



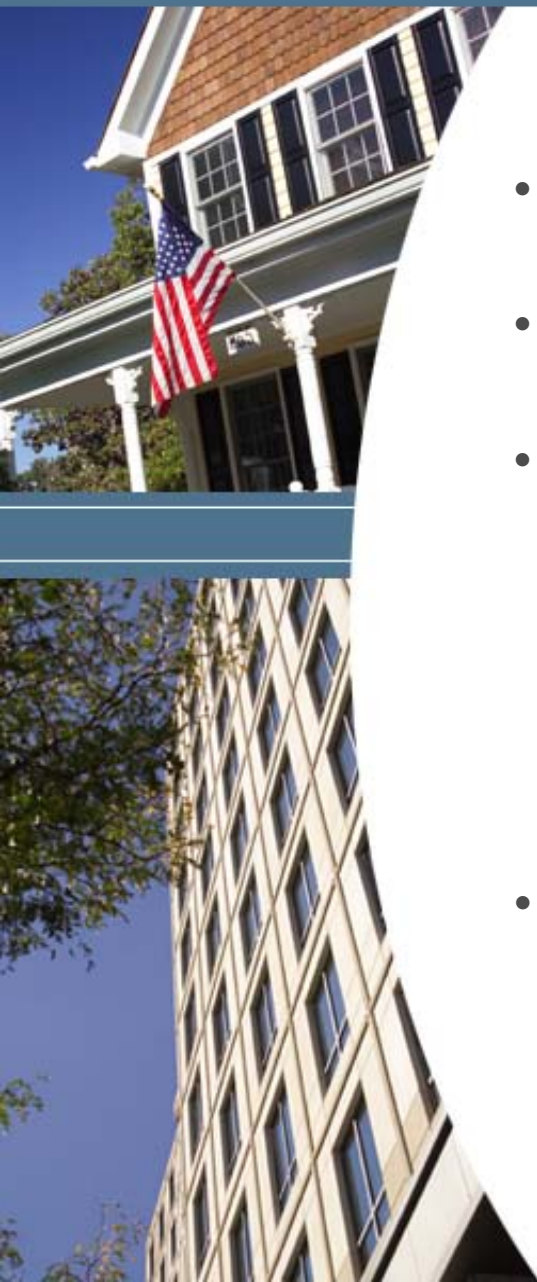
# **Building a Fraud Detection Program from the Bottom Up**

