LexisNexis® Mortgage Asset Research Institute

THIRTEENTH PERIODIC MORTGAGE FRAUD CASE REPORT

May 2011

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Table of Contents

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Executive Summary

Although origination volumes have decreased to just over one trillion dollars in 2010, fraud and misrepresentation continue to be a highly visible issue for mortgage lenders. Depreciated housing inventories and the threat of homeownership uncertainty by consumers have opened new doors for fraudsters to evolve their craft.

There are several factors that contribute to the pervasiveness of fraud, each of which requires increased attention to the scrutiny of information considered in connection with a transaction. As will be discussed in this report, many authoritative sources have shared similar insights about fraud and misrepresentation that correlate with industry-contributed reports to the LexisNexis® Mortgage Asset Research Institute. As such, law enforcement officials, regulators and state lawmakers have heightened their vigilance in strengthening legal protections and prosecuting perpetrators of these unscrupulous acts against society.

In 2010, Mortgage Fraud Suspicious Activity Reports (SARs) rose to 70,472 (Figure 1), a near five percent increase over 2009. The Financial Crimes Enforcement Network (FinCEN) estimates losses at more than $1.5 billion, a total that is still likely to be grossly under-reported. Analysis of reported incidents of fraud and misrepresentation by industry professionals contained in the Mortgage Industry Data Exchange (MIDEX) reveals that misrepresentation on loan applications and verifications of deposit, along with appraisal and valuation issues, presented the most egregious problems in 2010 originations. Florida, New York, and California occupied the top three spots for states, ranking the highest on the Mortgage Asset Research Institute's Mortgage Fraud Index, exhibiting at least two times the amount of reported fraud and misrepresentation when compared to their number of 2010 originations. More notably, multiple industry reports indicate that identity-, bankruptcy- and income-related frauds are on the rise and have been directly associated with mortgage fraud.

Fraudsters thrive on inadequacies within lengthy loan-related processes and a lack of consistency across organizations and/or industries that help them hide their true motives. Technology has enabled faster loan production through automation, ease of processing, and analytics. Industry professionals have keen knowledge of those processes, which makes it much easier to manipulate protocols in place to thwart adverse activities. This is the thirteenth annual report by the Mortgage Asset Research Institute. These annual reports examine the current composition of residential mortgage fraud and misrepresentation involving industry professionals in the United States. (See Appendix I at the end of this report for information about the Mortgage Asset Research Institute and the methods it uses to collect data on mortgage fraud.) Findings in this report will include trends associated with originations that took place during 2010 and, as the industry has shifted more focus to recovery and loss mitigation efforts, will also include trends involving forensic investigations into originations that occurred in years prior to 2010.

> The new rules of engagement are clear: fraud risk management requires a multi-faceted approach that includes verification, monitoring, collaboration, and reporting.

At a glance, the Mortgage Asset Research Institute examination of industry-contributed reports to MIDEX for 2010 identified that:

- Florida topped other states with the highest percentage of reported incidents of fraud and/or misrepresentation for originations and post-funding investigations in 2010;
- Other states that made the top ten on both lists include California, Michigan, Illinois, Maryland, and Virginia;
- California reclaimed its place in the top three for new originations with reported misrepresentation during 2010 and remained flat in sixth place for reported misrepresentation found during post-funding investigations; and
- Appraisal and valuation issues continue to be highly reported in both originations and post-funding investigations. Twenty-five percent of loans originated and 33 percent of loans investigated post-funding in 2010 included some type of appraisal fraud and/or misrepresentation.

The body of this report presents the data and analysis supporting the findings cited above. The information contained in this report is meant to provide insights into current mortgage market activities. The new rules of engagement are clear: fraud risk management requires a multi-faceted approach that includes verification, monitoring, collaboration, and reporting.

Data and Information Sources Used in This Case Report

For two decades, major mortgage lenders, agencies, and insurers have been submitting information describing incidents of verified fraud and material misrepresentation to an industry-contributed database, known as MIDEX (Mortgage Industry Data Exchange), in order to share adverse experiences involving professionals operating within the mortgage industry. Contributing subscribers use information services derived from the MIDEX database as a risk management tool to protect against mortgage fraud perpetrated by industry professionals. MIDEX enables subscribers to perform due diligence checks on mortgage professionals and companies as part of their business relationship credentialing process. The Mortgage Asset Research Institute utilizes MIDEX submissions to develop representative statistics on a wide range of mortgage fraud and misrepresentation characteristics. Findings from this analysis are presented in annual Case Reports to provide key insight into mortgage fraud trends, as reported by the industry.

In addition to MIDEX incident data, the report utilizes Home Mortgage Disclosure Act (HMDA) data sourced by the Mortgage Bankers Association (MBA), a key component used for calculating a state's Mortgage Asset Research Institute Fraud Index (MFI) value. Please refer to Appendix II for information on the MFI and its computation.

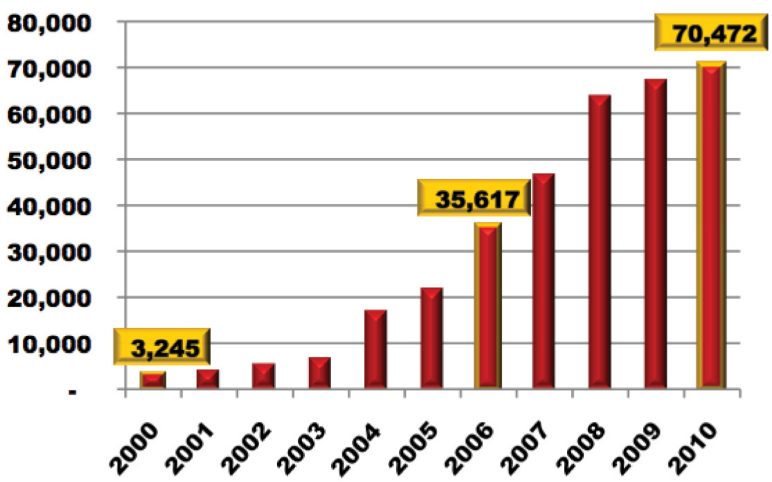
The Mortgage Asset Research Institute Reports and SAR Filing Trends

