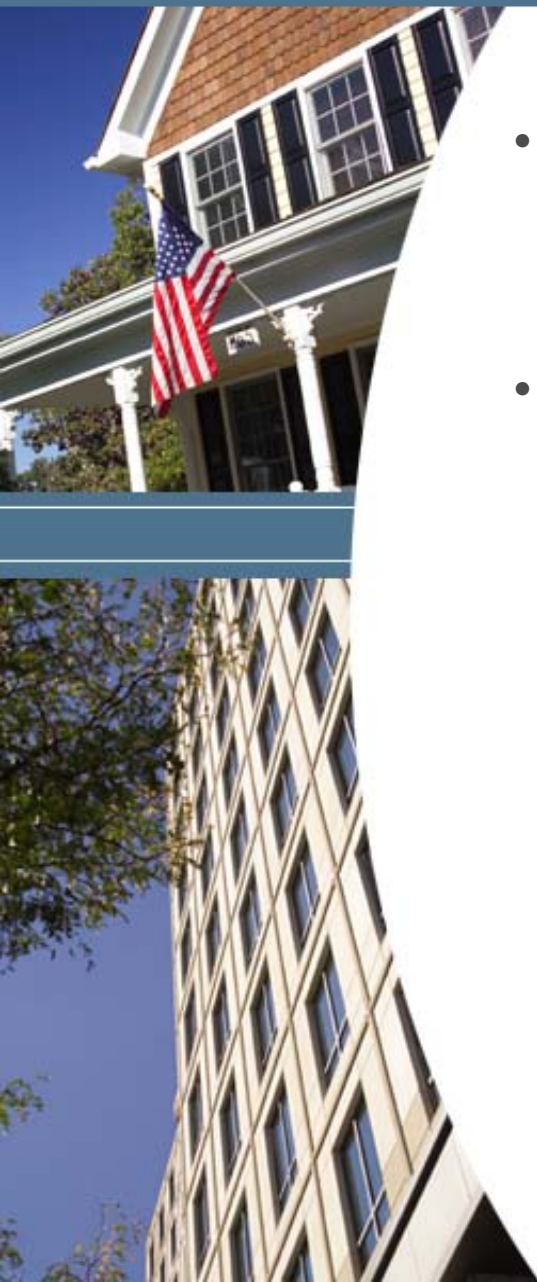
# Government vs. Agency Fraud Requirements



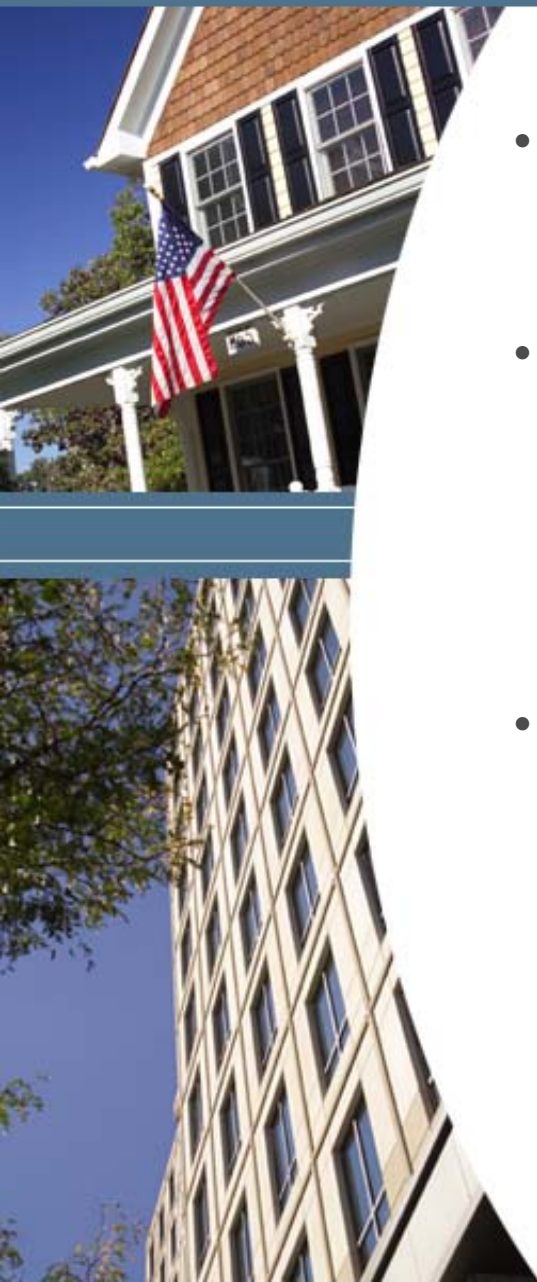
Control	Fannie	Freddie	FHA	VA	RD
VVOE within 10 days of closing for salaried	X	X			
VVOE within 30 days of closing for self employed	X	X			
VVOE prior to funding					Commission income
4506T signed at application and/or closing	X	X	When tax returns are used		On self employed and non employed
4506T processed by lender through the IRS					On self employed and non employed
If 4506T processed, transcripts retained in file	X	X			
Undisclosed debts prior to funding	X		X		
Altered documents			X		No alterations, erasures, or "white-outs."
SSN validity / identity check	X		X	X	
Occupancy red flag / discrepancy check	X		X	X	X
Integrity requirements (employees and officers)	X		X		
Other Similar Requirements				CIRC. 26-91-6: QUALITY UNDERWRITING OF VA LOANS (02/14/91)	