Government Housing Finance Conference 2010

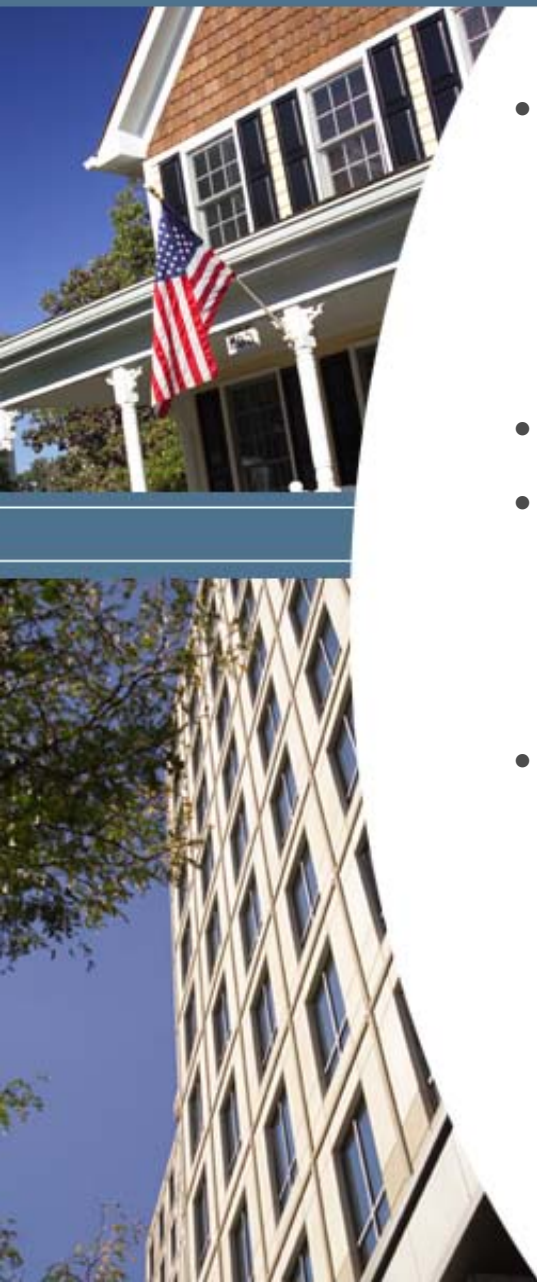
Presented by – Mary Dee LeMaire

Wells Fargo Home Mortgage

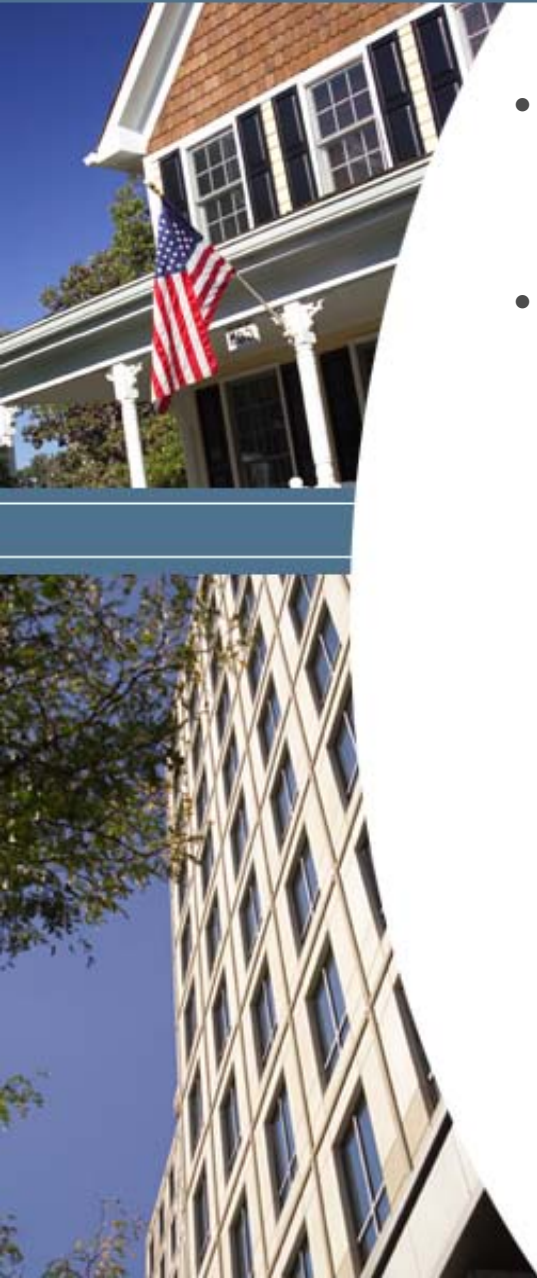




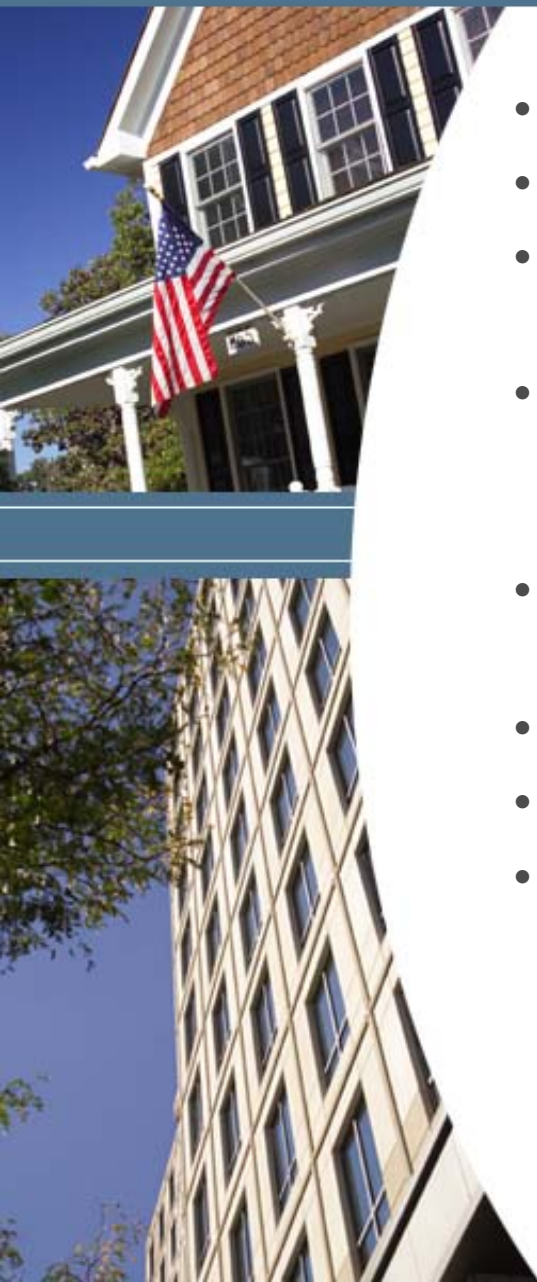
- Formalize fraud organization structure
  - » Appropriateness to organization size
- Visibility and accountability into executive management
  - » Regular meetings and reporting structure
- Inclusive to all areas of the organization
  - » Fraud department
  - » Credit risk
  - » Servicing
  - » Operations/underwriting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