The Financial Crimes Enforcement Network (FinCEN) is the agency that collects Suspicious Activity Reports (SARs) from all federally-insured financial institutions. Figure 1 shows the increase in mortgage fraud SAR submissions to FinCEN over the past several years. In 2010, the total number of mortgage fraud SARs rose to more than 70,000 submissions, a nearly five percent increase over 2009. As the mortgage industry emerges from a tumultuous three-year period, regulators and lawmakers have focused their attentions on investigating and prosecuting cases of mortgage loan fraud. In 2010 alone, the FBI filed 1,531 indictments/informations and received 970 convictions. Through the end of February 2011, they report 3,020 pending investigations, 72 percent of which involve losses of more than $1 million.[i]

In 2010 alone, the FBI filed 1,531 indictments/informations and received 970 convictions. Through the end of February 2011, they report 3,020 pending investigations, 72 percent of which involve losses of more than $1 million.

These year-over-year increases in SAR submissions are not likely to be entirely reflective of mortgage fraud activity. SAR submissions are currently only required of federally-insured financial institutions and their affiliates, though this could soon change as FinCEN may implement mandatory reporting for non-depository institutions including mortgage brokers and lenders. Therefore, fraud experiences of independent mortgage entities are currently not likely to be reflected in Figure 1. These companies, however, comprise a portion of MIDEX subscribers, and therefore, their reported incidents of fraud and misrepresentation are represented in the MIDEX data.

Figure 1: Mortgage Fraud SARs (2000-2010)



Source: www.fincen.gov; March 2011

Furthermore, incident reports submitted to the Mortgage Asset Research Institute must be verified, material misrepresentations involving industry professionals, criteria that are slightly different from SAR reporting rules in that SARs include suspicious activities which typically have not been verified and may include strictly borrower fraud.

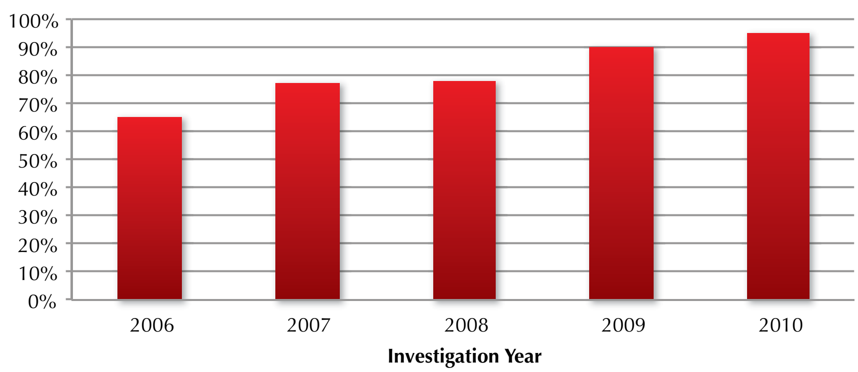
For the first time in several years the Mortgage Asset Research Institute experienced a decrease in reported instances of fraud and material misrepresentation. From 2009 to 2010, 41 percent fewer reports of verified, material misrepresentation were received. However, the decline brings the number of cases reported in 2010 to the same level (by less than half a percentage point) as the number of reported cases in 2006.

There are several possible contributing factors. The decrease in submissions can be attributed to a decrease in loan origination volumes, increased focus on loss mitigation and recovery efforts, and fewer resources available to investigate and report incidents as discovered. Additionally, new FinCEN reporting mandates include a broader group of industry participants encouraged to submit SARs. Though due diligence is required, SARs do not require the level of verification of reported activities that is required for incidents to qualify for inclusion into the MIDEX database. Furthermore, as the post-economic crisis mortgage fraud landscape has evolved, fraud has become more complex and harder to verify using traditional methods. Mortgage businesses are quickly trying to implement new procedures to detect emerging frauds while, at the same time, focusing their energies on recovering the huge financial loses of recent years.

As the mortgage industry has temporarily shifted more focus to recovery and loss mitigation from origination production, reporting trends have also slightly shifted. According to FinCEN's Mortgage Fraud Update issued in March 2011, "[time lapses between filing and activity dates in 2010 [Mortgage Loan Fraud] SAR filings showed a continued focus on older activities."

As Figure 2 indicates, we show the same time lapse trend in submissions from subscribers:

Figure 2: Reported Incidents for Post-Funding Investigations



In 2006, 65 percent of loans investigated and submitted to the Mortgage Asset Research Institute were for loans originated in prior years, which means that 35 percent of investigations submitted in 2006 involved loans originated during that year. In 2010, there is a marked increase in submissions for years older than the investigation year. Ninety-five percent of all incidents reported to MIDEX in 2010 were for loans originated prior to 2010, compared to 65 percent in 2006. Lenders appear to be to expending increased time and resources for scrutinizing poorly performing or defaulted loans. Fraud investigation units within lending institutions are attempting to both understand what went wrong and provide implementation guidance for fraud avoidance programs.

The Mortgage Asset Research Institute recognizes the significance of this shift in focus and as such, will offer trends found for top fraud areas and reported fraud types in two ways: by origination year and by post-funding investigation year.

In 2006, 65 percent of loans investigated and submitted to the Mortgage Asset Research Institute were for loans originated in prior years, which means that 35 percent of investigations submitted in 2006 involved loans originated during that year.

Geographic Distribution of Mortgage Fraud

Tables 1 and 2 and Figure 3 on the next few pages present the states with the highest mortgage fraud indices (MFIs) based on incident reports submitted to the Mortgage Asset Research Institute. The first three columns of Table 1 show the rankings of states with the most serious mortgage fraud problems in loans originated during 2010 (Origination MFI). The remaining columns of the table show the rankings and a numerical measure for the same ten states in preceding years, back to 2006.

Table 2 provides a different view of states with high volumes of reported fraud and/or misrepresentation. This table examines the rankings of states with the most serious reported mortgage fraud problems in loans investigated post-funding, during 2010 (Investigation MFI). Similar to Table 1 above, the remaining columns of the table show the rankings and a numerical measure of the same ten states in prior years, dating back to 2006.