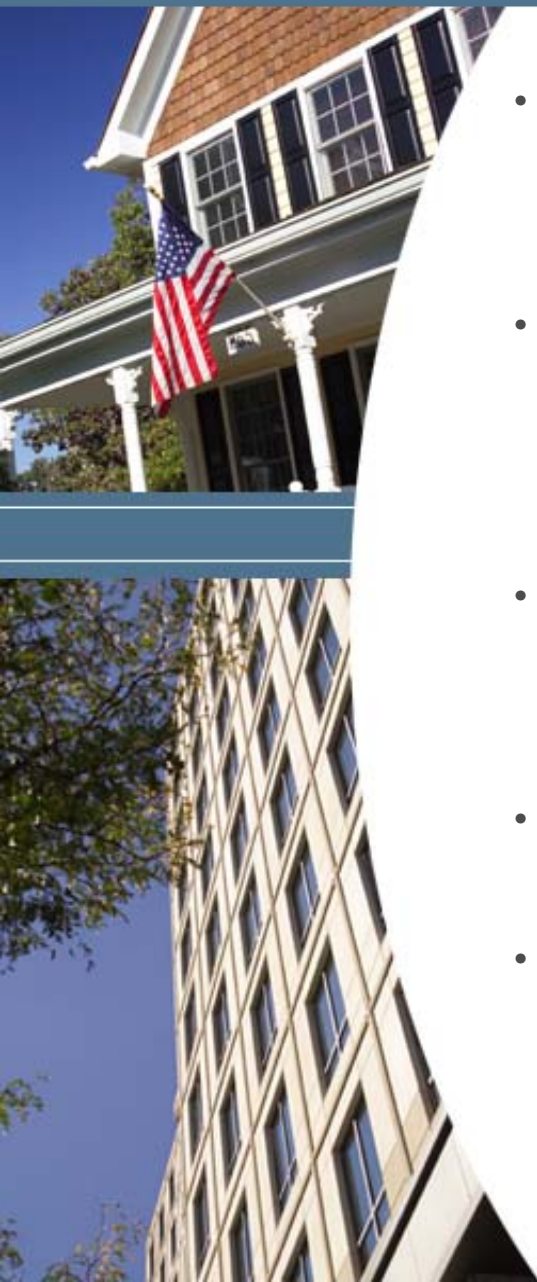
- FHA may reject a mortgage for insurance for misrepresentation or fraud on the part of any party
- FHA requires lenders to self report instances of fraud
- FHA Remedies:
  - » Automatic indemnification
  - » Effect of an MI rescission
  - » Lender cannot file a claim for benefits under the MIC and may incur a make whole for any losses after property is sold post-foreclosure
  - » Fraudulent loan may prevent a successful claim
    - Even when no indemnification is outstanding with FHA, any identification of fraud could result in the denial of a claim by FHA
- Fraudulent loans tend to default early or never make a payment
  - » May preclude loan from being submitted for insuring
  - » Ultimate repurchase from investor or GNMA pool



- VA Loan Note Guaranty is contingent upon:
  - » No fraud or material misrepresentation on the part of the lender
- VA's Remedies:
  - » VA can seek recovery of any loss on a loan for material misrepresentation
  - » VA can suspend lenders or individual employees who have committed fraud or who were responsible for material misrepresentation in soliciting, processing, or approving VA loans.
  - » Lender's automatic authority can be withdrawn
  - » Lender can be suspended from participation