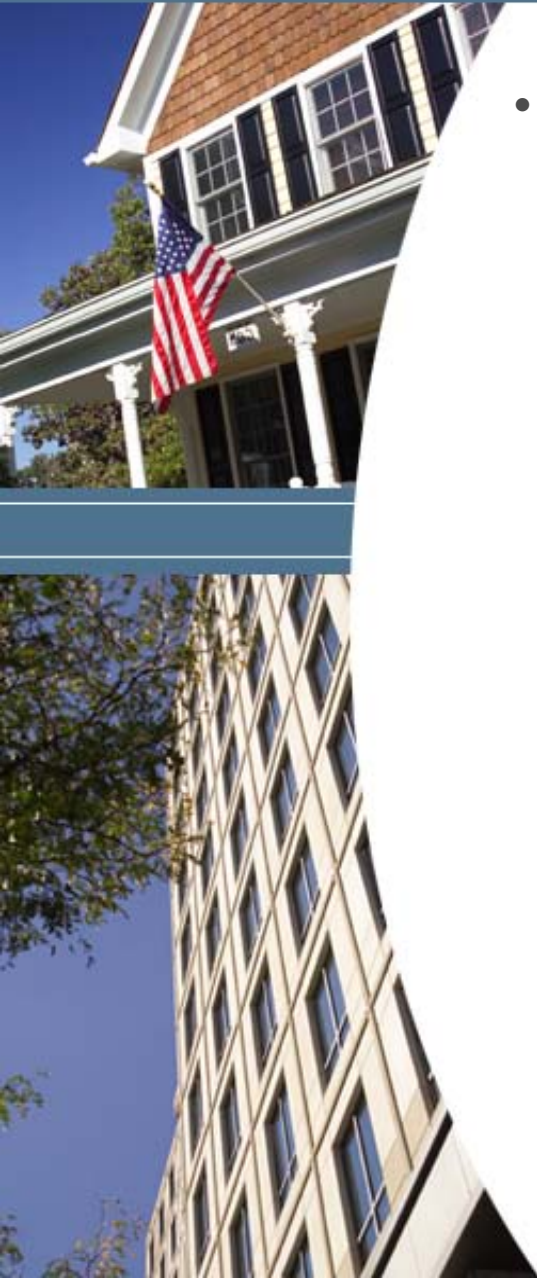
- Centralized database
  - » Build or buy
    - Most fraud tool vendors can support
  - » Integration into LOS and AUS
  - » Investigation results
- Tracking of all watch lists
- Monitoring of all prefund alerts
  - » Alert rates
  - » Cleared to fund
  - » Declined/cancelled
- Monitor and compare
 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