The numerical measure of each state's fraud problem is represented by the Mortgage Asset Research Institute Fraud Index (MFI). An MFI of 0 would indicate no reported fraud to MIDEX from a state. An MFI of 100 would indicate that the reported fraud for a state is level with expectations specific to fraud rates, given the number of loan originations for that state. That is, a state that has five percent of the cases in MIDEX for 2010 and also has five percent of the country's loan originations in the same year would have an MFI of 100. Appendix II at the end of this report explains in detail how the MFI is calculated.

Table 1 details how states rank against others for reported fraud and misrepresentation in the past five years. Based on incident reports submitted to the Mortgage Asset Research Institute through the first quarter of 2011, Florida's MFI ranked first in the nation for loans originated in 2010. The reported fraud rate was over three times ($MFI_{FL}/2010 = 302$) that of Colorado, based solely on its origination volume. This is a decrease from its updated fraud rate for loans originated in 2009 ($MFI_{FL}/2009 = 361$) and 2008 ($MFI_{FL}/2008 = 445$).

Based on incident reports submitted to the Mortgage Asset Research Institute through the first quarter of 2011, Florida ranked first in the nation for loans with misrepresentation originated in 2010.

Table 1

Mortgage Asset Research Institute Fraud Index (MFI)[ii]										
By State: (2006-2010 All Originations)										
	2010		2009		2008		2007		2006	
State	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	302	1	361	1	445	1	372	1	240
New York	2	279	3	262	5	162	21	52	12	79
California	3	233	10	130	7	156	4	152	2	166
New Jersey	4	191	5	155	11	107	19	57	19	56
Maryland	5	163	8	152	4	171	13	67	15	66
Michigan	6	130	6	155	3	182	3	186	4	160
Virginia	7	113	23	79	20	53	11	75	13	71
Ohio	8	112	24	78	29	37	26	46	14	70
Colorado	9	96	32	50	17	61	16	62	9	106
Illinois	10	93	11	126	8	154	7	130	6	125

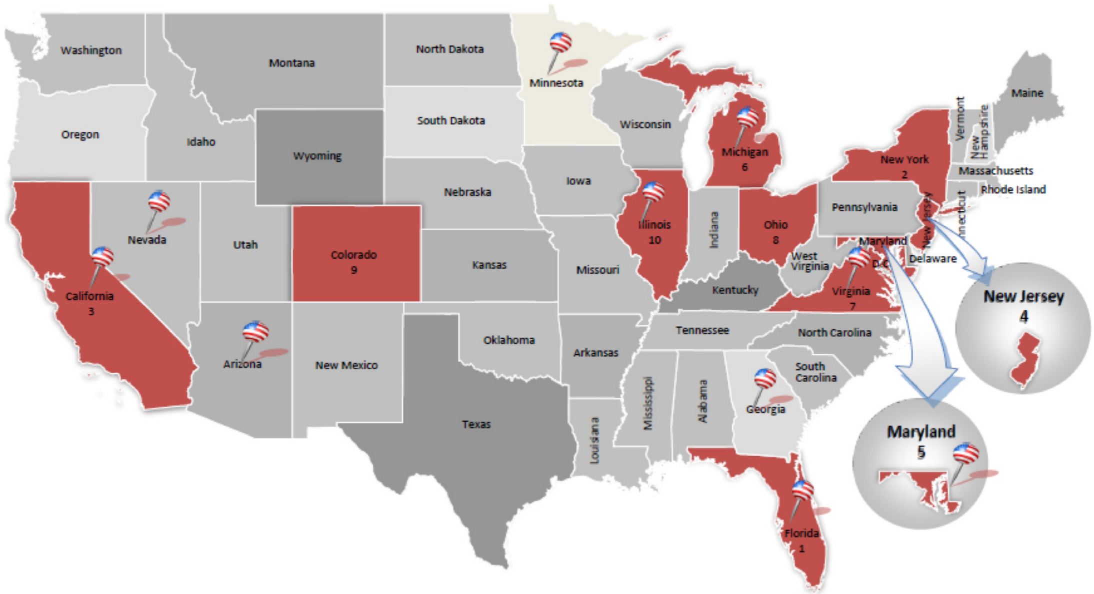
It should be noted that the 2006 through 2009 MFI values for all states listed in Table 1 differ somewhat from those shown in the same table of last year's Case Report. This is due to the fact that Table 1 is based on an additional year of submissions, some of which were reported on loans originated in years 2006 through 2009.

Further analysis of Table 1 and the map yields the following conclusions:

- Florida once again owns the highest 2010 MFI origination value, 302. This indicates that the state has just over three times the expected amount of reported mortgage fraud for its origination volume.
- After falling to tenth place for 2009 originations, California is ranked third for 2010 originations.
- Michigan, though ranked in sixth place in both 2010 and 2009, experienced a decrease in its Origination MFI—from 155 in 2009 to 130 in 2010.
- With an Origination MFI of 112, Ohio has risen to eighth place.
- With an Origination MFI of 96, Colorado is at its highest rank since 2006.
- Illinois' Origination MFI has improved from 126 in 2009 to 93 in 2010.
- Seven of the top 10 states are located in the Northeast.

Figure 3 represents Tables 1 and 2 graphically.

Figure 3 (Top Ten States: 2010 Originations)



1 = Florida
2 = New York
3 = California
4 = New Jersey
5 = Maryland
6 = Michigan
7 = Virginia
8 = Ohio
9 = Colorado
10 = Illinois

Represent Top 10 States: Current Originations

Represent Top 10 States: Post-Funding Investigations

Table 2 includes data from completed investigations submitted in 2010, regardless of origination year. In this view, the top 10 states are slightly different—though Florida, California, Michigan, Illinois, Maryland, and Virginia occupy both lists.