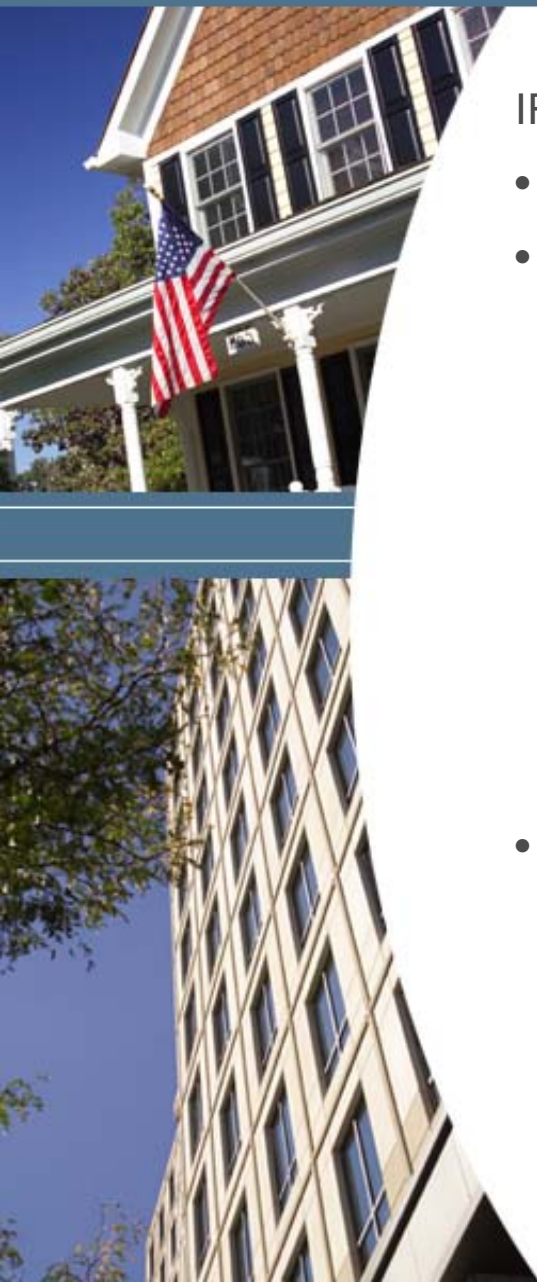
- Once issued, Loan Note Guarantee incontestable absent fraud or misrepresentation
- Definition:
  - » Fraud or misrepresentation of which the Lender has actual knowledge or which the Lender participates in or condones
  - » Responsible for acts of agents, including appraisers
- RD Remedies:
  - » Significant findings from audits can jeopardize program participation



- Your competitors have stronger, more updated controls
  - » Adverse selection – the path of least resistance will become the lender of choice for poor production and possibly a fraud target
  - » We are seeing external fraud rings that randomly call lenders attempting to get loans through; the lenders with the weakest controls are at greatest risk
- Your company thinks it has a silver bullet – the tool/process is the complete answer
  - » The best tools and processes do not catch all the fraud – expect a detection rate of 20% - 40% - what about the rest of the fraud?
  - » Most fraud tools detect origination/application fraud, but do not help with servicing fraud or settlement fraud
  - » Even when your tool finds the fraud, are there gaps in your follow-through?
- Your staff lacks fraud expertise
  - » Make extensive use of your vendor's tool and fraud training and other support
  - » Remember it's not enough to have a copy of the fraud tool report in the file
  - » Users must understand the tool, what it's telling them, and what actions to take
- Belief that enough paper and explanations will make an unreasonable file OK
  - » Not every file is approvable – **empower** your underwriters to use common sense and make them **accountable** for decisions
- Misperceptions about culpability/accountability
  - » It's not enough to be honest
  - » Lenders **are** responsible for all loans they make, even if there was no "fault" on the part of the lender and the lender feels they are a victim

