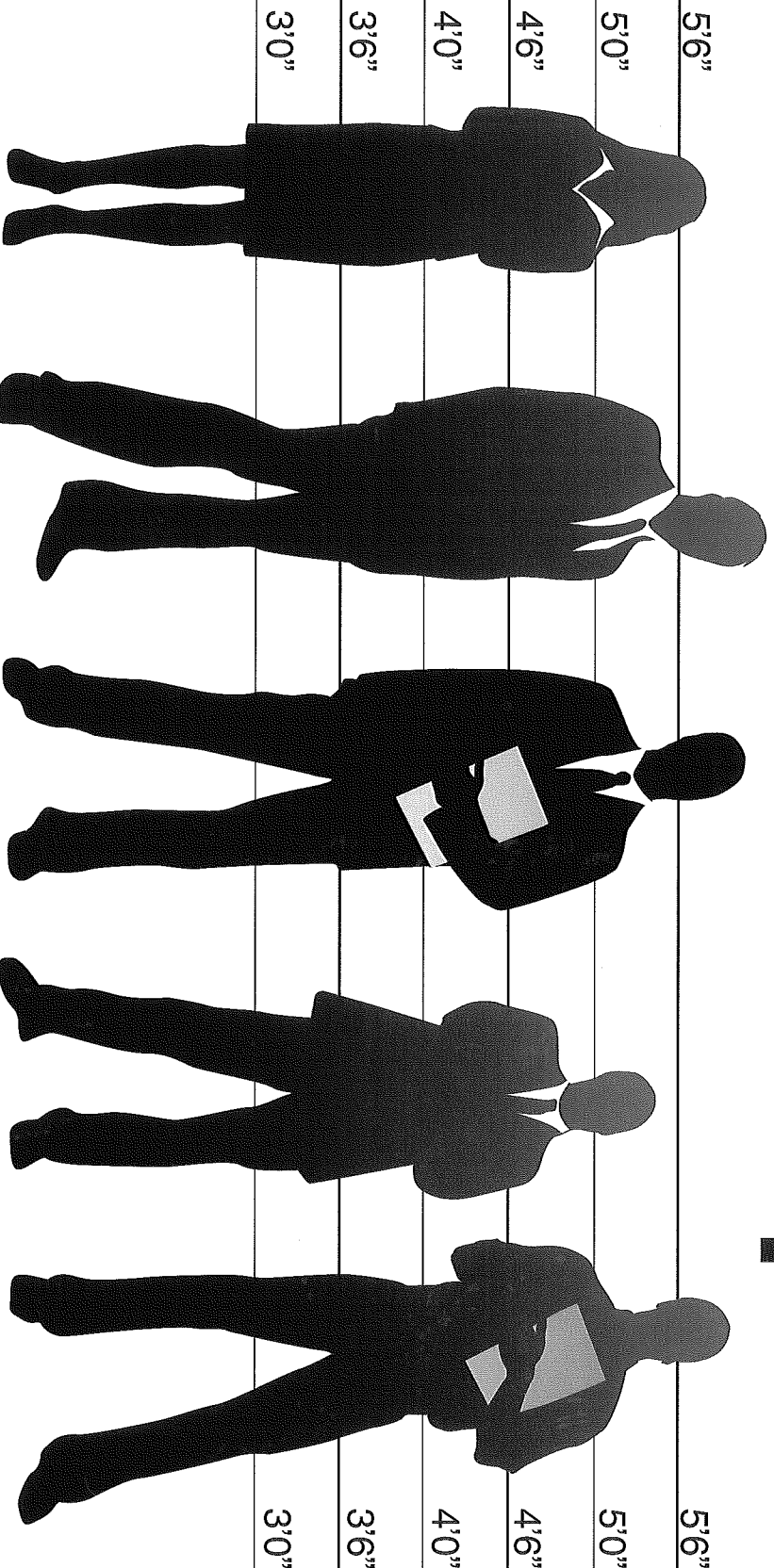


# FRAUD – the usual suspects



Brokers in Australia operate in an unregulated industry, putting them in a potentially vulnerable position when it comes to fraud. Some brokers – the bad apples – have used their positions to commit fraud. *Mark Bolton* investigates how big an issue fraud is, what impact regulating it will have and what brokers' responsibilities are in preventing it

**M**ortgage brokers operating as unregulated, self-employed, free agents are amongst the first to be scrutinised when there is a suspicion of fraudulent activities. When a woman was arrested earlier this year for allegedly counterfeiting certificates of title and pocketing \$9m, the Law Society of New South Wales and the Department of Lands issued urgent warnings to their members and customers, making specific reference to mortgage brokers. The Law Society warned that mortgages using unencumbered certificates of title "invariably with the apparent assistance or intervention of a broker" were of high risk.