Table 2

Mortgage Asset Research Institute Fraud Index (MFI)										
By State										
(2006-2010 All Post-Funding Investigations)										
	2010		2009		2008		2007		2006	
State	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	729	1	720	1	426	1	225	5	144
Nevada	2	228	4	199	6	165	3	202	15	79
Arizona	3	227	3	199	9	108	15	76	19	57
Georgia	4	184	5	151	5	167	6	162	1	342
Michigan	5	177	2	251	2	195	2	219	3	209
California	6	142	6	130	4	187	4	185	8	121
Illinois	7	120	10	112	7	143	8	125	7	129
Minnesota	8	91	8	119	8	137	7	133	13	94
Maryland	9	81	11	103	10	93	21	50	21	53
Virginia	10	72	22	50	21	58	17	70	24	45

As evidenced in Table 2, states with the top MFIs for loans investigated and reported during 2010 differ slightly when compared to the states with the top MFIs for loans originated in 2010.

Noticeable differences include:

- Although Florida owns the top spot in both lists, its Investigation MFI is over double its Origination MFI—729 versus 302. Twenty-seven percent of all reported loans with fraud and/or misrepresentation investigated in 2010 were for Florida properties.
- States in this top Investigation MFI list not on the Origination MFI list include: Nevada, Arizona, Georgia, and Minnesota.
- The Investigation MFIs of Nevada and Arizona are 228 and 227, respectively. Both are over double what is expected for their states, based on loan origination volume.
- California's 2010 Investigation MFI is 142; however, its 2010 Origination MFI is 233.

The downward trend in overall application fraud and misrepresentation that began with loans originated in 2009—from a high of 68 percent in 2006 to 39 percent in 2010—is significant.

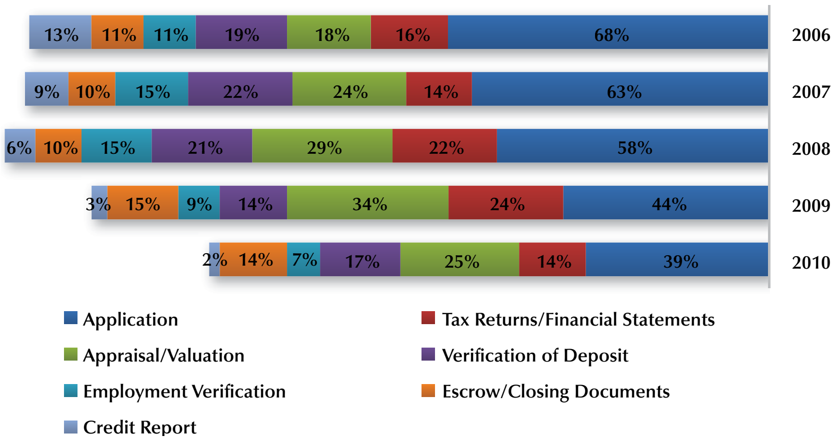
Types of Fraud Reported

The Mortgage Asset Research Institute's MIDEX system classifies the types of verified fraud involved in each incident reported by its cooperating subscribers. These classifications are shown in Figure 4 for loans originated in the five-year period from 2006 through 2010. Again, it should be noted that fraud perpetrated in 2010 will continue to surface and be reported for another two years or more.

In a five-year fraud assessment, Figure 4 shows each type of fraud and misrepresentation as a percentage of all incidents submitted to the MIDEX database. Note that the total percentage for each year exceeds 100 percent because most reported incidents involve more than one type of fraud or misrepresentation. For instance, 39 percent of all incidents reported to the database for mortgages originated in 2010 contained application misrepresentation.[iii] Misrepresentation on the application ranks as the most common fraud type for prior years as well. These percentages are hardly surprising, given that the application form is comprehensive in collecting borrower personal identity, employment, asset, and liability information (all of which present verification challenges). However, the downward trend in overall application misrepresentation that began with loans originated in 2009—from a high of 68 percent in 2006 to 39 percent in 2010—is significant. That number is higher for loans investigated in 2010.

Figure 4

2010 Mortgage Fraud and Misrepresentation Types: Originations (All States)

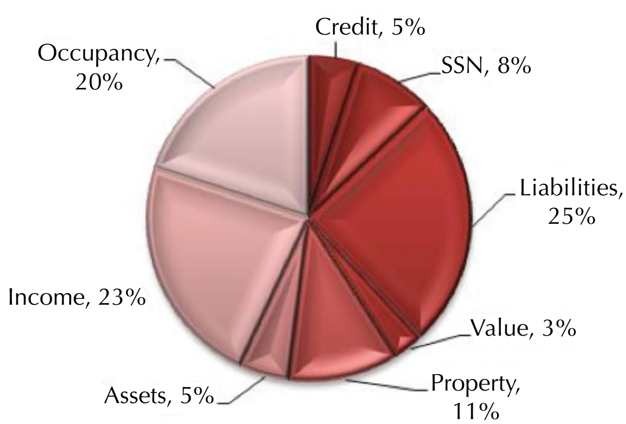


Origination volumes appear to be stabilizing at an estimated $1 trillion, with expected minimal increase over the next few years. The trend in the number of new originations continues to yield strong rates of reported fraud and misrepresentation, as depicted above. There was minimal improvement overall amidst compounding regulations, strengthened quality control initiatives, and increased verifications.

Fannie Mae's February 2011 Fraud Findings Statistics revealed steady or increased misrepresentations contained within newer originations. Analyses of delivered loans to Fannie Mae are shown in the chart below.

Fannie Mae: Fraud Findings Statistics (February 2011)

Types of Misrepresentation (2009 - 2010 Originations)



Social Security Number misuse, occupancy and asset misrepresentation increased from prior years. While liabilities and income issues showed slight improvements, the frequency of incidence remains significant concern.

Fannie Mae - February 2011

The industry is plagued with vulnerabilities within the origination process that expose lenders to risk. Fragmentation across segments facilitates a lack of transparency and consistency in data flow, which enables fraudsters to select pockets of opportunities to defraud lenders. Common contributors to the pervasiveness of fraud include:

1. Consumers who misrepresent information to qualify for a loan that could not be afforded if the truth were known at the time of funding;
2. Professionals who have inside knowledge of lender systems and the difficulty in verifying information that can be used to manipulate the process;
3. Consumers who, out of the sheer desperation of potentially losing their homes, are left susceptible to unscrupulous professionals posing as helpful advocates;
4. Technology misuse and a lack of transparency across the industry which elevates persistence, ease of perpetration, and detection challenges; and
5. Real estate being leveraged in broader criminal activities as housing inventory increases and lenders struggle to stave off financial losses.