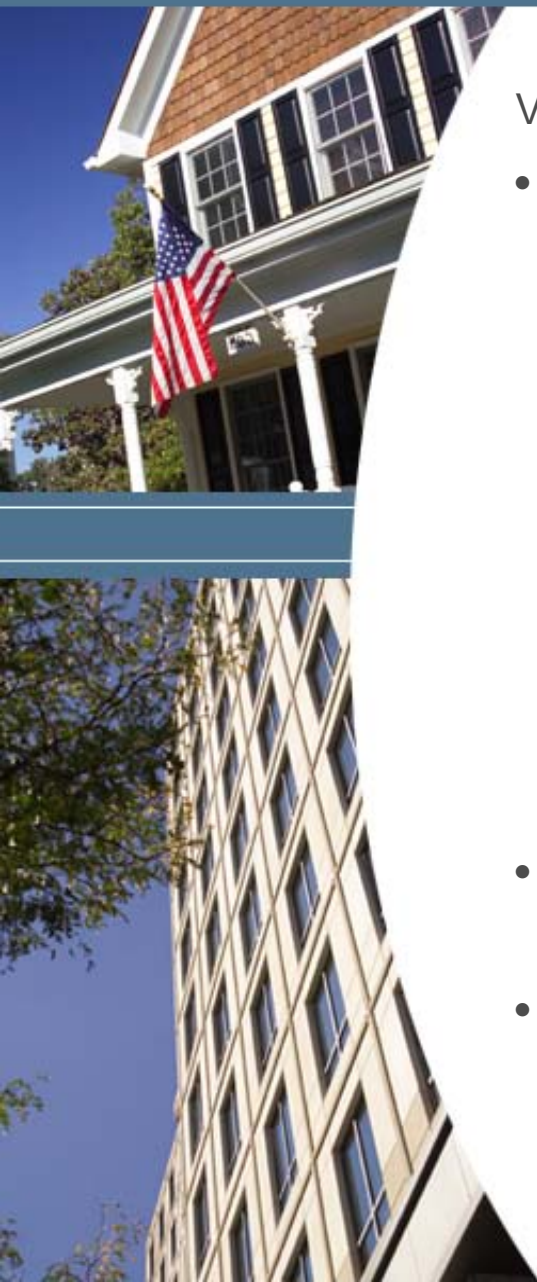
## IRS Income Validation

- File submitted in March, 2010
- Borrower provided income documentation from 2007 to present
  - » Truck Driver
  - » 2007-2008 income of \$19,000 - \$20,000 as a mixture of W-2 and 1099 wages
  - » IRS verification supported this income
  - » 2009-2010 income of \$72,000/year – steady salary of \$1,400/week
  - » Recent income documented with a VOE, W-2s, and unprofessional paystubs
  - » Recent checking account statements supported salary but appeared altered; outbound checks appeared to be starter checks
  - » Loan was approved at the income of \$72,000/year with no explanations or further validation
- IRS income validation was irrelevant because the increase in income and other red flags were not addressed



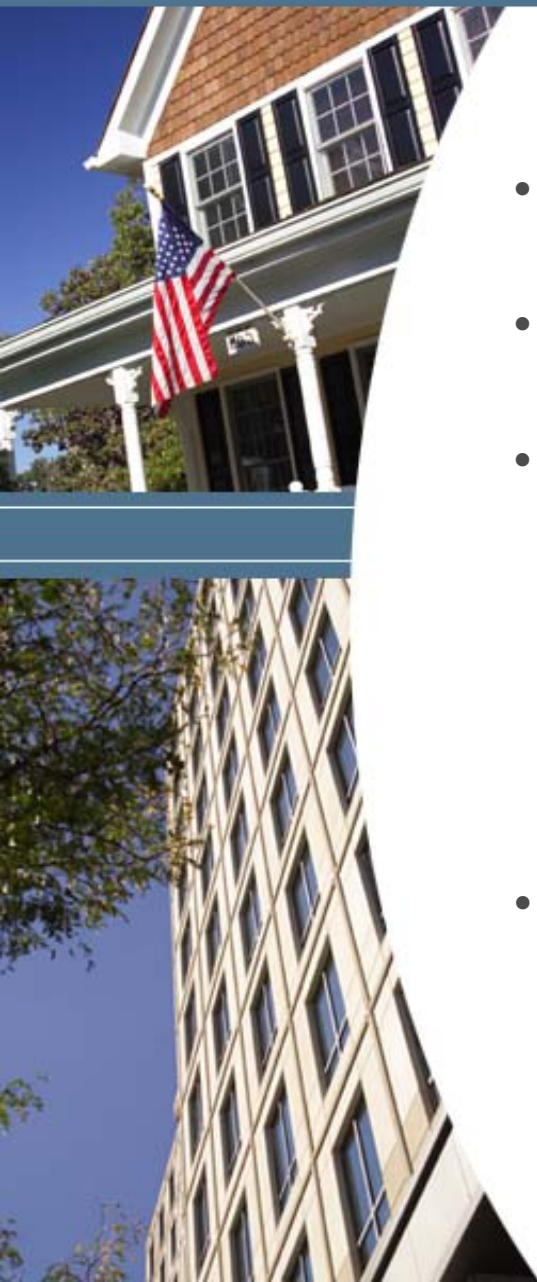
## IRS Income Validation

- File submitted in February, 2010
- Borrower provided income documentation from 2007 to present
  - » 2007-2008 income of \$86,000 - \$87,000 from wages
  - » IRS tax transcript verification supported 2007-2008 income
  - » Employer has minimal presence on the Internet – just a phone listing
  - » Lender did not notice that the borrower's tax returns for 2007 and 2008 were both filed in November 2009
  - » Further investigation – ordered IRS W-2 transcripts for 2007-2008; earnings were \$1,000 - \$2,000 each year
  - » It appears the borrower is a straw buyer or a stolen identity, and had never filed 2007 or 2008 returns
  - » Shortly before applying for the mortgage, perpetrator of flipping scheme facilitated the filing of borrower's past unfiled tax returns with inflated wages for the purpose of circumventing the industry's IRS validation control
- IRS income validation was misleading because it appeared to support an inflated income – the process was exploited