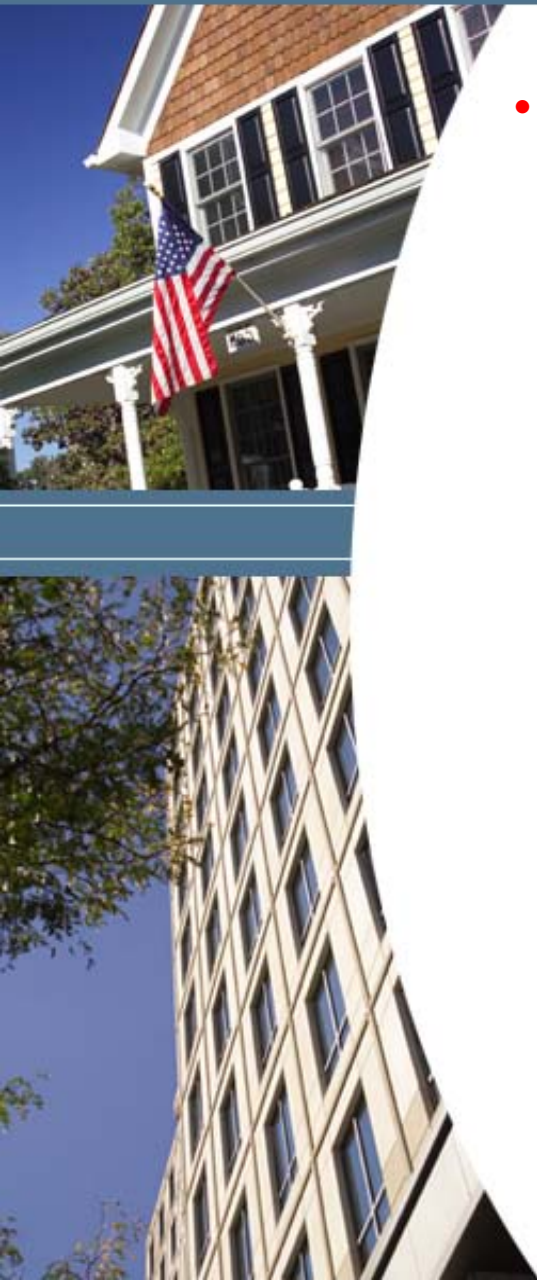


- Evaluate effectiveness of controls
- Economics of fraud
- Set acceptable and unacceptable levels of fraud
  - » Continual monitoring
- Evaluation of all EPDs, audits and repurchases
  - » Assess controls for gaps and process execution
  - » Economic accountability to origination area
- Partnership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

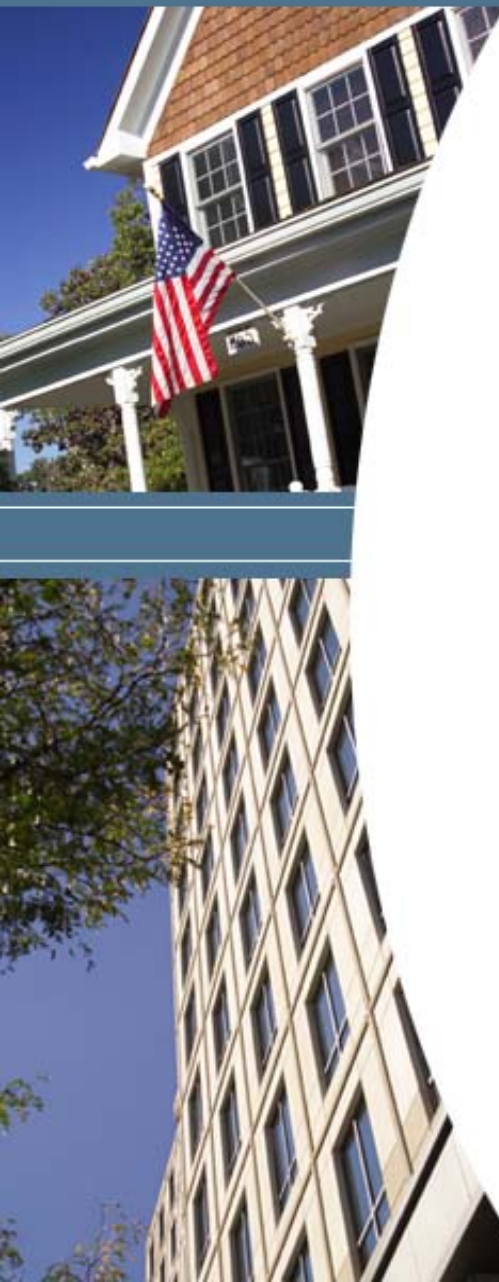


- Evaluation of broker's fraud controls
  - » Prefund tools
    - Alert rates
    - Evaluation/clearing processes
    - Funding rates
  - » QC results
    - Performing
    - Fraud findings
    - EPDs
  - » Organizational risk structure
  - » Loan performance