Lenders are stepping up their efforts to learn from their mistakes, identify incidents that made them vulnerable to fraud, and develop programs that help to protect their organizations from further adverse activities. Considerable time and resources are now being allocated to facilitate forensic reviews of loans originated over the last few years. For many, the objective is to catapult ahead of fraudsters by implementing fraud avoidance methodologies that are more predictive of behavior which ultimately results in financial risk.

Lenders are stepping up their efforts to learn from their mistakes, identify incidents that made them vulnerable to fraud, and develop programs that help to protect their organizations from further adverse activities.

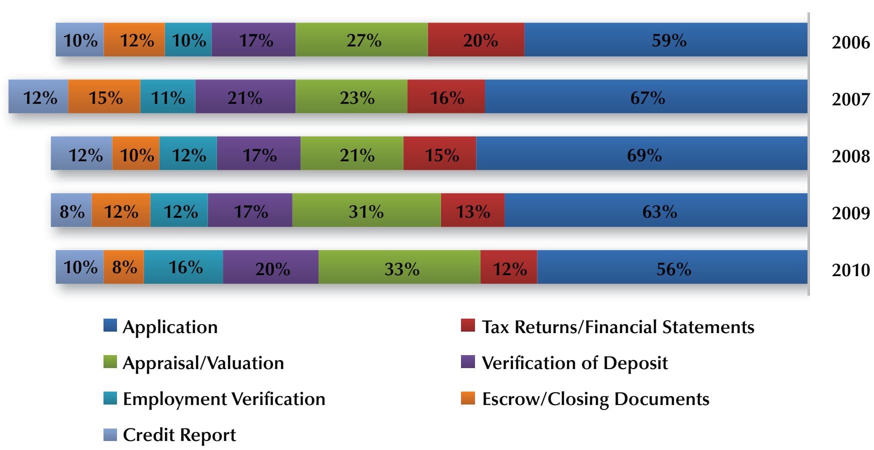
The Mortgage Asset Research Institute has analyzed submissions of incidents from forensic or post-funding investigations of loan files to provide additional insight into trends experienced from originations in prior years. The Mortgage Asset Research Institute found that application misrepresentation topped the investigation leader board as represented in Figure 5, followed by appraisal and valuation misrepresentation and verification of deposit information. Appraisal and valuation misrepresentation continues to rank highly across all classifications, even in a weak housing market. One can attribute this steady rise to, among other things, newer fraudulent acts that take advantage of the minimal information required to validate declining values, and lender desperation. An example of this type of fraud is what the industry calls “flopping.”

The rise in foreclosures and mortgage payment defaults has exposed lenders to industry insiders who know how to manipulate illegal flipping in a depreciating housing market. In a flipping scheme, a realtor or mortgage broker identifies properties within areas experiencing severely depressed values and minimal sales. A property is valued by the realtor or broker using a Broker Price Opinion (BPO) for well under what it could sell for on the open market. In many cases, the realtor or broker works with the money person or “funder” to purchase the property at the negotiated short sale price. In other cases, the realtor or broker will have the distressed homeowner deed the property to them in trust. Regardless of how the property is obtained, the realtor or broker will have a buyer waiting to purchase the property at a higher price than negotiated with the lender. Next, the lender agrees to take another loss on the property and the realtor or broker purchases the property. In the same day or next few days, the realtor resells the property for much more than the stated short sale value to the lender.

As is evident from Figure 5, 33 percent of loans investigated in 2010 included some type of misrepresentation involving the property and/or appraisal. This steadily-growing figure includes property misrepresentation like flopping. Fifty-six percent of loans investigated last year involved some kind of fraud and/or misrepresentation on the loan application. Again, note that the total percentage for each year exceeds 100 percent because most reported incidents involve more than one type of fraud or misrepresentation.

Figure 5

2010 Mortgage Fraud and Misrepresentation Types: Post-Funding Investigations (All States)

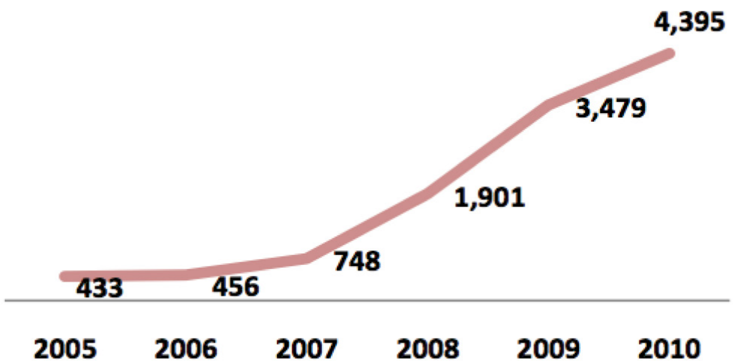


The rise in foreclosures and mortgage payment defaults has exposed lenders to industry insiders who know how to manipulate illegal flipping in a depreciating housing market.

Additional statistics of note in the 2010 data include:

- Per Figure 4, there was a marked decrease in reported tax return and financial statement fraud and/or misrepresentation in 2010 originations—from 24 percent in 2009 to 14 percent this year.
- Reported misrepresentation on escrow and closing documentation were somewhat higher in 2010 originations (14 percent) than in earlier years—10 percent in 2008 and 2007 and 11 percent in 2006 (Figure 4). However, with eight percent of reports received, they slightly decreased in the year-over-year investigation analysis (Figure 5).
- Verification of Employment fraud and/or misrepresentation was reported in 16 percent of loans investigated in 2010, a five-year high.
- Only two percent of loans originated in 2010 reported misrepresentation involving credit reports (Figure 4). Ten percent of loans investigated during this year reported this type of fraud and/or misrepresentation (Figure 5).