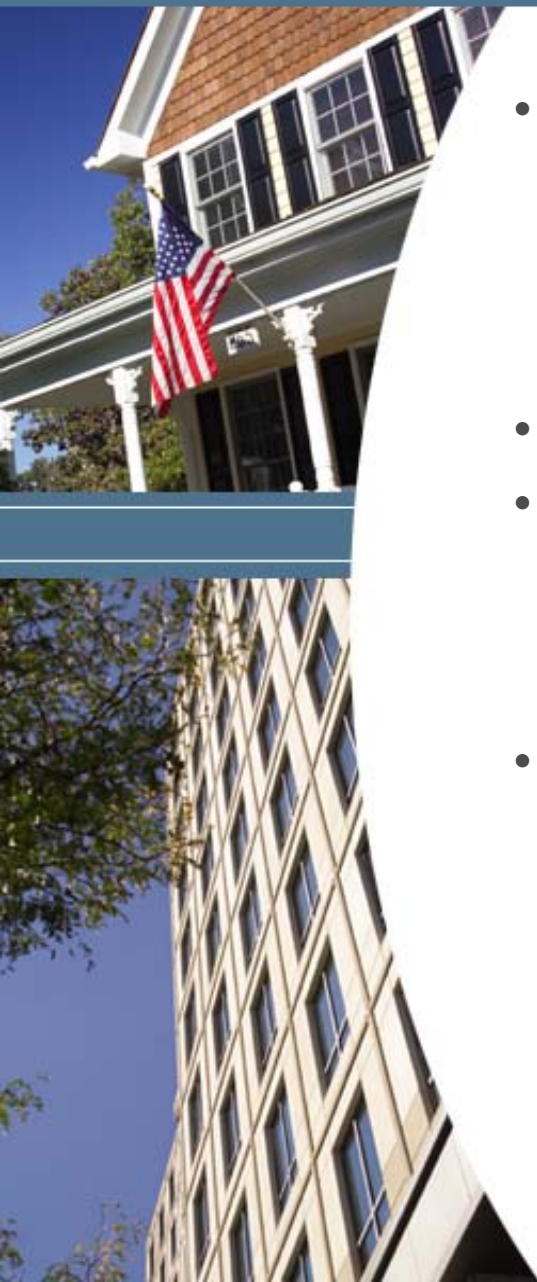


## Vendor Comprehensive Fraud Tool – Same file

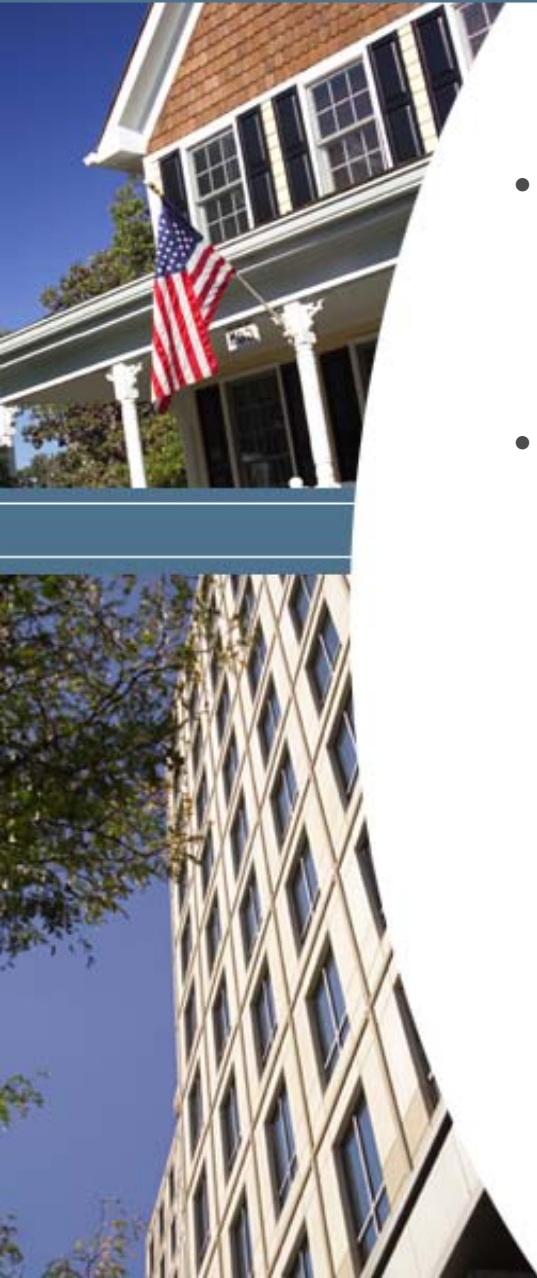
- Tool was used and report was in the file, showing:
  - » Property in highest risk category; 97% of the 155 comps found had lower sales prices although property was in mid-range for assessed value
  - » Current owner of the property per public records on the fraud report did not match the property seller (would require lender to compare between appraisal/title/purchase agreement)
  - » Alerts were present highlighting possible straw buyer risk and showing borrower's current address as having been reported in connection with fraudulent activity
  - » Employer could not be validated per the vendor's report
  - » Appraiser associated with several other high-risk properties
- There is no evidence that the lender did any additional diligence on the alerts or discrepancies
- Due to the timing of the public records, the tool could not identify that the transaction was a flip