## FBI CRACKDOWN ON MORTGAGE FRAUD

If trends in the US are anything to go by, mortgage fraud is an issue of growing concern and one which is now being tackled by the FBI.

Last year, the FBI investigated 818 cases of mortgage fraud, resulting in 263 indictments and 204 convictions. The convictions led to US\$388.9m in restitution, US\$1.4m in recoveries and US\$231m in fines.

"The increased reliance by both financial institutions and non-financial institution lenders on third-party brokers has created opportunities for organised fraud groups, particularly where mortgage industry professionals are involved," an FBI report said.

Of most concern in the US is "insider" involvement. "Eighty per cent of all reported fraud losses involve collaboration or collusion by industry insiders," the report says.

Given the US's current sub-prime lending collapse, there is enormous pressure to limit fraud.

"Combating significant fraud in this area is a priority, because mortgage lending and the housing market have a significant overall effect on the nation's economy," reported the FBI.

But are these warnings justified? According to Jon Downes, general manager, legal & underwriting at First Title, brokers are finding themselves on the frontline as the mortgage industry becomes increasingly exposed to fraud. "With access to funds becoming easier by the day and pressure on brokers to earn a living in the very competitive residential mortgage space, no matter how diligent they are, frauds will still be perpetrated," says Downes. Downes says First Title is exposed to many examples of this practice within the industry. "Our experience is that mortgage fraud is on the rise. The number of mortgage fraud claims we've had has increased from about 30% of overall claims five years ago to approximately 80% of claims last year. This is in line with similar experiences we have had in other jurisdictions, such as the US and Canada."

### Is mortgage fraud really a problem?

According to some of the leading industry figures it is not as big an issue as some make out.

"It's not as rife as one would think it is," claims Maurice Urwin, the general manager of the Finance Brokers Association of Australia.

Phil Naylor, the president of the Mortgage & Finance Association of Australia (MFAA), also plays down the issue. "We're receiving anecdotal reports from members that they are seeing more fraud. However, this hasn't translated into a noticeable increase in matters dealt with under the MFAA's Disciplinary Rules," says Naylor. "It should also be said that while the industry must always be vigilant against fraud, it should not be overstated as an issue."

According to BankWest, which is reliant on brokers on the East Coast, fraud is not a major problem.

"Mortgage fraud is not an issue for BankWest, as we have rigorous risk management and credit policies in place to ensure we minimise acts of fraud committed against the bank," says Phil Colton, head of broker sales at BankWest.

Aggregators, as middlemen, appear to be more wary. "It hasn't been a significant issue in terms of the brokers aggregating under FAST but it is always a relevant and prevalent issue in the marketplace," says FAST CEO Steve Kane. Julianne McKnight, compliance manager at PLAN Australia, agrees and says mortgage fraud is an issue for the entire industry regardless of its level of occurrence. "It is a concern if it occurs at all," she says.

#### So are brokers to blame?

Given brokers' position within the lending process, the close relationship they often develop with borrowers and the reliance placed on them by the lenders, broker involvement in fraudulent activities is often alleged. But according to the MFAA that is not always justified.

"It should not be assumed that fraud equals broker involvement," says Naylor. "There is no evidence to suggest that fraud involving brokers is higher than that identified amongst lenders' staff."

BankWest, a lender heavily tied into the broker market, believes its processes and the reliance it places on brokers has something to do with keeping fraud a non-issue for the bank, not the opposite.

"BankWest undertakes all security checks of all loan applications and does not require the broker to do this," says Colton. "BankWest also ensures our brokers are correctly accredited and regularly checks industry lists."

And then there is the question of the non-banking sector, also heavily reliant on brokers. A warning released by the Department of Lands earlier this year noted some identical features of fraudulent schemes uncovered. One of the features was that all the loans were sought by mortgage brokers from non-bank financial organisations. Whether it was the security processes used by the non-bank lenders that lured the culprits was not made known.

#### So what can brokers do themselves?

Even though brokers may sometimes be unfairly associated with fraudulent activity, their position on the lending chain will continue to make them vulnerable to attack. So it seems brokers have an added responsibility, both to themselves and to lenders, to ensure they do everything they can to minimise fraud.