Figure 6: Mortgage Loan Fraud SARs and Bankruptcy



Source: FinCEN, Mortgage Loan Fraud Update, March 2011

Figure 6 shows that FinCEN has updated its view into mortgage fraud SARs to include insight into bankruptcy filings as a selected category of SARs in connection with perpetrating mortgage fraud. It is coordinating efforts with the United States Trustee Program (USTP) and the Federal Bureau of Investigation (FBI) to identify potential abuses of the bankruptcy system associated with mortgage fraud. In its March 2011 Mortgage Loan Fraud Update, FinCEN has reported that bankruptcy filings have steadily increased over time in SARs filings and rose to six percent in 2010, up from one percent in 2006 and 2007.

Tables 3 and 4 present a closer look at the three states with the top MFIs for 2010 and the most prevalent mortgage fraud issues within those states (for both 2010 originations and post-funding investigations performed in 2010 for loans originated prior to 2010), compared to the same reported issues for 2009. Total percentages for each year exceed 100 percent because most reported incidents involve more than one type of fraud or misrepresentation.

Table 3

Analysis of Top Three States (Originations)						
Fraud Classification	Florida 2010	Florida 2009	New York 2010	New York 2009	California 2010	California 2009
General Application Misrepresentation	**24%**	41%	**23%**	49%	**48%**	58%
Verification of Employment Misrepresentation	**0%**	14%	**15%**	14%	**13%**	13%
Verification of Deposit and/or Bank Statement Misrepresentation	**18%**	12%	**0%**	17%	**20%**	23%
Tax Return and/or Financial Statement Misrepresentation	**18%**	28%	**15%**	34%	**13%**	20%
Appraisal Misrepresentation	**47%**	36%	**38%**	17%	**10%**	25%
Credit History Documentation Misrepresentation	**0%**	3%	**0%**	0%	**3%**	3%
Escrow and/or Closing Document Misrepresentation	**0%**	7%	**15%**	17%	**18%**	11%

Table 4 shows the top three states per loans investigated in 2010. This is different from Table 3, which includes the top three states per loans originated in 2010.

Table 4

Analysis of Top Three States (Post-Funding Investigations)						
Fraud Classification	Florida 2010	Florida 2009	Nevada 2010	Nevada 2009	Arizona 2010	Arizona 2009
General Application Misrepresentation	**57%**	66%	**70%**	71%	**59%**	66%
Verification of Employment Misrepresentation	**20%**	14%	**23%**	11%	**13%**	11%
Verification of Deposit and/or Bank Statement Misrepresentation	**22%**	18%	**15%**	18%	**16%**	11%
Tax Return and/or Financial Statement Misrepresentation	**12%**	10%	**10%**	18%	**9%**	9%
Appraisal Misrepresentation	**29%**	28%	**25%**	18%	**30%**	28%
Credit History Documentation Misrepresentation	**11%**	9%	**10%**	11%	**15%**	6%
Escrow and/or Closing Document Misrepresentation	**8%**	12%	**7%**	9%	**3%**	5%

This breakdown of state-specific trends in Tables 3 and 4 reveal the following:

- The only state to appear in both top three lists is Florida. Noticeable differences between the two lists include a significantly lower percentage of reported application fraud and/or misrepresentation on loans originated in 2010 versus those investigated in 2010—24 percent versus 57 percent. None of the reports for loans originated in 2010 in Florida included reported Verification of Employment issues, although 20 percent of 2010 investigated loans reported those problems. Similarly, zero percent of 2010 Florida originations reported escrow and/or closing document fraud and/or misrepresentation, while eight percent of loans investigated in 2010 for Florida properties included this type of misrepresentation.
- Credit history documentation misrepresentation was very rarely reported for loans originated during 2010. As is evidenced in Figure 4, only two percent of loans nationwide were reported to have some kind of credit history fraud and/or misrepresentation. Of the top states included in Table 3 above, neither Florida nor New York reported loans with these issues.
- In 2010 investigations, 70 percent of incident reports from Nevada included reported application fraud and/or misrepresentation, higher than that of any state.
- Of Arizona reports of mortgage fraud and/or misrepresentation, 15 percent of 2010 investigations reported credit history documentation misrepresentation, an increase of nine percent over loans investigated in 2009.

Top National MSAs, per Loans Originated

At the Metropolitan Statistical Area (MSA) level, the top national areas for 2010 originations are evidenced in Table 5. These top areas are based on incidents received, not MSA population. The top five property locations are:

Table 5

Top National MSAs	Percentage of All Reports Received
Los Angeles-Riverside-Orange County, CA	17%
New York-Northern New Jersey-Long Island	11%
Washington-Baltimore, DC-MD-VA-WV	7%
San Francisco-Oakland-San Jose, CA	6%
Miami-Fort Lauderdale, FL	5%

The top Metropolitan Statistical Area (MSA) for loans originated in 2010 is Los Angeles-Riverside-Orange County, California. Seventeen percent of all reports received included properties in this MSA. Another California MSA, San Francisco-Oakland-San Jose, ranks fourth with six percent. Although the state of New York ranks second and New Jersey fourth in the national origination top ten, the New York-Northern Jersey-Long Island MSA ranks in second place. The Washington-Baltimore, DC-MD-VA-WV area ranks third, with seven percent of all reports. The first ranked state, Florida, owns the number five MSA: Miami-Fort Lauderdale.

Final Remarks

Mortgage fraud schemes occur in a variety of forms and can be perpetrated by anyone. Over the last several years, the Mortgage Asset Research Institute has been providing insight into trends as they occur within the mortgage market. Fraud continues to be an obstacle which challenges lenders, mortgage investors, insurance companies, businesses that provide services, and professionals. Fraud is and will always be a crime of opportunity, especially in times of desperation.

The Mortgage Asset Research Institute Periodic Mortgage Fraud Case Report and other industry publications have identified mortgage fraud and misrepresentation as a persistent act that is constantly evolving. Unfortunately, for every new tool or process created as a measure to combat this problem, there is a fraudster already motivated and equipped to circumvent them. Fraudsters thrive on inadequacies within lengthy processes and a lack of consistency across organizations and/or industries that help them hide their true motives. Technology has enabled faster loan production through automation, ease of processing, and analytics. Industry professionals have keen knowledge of these processes, which makes it much easier to manipulate protocols in place to thwart adverse activities. The creation of information superhighways supports ease of access to data about people, businesses, and their assets. Fraudsters are combining seemingly independent components to create personas that commit egregious crimes of theft and/or acquisition.