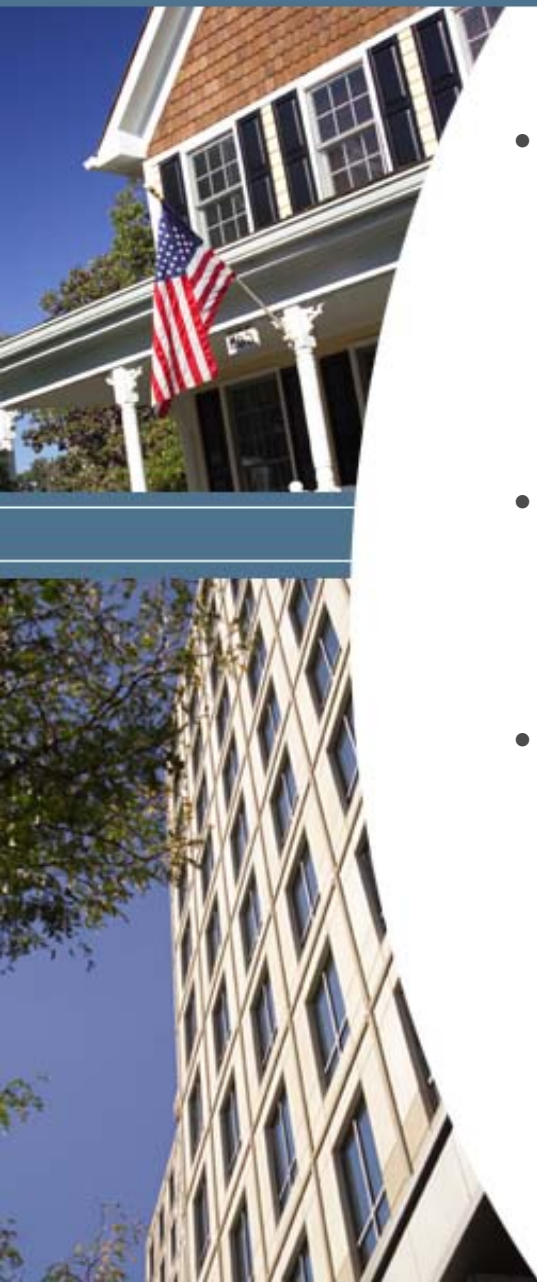
- Inserting slide on how to use Tools and Recognize Issues



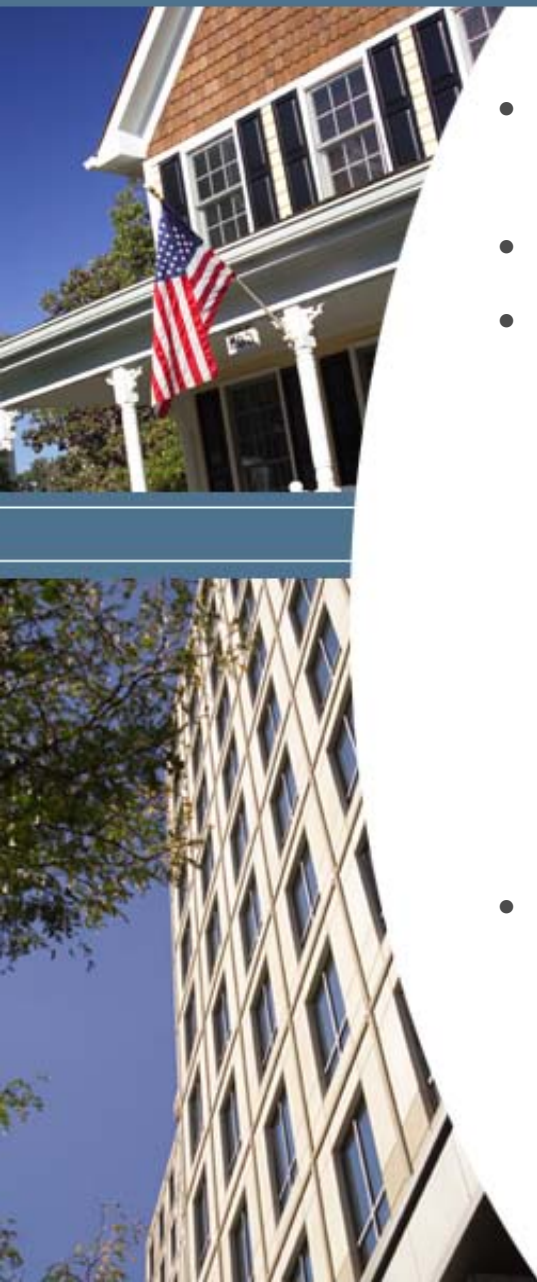
# Government vs. Agency Fraud Requirements