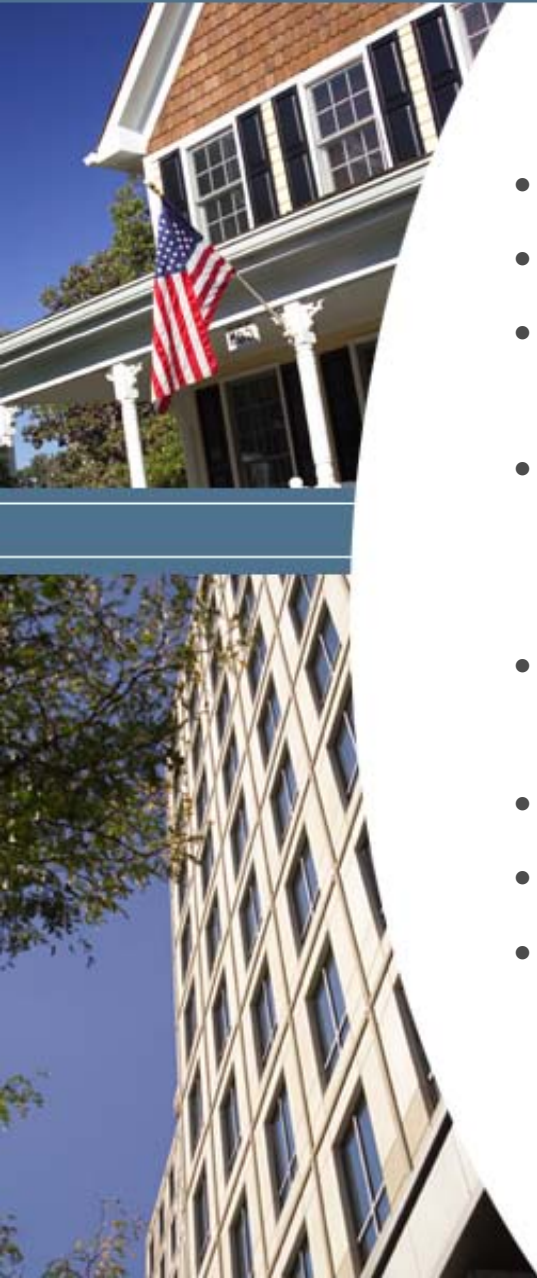
- Formalize fraud organization structure
  - » Appropriateness to organization size
- Visibility and accountability into executive management
  - » Regular meetings and reporting structure
- Inclusive to all areas of the organization
  - » Fraud department
  - » Credit risk
  - » Servicing
  - » Operations/underwriting – all business lines
  - » Sales
  - » Third party management
- Agreed upon metrics
  - » Prefund
  - » Post fund
  - » Investigation results



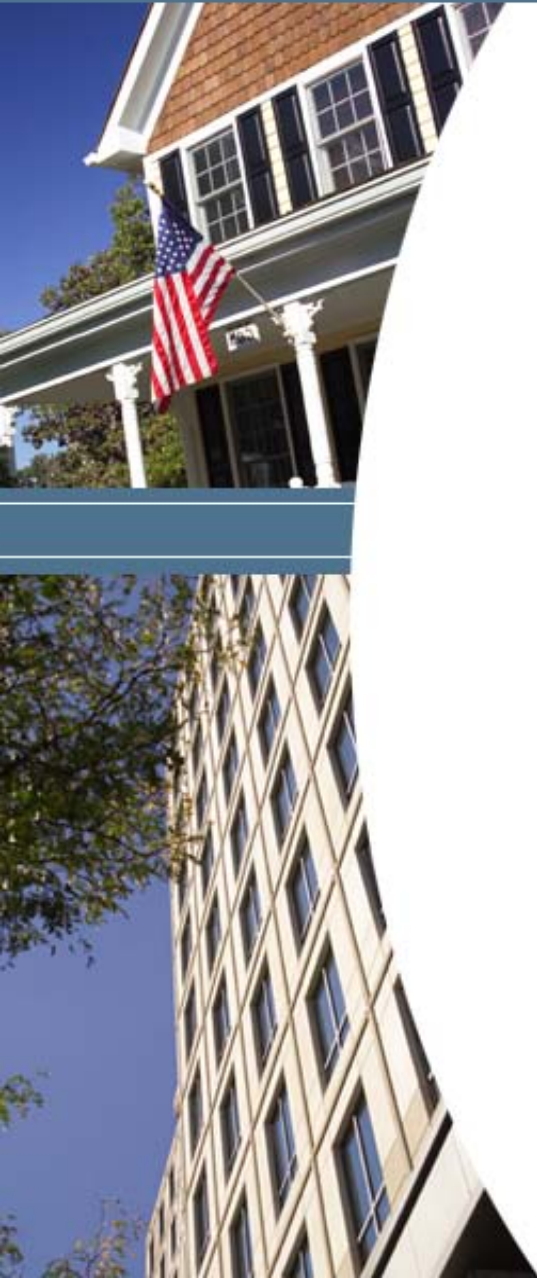
- Centralized database
  - » Build or buy
    - Most fraud tool vendors can support
  - » Integration into LOS and AUS
  - » Investigation results
- Tracking of all watch lists
- Monitoring of all prefund alerts
  - » Alert rates
  - » Cleared to fund
  - » Declined/cancelled
- Monitor and compare
  - » Business line
  - » Broker
  - » Geographic areas
  - » Sites
  - » Loan officers
  - » Underwriters