Collectively, these efforts and new safeguards are helping—but remain subject to loopholes and exposure due to lack of transparency at a global level and use of intelligence acquired during the normal course of business.

The mortgage industry is re-inventing itself through massive regulation, changing loan quality standards, and the implementation of improved fraud risk policies. After several years of risk-prone lending, industry participants have scaled back funding and elevated the scrutiny of would-be borrowers in an effort to restore balanced lending decisions. Collectively, these efforts and new safeguards are helping—but remain subject to loopholes and exposure due to a lack of transparency at a global level and the use of intelligence acquired during the normal course of business. New rules of engagement require a multi-faceted approach to combating mortgage fraud.

Appendix I
Source and Analysis of the Mortgage Asset Research Institute's Mortgage Fraud Data

The statistical data presented in Figures 2 – 5 and Tables 1 – 5 of this report were derived from information in a cooperative mortgage fraud database operated by the Mortgage Asset Research Institute, a LexisNexis service. The Mortgage Asset Research Institute has designed and offered various mortgage industry databases for the past 20 years. Its most recognized database system is the Mortgage Industry Data Exchange (MIDEX®) that contains information about licensing, public sanctions and incidents of alleged fraud and misrepresentation by mortgage industry professionals reported to the Mortgage Asset Research Institute by MIDEX subscribers.

The MIDEX statistical data discussed in this document were derived from the incidents that MIDEX subscribers describe in reports to the Mortgage Asset Research Institute. (Agreeing to submit reports describing their fraud investigation findings to the non-public section of the MIDEX system is required for those who wish to access other subscribers' non-public reports.) Only material misrepresentations are permitted to be included in these reports. That is, companies only submit reports to MIDEX in those cases where, knowing what they know after thorough investigations, they would not have originated, bought or insured the loans in question.

The reports submitted to the Mortgage Asset Research Institute include the following information about each incident:

- Location of the collateral (state, city and address, to the extent known)
- Names of the originating entity and the loan officer who took the application
- Date the misrepresentation took place
- The method used to verify the existence of the reported misrepresentation(s)
- A short narrative description of the misrepresentation(s) found during the MIDEX subscriber's investigation
- Names of any other professionals who appear to be in a position to influence the accuracy of the information found to be misrepresented; e.g., the name of the appraiser and appraisal firm in cases where the property value is found to be significantly inflated

- A certification from an authorized individual at the submitting mortgage entity that the report is, to the best of his/her knowledge, complete and accurate

The Mortgage Asset Research Institute staff reviews the reports to assure they meet submission standards for severity and consistency. Submissions are input directly by MIDEX subscribers via an online form, or data entry staffers convert hard copy submissions to a standard, searchable format for inclusion in the MIDEX system. After reading the report's narrative description, the Mortgage Asset Research Institute will classify the incident as involving one or more of the types of misrepresentations listed in Figures 4 – 5 and Tables 3 – 4.

If the Mortgage Asset Research Institute makes any changes to a submitted report, it is returned to the submitting subscriber for review prior to its being entered into the system.

The subscribers participating in the MIDEX system represent a wide range of mortgage entities. They include secondary market agencies, major private mortgage insurance companies, and lenders that account for the vast majority of wholesale lending in the country.

Appendix II
Computation of the Mortgage Asset Research Institute Fraud Index (MFI)

The Mortgage Asset Research Institute Fraud Index, or MFI, is an indication of the amount of mortgage-related fraud and misrepresentation found through MIDEX subscriber fraud investigations in various geographical areas within any particular year. It involves very straightforward calculations.

To come up with Table 1's MFI for loans originated in 2010 in a sample state (e.g., Florida) the Mortgage Asset Research Institute staff determines the percentage of all MIDEX fraud reports that were submitted for loans originated on properties located in Florida in 2010. They determined that, to date, more than 11 percent of MIDEX reports submitted from across the country by subscribers for 2010 originations involved loans on Florida properties. But according to HMDA data, Florida had slightly over three and a half percent of the nation's total 2009 mortgage originations—the most recent year such data are available.

If mortgage fraud were distributed throughout the country like originations, then we would expect approximately three and a half percent of mortgage fraud to occur in Florida. But the 11 percent fraud figure for Florida in 2010 was triple its origination figure. Therefore, the 2010 MFI for Florida, as of this report's date, is:

$MFI_{FL}/2010 = (11.26/3.72) \times 100 = 302$

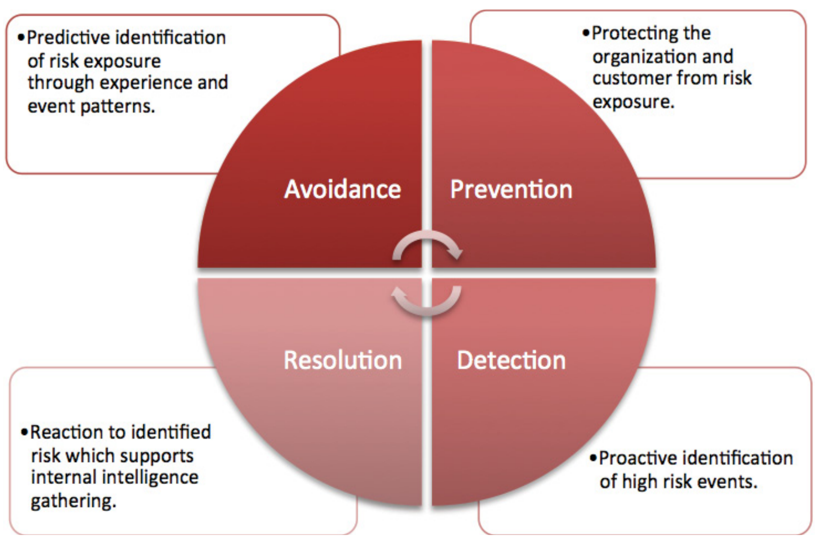
This is, of course, a dynamic figure. Often, a fraud investigation is not completed until a year or two after the loan was originated. The Mortgage Asset Research Institute will continue to receive Florida fraud reports for another two to three years from its MIDEX subscribers that find misrepresentation in their 2006-2010 books of business. Therefore, Florida's (and all other states') MFI figures will continue to change somewhat in future Periodic Reports, especially those containing recent years like 2009 and 2010.