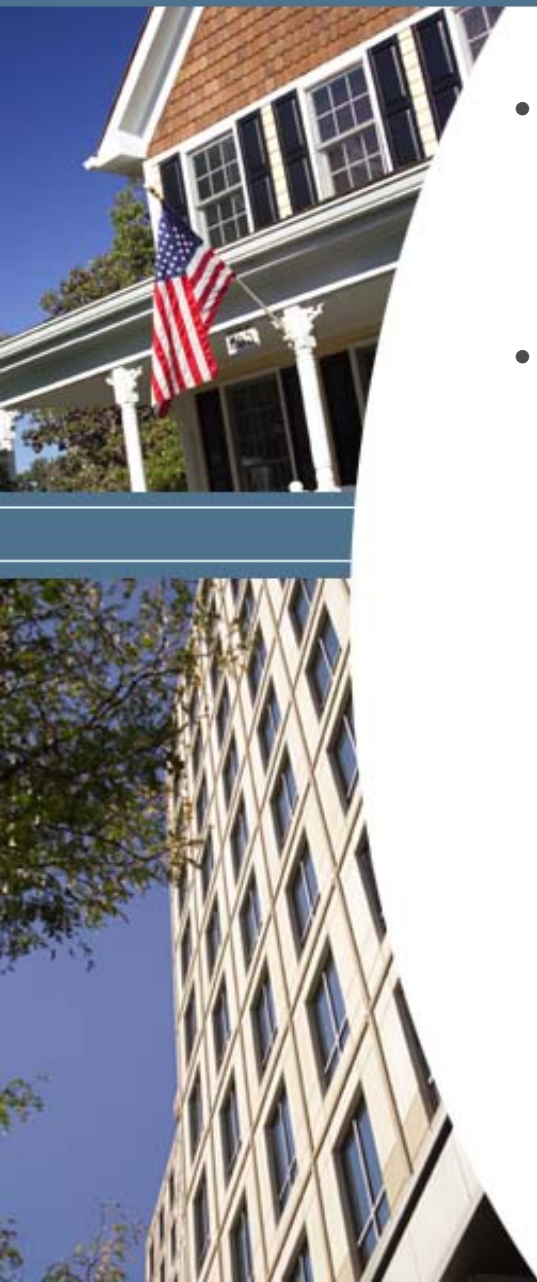
Control	Fannie	Freddie	FHA	VA	Rural Development
VVOE within 10 days of closing for salaried	X	X			
VVOE within 30 days of closing for self employed	X	X			
VVOE prior to funding					Commission income
4506T signed at application and/or closing	X	X	When tax returns are used		On self employed and non employed
4506T processed by lender through the IRS					On self employed and non employed
Undisclosed debts prior to funding warrant					
Altered Documents					The documents in the application package must be legible and must not have any alterations, erasures, or "white-outs."
SSN Check			X		