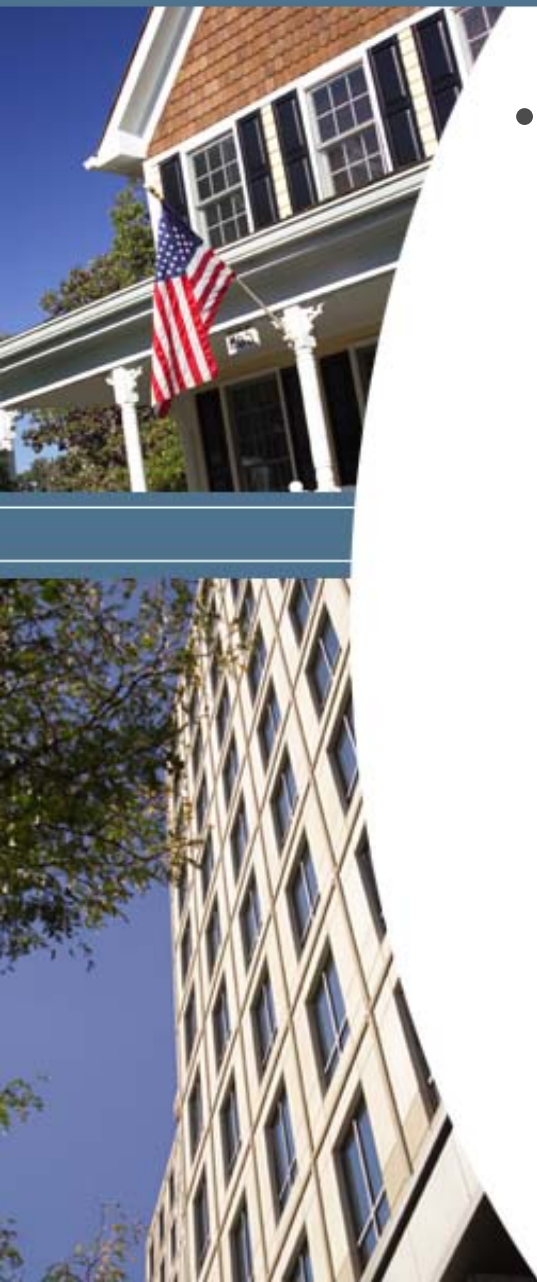
- Consolidated summary reporting
  - » Detailed trending
  - » High level summary for executive management
  
- Other key areas of reporting
  - » Fraud averted
  - » Fraud identified
  - » Cost of fraud
    - Current losses
    - Expected future losses
    - Reserve monitoring
  - » Prefund QC results
  - » Post fund QC results