Kane has some suggestions for brokers to limit their exposure to fraud. "I think the most important thing for mortgage brokers is understanding the information that they get and verifying first the identity of not only the borrowers they're dealing with but the referrers and also the sources of the information that those referrers are bringing to their brokers," he says.

"It's important that verification of the information and the accuracy of the information are paramount in any application," he continues.

Advice also comes from PricewaterhouseCoopers (PwC) who, in conjunction with the MFAA, recently released a report, an industry white paper, on managing fraud in the loan application process.

The report specifically dealt with three areas brokers should focus on. These were the loan application form, identity verification and income verification.

For the loan application form, PwC stresses the need to ensure integrity and accuracy. It recommends that each relevant section of the application form be fully completed, that the application contain the original signatures of all the applicants and that the application form, and all accompanying information and documentation, be retained by the broker.

Viewing original documents is a method suggested to help with verification. Particular caution should be taken if the borrower is acting under a power of attorney, especially when it involves a transfer of an unencumbered property. Brokers should be aware that as of 12 December 2007 the 100-point check for identification will be replaced by the requirements of the Anti-Money Laundering and Counter-Terrorist Financing legislation.

Obtaining sufficient documentation to verify employment is also paramount. The report suggests that if suspicion exists about employment some simple checks brokers can perform include: calling the employer, checking the White Pages, obtaining a business card or checking the deposit description on bank statements.

One example the report referred to was a \$585,000 loan taken out in November 2004. When the loan fell into arrears it was established that the supposed borrower was actually in jail at the time of the loan application and the person who signed the reference on behalf of the employer company did not exist.

#### Will regulation have any impact?

National regulation appears to be 12 to 18 months away. But will it make any difference? According to the MFAA, regulating the industry will help but only to a certain extent.

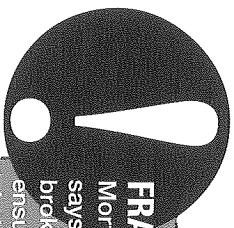
"It will assist, but it won't wipe out fraud completely," says Naylor. "There will always be an unscrupulous element in any industry, regulated or not. However, the probity checks with licensing are likely to weed out those who may be more likely to commit fraud."

McKnight agrees that there will be only a limited impact on fraud from regulations.

"Well-thought out and well-structured regulation will not hurt; however, we all must be conscious of the fact that it will not provide the entire answer.

"I don't believe we will ever eradicate the risk of fraud entirely. Technology provides increasing avenues for fraud for those who wish to do the wrong thing in finance and other industries."

Kane believes regulating the industry will have some positives. "I think that regulation in the industry will ensure that the standard of people entering the industry is maintained and improved, and that should impact on fraud over time," says Kane. However, he adds that "clearly systemic fraud, organised crime, etc are relevant and prevalent in the marketplace all the time, so you just have to be ever vigilant about that."



#### FRAUD ALERT TIPS

Mortgage insurer First Title says these tips should help brokers to detect fraud and ensure they do not become victims themselves.

- Be thorough and take time to complete the identification process. Be suspicious and question during the process
- Verify employment details against all available documentation (pay slips, account statements, tax information) and contact employer directly
- Ensure that all documents the customer has filled out are fully completed
- Insist on seeing original forms of photo identification
- Ensure the customer gives you a phone number for work or home that is not a mobile number. Check it
- Ensure the customer gives you a postal address other than a post box. Be suspicious if they will not look for alterations in documents and for signatures that differ between documents or look traced
- Check that the certificate of title is not fraudulent
- If there is a power of attorney or the title is unencumbered, check the transaction carefully

#### MORTGAGE FRAUD IN THE US

The FBI has identified these schemes as the most common way mortgage fraud is committed in the US:

- Property flipping – property is purchased, falsely appraised at a higher value and then quickly sold
- Silent second – the buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage
- Nominee loans – the identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan
- Fictitious/stolen identity – a fictitious/stolen identity is used on the loan application
- Inflated appraisals – an appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender
- Foreclosure schemes – the perpetrator misleads homeowners at risk of defaulting to give them a transfer of the deed and upfront fees to save their homes
- Equity skimming – an investor may use a straw buyer, false income documents and false credit reports to obtain a mortgage loan in the straw buyer's name then sign the property over to the investor