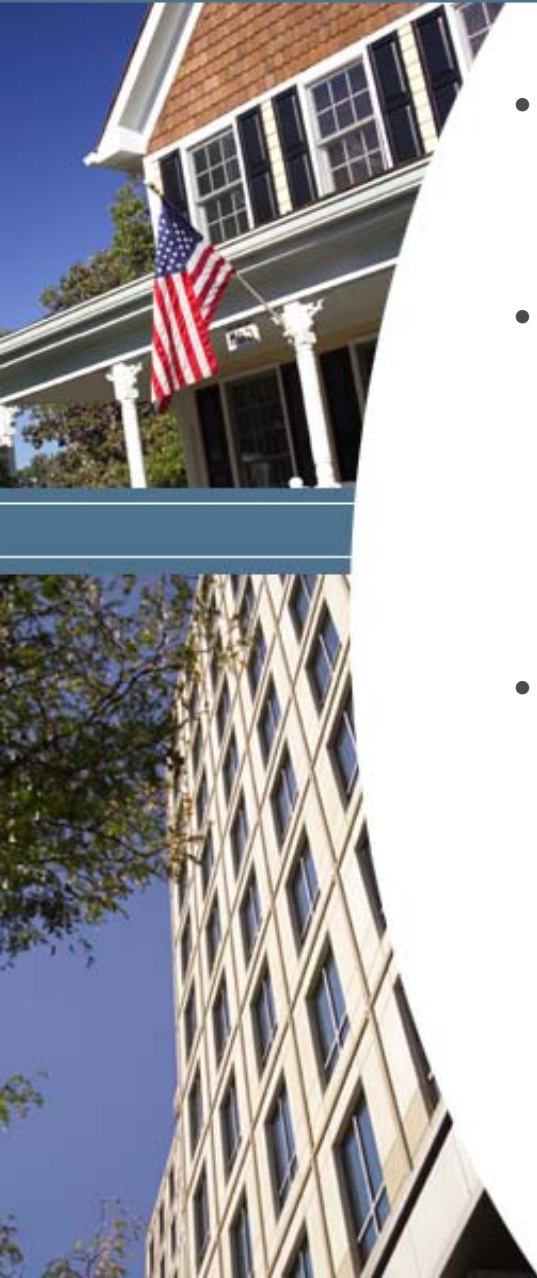
- FHA requires lenders self report proven fraud
  - » Results in automatic indemnification
  - » Has the effect of an MI rescission
  - » Lender cannot file a claim for benefits under the MIC and must pay FHA a make whole for any losses after property is sold post-foreclosure
- Fraudulent loan may prevent 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
  - » Loan will ultimately have to be repurchased from investor or GNMA pool



- FHA may reject a mortgage for insurance for misrepresentation or fraud on the part of any party
- Quality Assurance plans require lenders to self report proven 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