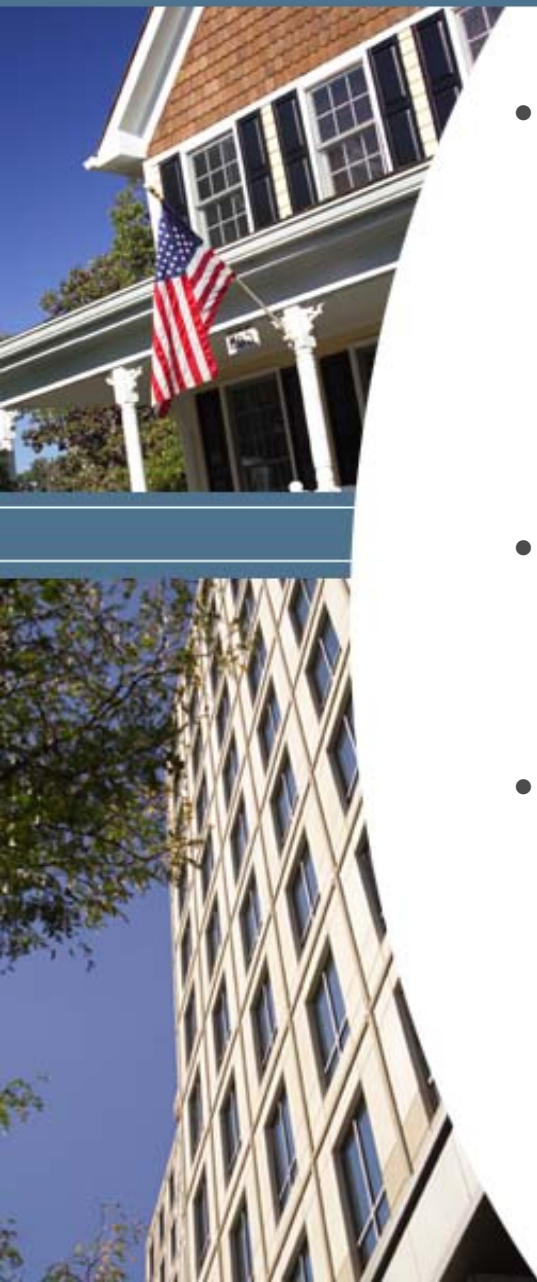


- Evaluate effectiveness of controls
- Economics of fraud
- Set acceptable and unacceptable levels of fraud
  - » Continual monitoring
- Evaluation of all EPDs, audits and repurchases
  - » Assess controls for gaps and process execution
  - » Economic accountability to origination area
- Partnership with sales, underwriting, operations , servicing and risk management
- Incent proper behavior
- Disincentive for improper behavior
- Formal employee and underwriting fraud training programs

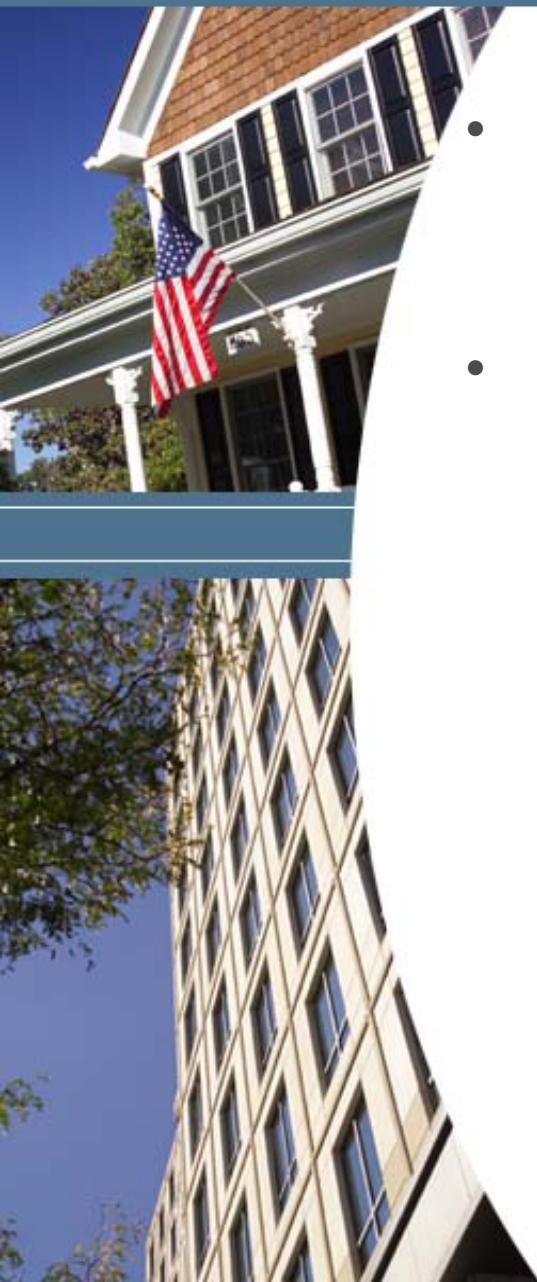


- Evaluation of broker's fraud controls
  - » Prefund tools
    - Alert rates
    - Evaluation/clearing processes
    - Funding rates
  - » QC results
    - Performing
    - Fraud findings
    - EPDs
  - » Organizational risk structure
  - » Loan performance

- 
- Final Rule published April 20, 2010
    - » Eliminated FHA Approval of Loan Correspondents
    - » Increased the Net Worth Requirements for FHA-Approved Lenders
    - » Codified the HFSH Act Ineligibility Requirements for FHA-Approved Lenders
    - » Made Modifications to the Principal-Authorized Agent Relationship



- Currently approved loan correspondents in good standing may retain their approval through **December 31, 2010** provided that:
  - » They complete the annual recertification, and
  - » Pay the recertification fee through FHA Connection
- Effective **May 20, 2010**, FHA will no longer approve any application for loan correspondents.
- Effective **May 20, 2010** non-approved sponsored originators that have established a sponsor relationship with an approved mortgagee may originate FHA loans.

- 
- Effective May 20, 2010, all new applicants for FHA approval must possess a net worth of \$1 million.
  - Effective May 20, 2011, all currently-approved mortgagees must meet the following net worth levels, as applicable:
    - » Small business mortgagees must possess a net worth of \$500,000.
    - » Non-small business mortgagees must possess a net worth of \$1 million.

- 
- FHA approved Lenders may sponsor appropriately licensed mortgage originators for FHA origination
    - Approved lender assumes strict liability for loan
  - FHA will provide aggregate sponsored originator loan performance information in Neighborhood Watch
  - Principal-Authorized Agent relationships now only can be entered into by two FHA-approved Direct Endorsement mortgagees.
    - The Principal in these relationships must originate the loan and the Authorized Agent must underwrite the loan.
    - The loan may close in either the name of the Principal or the Authorized Agent.