It should be noted that the MFI is based on the number of fraud and misrepresentation incidents reported for each state, and not the dollar amounts of those mortgages. Therefore, a fraud on a $120,000 loan in Des Moines, Iowa, is counted the same as a fraud on a $720,000 loan in Los Angeles, California. Also, there is currently no distinction made between purchases, refinances or home improvement loans in these figures.

Appendix III
Considerations for the Industry

The Fraud Risk Management Process

Today's fraud risk management processes serve as the building block for the development of risk intelligence as the industry progresses.

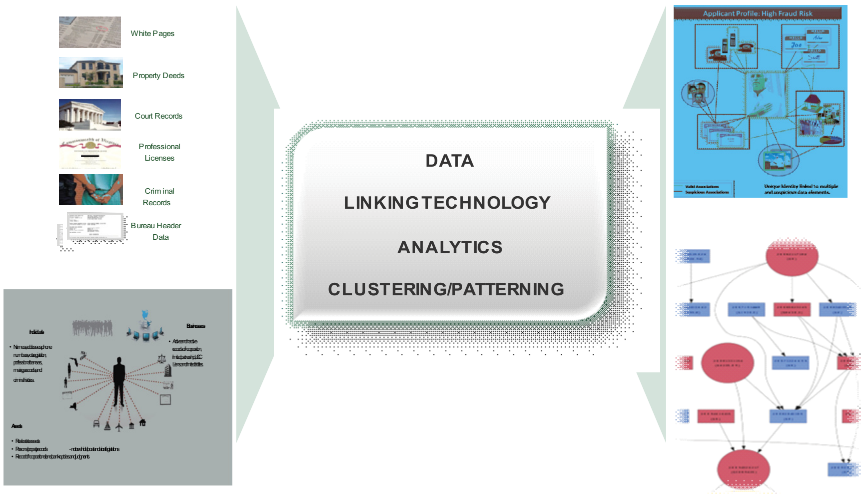


> ***"We have developed new ways to detect and combat mortgage fraud, including collecting and analyzing data to spot emerging trends and patterns. And we are using the full array of investigative techniques to find and stop criminals before the fact, rather than after the damage has been done."***
>
> **http://www.fbi.gov/about-us/investigate/white_collar/mortgage-fraud/mortgage_fraud**

Lenders are moving forward with their approach to implementing comprehensive insights and mitigation policies that build risk intelligence frameworks across their enterprises. Risk intelligence leverages fraud management components to deliver predictive risk entities based on internal and external factors.

The Risk Intelligence Model

The risk intelligence model uses data, analytics, link analysis, and pattern/clustering technology.



Fraud and misrepresentation should be embraced as activities that are long lasting and profitable for those who can identify manipulative opportunities.

Risk Intelligence requires the use of more data to verify application information and the financial capacity of borrowers for improved quality during origination and to comply with consumer protections outlined in various regulatory mandates and investor purchase policies. The Dodd-Frank Act (2010) lays the framework for best practices in mortgage loan origination, specifically as it applies to due diligence of business relationships (industry insiders) and determining a borrower's ability to repay mortgage debt through comprehensive examination of financial conditions. Analytics remain a staple method to help drive operation and decisioning efficiencies. However, even analytics must be monitored for changes in market conditions and organizational experiences in order to better detect fraud risk. The use of link analysis is new to the industry but is an invaluable form of identifying risks associated with unknowns or undisclosed associations not easily detected through traditional information sources, such as credit bureau data.

Throughout this report, we have identified credit reports and personally identifiable information as facilitators for increased identity misuse and the misrepresentation of liabilities and/or assets. Combining internal and external data sources can improve a lender's ability to build a comprehensive view into a prospective borrower relationship, as well as minimize ongoing risk during the customer lifecycle. Lastly, pattern and cluster analysis enables global insight into larger scale frauds that are more difficult to detect through linkage of events, experiences, customer information, and external experiences beyond the mortgage market boundary. Law enforcement and agencies at all levels are incorporating this mindset to ready themselves in combating evolving fraud.

The mortgage industry has a long road ahead as it tries to reassemble and stabilize. It can expect increased regulatory scrutiny in a fragmented manner, similar to the current make-up of segments within the market today. Fraud and misrepresentation should be recognized as activities that are long lasting and profitable for those who can identify manipulative opportunities. But there is good news: increased awareness and demand for accountability, along with solution providers that are available to help develop tools for combating and preventing fraudsters from succeeding are also here for the long haul. Leverage the insights provided in this report and others to defend against fraudsters who hope to adversely select your organization for profit and damage your brand reputation. The Mortgage Asset Research Institute will continue to aggregate, analyze, and report trends associated with mortgage fraud and misrepresentation by professionals in the mortgage and real estate industries submitted to MIDEX, so that market participants remain armed with key information to protect their assets.

End Notes

i http://www.fbi.gov/about-us/investigate/white_collar/mortgage-fraud/mortgage_fraud

ii Readers who compare the MFI figures in Table 1 for the same states as those found in previous Reports in this series will find that the rates have changed. This is due to the fact that MIDEX subscribers in 2010 continued to uncover and report fraud and misrepresentation findings from 2006 through 2009. Therefore, all numbers in this Report are dynamic and will change as time passes.

iii Application fraud and misrepresentation includes, but is not limited to, the following categories on the loan application: incorrect name(s) used for the borrower(s); occupancy, income, employment, debt, and asset misrepresentation; different signature(s) for the same name(s); invalid Social Security number(s); misrepresented citizen/alien status; incorrect address(es) or address history; and incorrect transaction type.

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