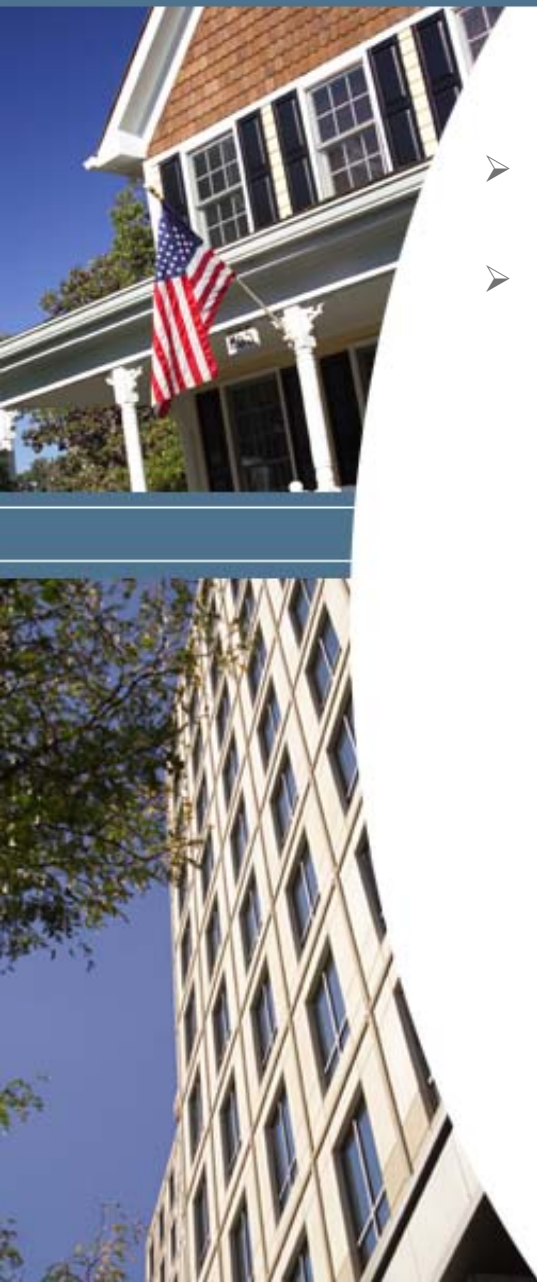


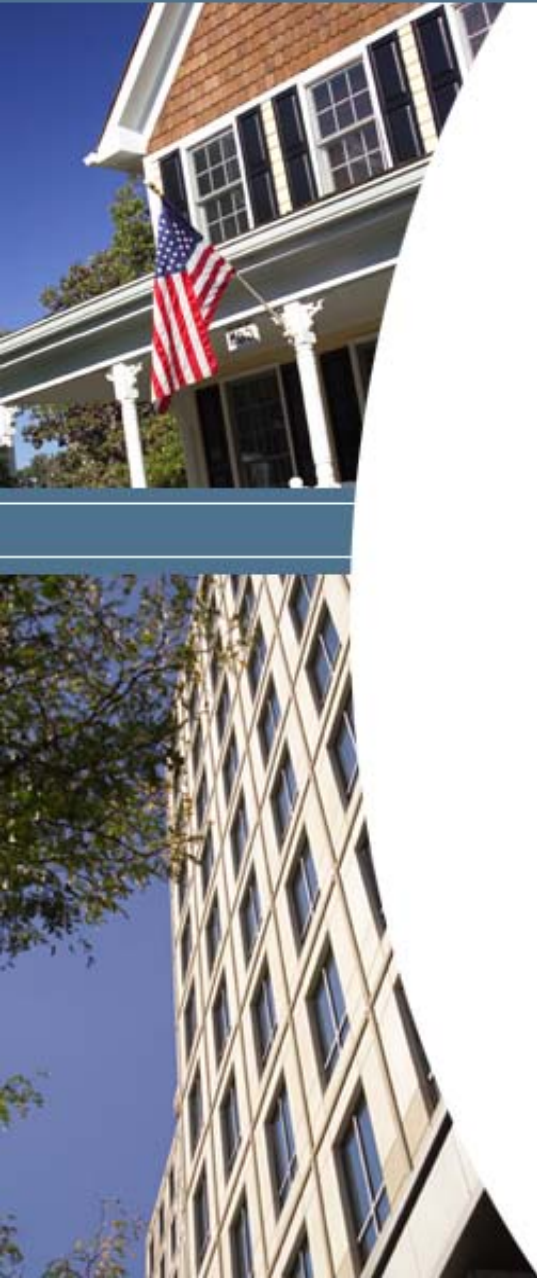
## **HUD Counterparty Requirements**

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Wells Fargo Home Mortgage

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- **FHA Published Final Counterparty rules 4/20/2010**
  - **Key Changes:**
    - Mortgagee Minimum Net Worth increase
      - Increase to \$1MM effective 5/20/2011 fiscal year-end.
      - Increase to \$1MM plus 1% incremental net worth for origination volume over \$25MM, capped at a \$2.5MM net worth effective 5/30/2013 fiscal year-end.  
(i.e. Mortgagees originating over \$150MM in FHA production / yr. required to meet \$2.5MM cap).
    - Entity of Integrity Requirements
      - All personnel involved in FHA loan origination must meet new ethical / integrity standards
      - Requirements align with those communicated in ML 09-31



- Elimination of FHA Broker Approval
  - FHA discontinues broker approval, Mortgagees solely responsible for performing this function (GSE model)
  - Mortgagee assumes responsibility for broker loan quality
  - HUD silent on broker approval criteria expectations, may lead Wholesale industry to compete for broker business based upon leniency of broker eligibility criteria
- Limited role for Non-Mortgagees
  - Mortgagee must order FHA Case Number
  - Loans must close in the name of the Mortgagee which underwrites the loan. Therefore, Table Funding or Closed-Loan FHA Sponsorship no longer available.
  - Loan Correspondents allowed to continue to operate as-is via grandfathering through year-end if recertified by FHA deadline



## ➤ Process Considerations for Broker Approvals for FHA Program

- Institute a recertification process of existing Broker clients previously approved by FHA
- Create FHA approval process for new or existing clients not previously FHA approved
- Establish financial and other approval criteria and communicate internally/externally
- Guiding principles:
  - Maintain high quality / strong HUD Compare Ratio performance of Wholesale FHA production
  - Ensure compliance with HUD “entities of integrity” requirements

## ➤ Process Considerations for Correspondent Channels

- In absence of HUD guidance, consider step-wise increases to avoid significant shock of increasing requirements in a short period of time
- Implement nominal recertification changes to ensure compliance with HUD entities of integrity requirements.