



Fraud is Serious Business.  
So is Prevention.





As **fraud** continues to plague the

mortgage industry, we must refine

our methods for **detecting** and

**preventing** it. Do you always recognize

possible mortgage fraud when you **see** it?

Consider the following scenarios:

### Scenario #1

Joe Smith has worked for ABC Company for three years as a technician. His loan application and income documentation in the file states that Joe is a manager. Does your staff verify the borrower's position/job title when performing a Verbal Verification of Employment?

### Scenario #2

Jane Smith's verification of rent states that she has rented at her present address for three years. The income and asset documentation reflects her current address. However, the credit report and an in-file quality control credit report do not list the same address, and the credit reports disclose that the borrower has applied for and received credit in the past two years. Does your staff validate the borrower's present address against credit reports?

PMI Mortgage Insurance Co. is a leader in the mortgage insurance industry, and is in the business of managing risk. Our objective is to share information, so that our customers are more aware of risk in all its forms, and to help reduce risk whenever possible.

Fraud is a crime of opportunity. By reducing the opportunity, we can all but eliminate fraud. In order to accomplish this goal, every organization involved in the mortgage industry needs to develop and implement a comprehensive fraud prevention program. Each program should include adequate policies and procedures, training and early detection systems.

At PMI, we continually gather information that might be useful in helping you develop a successful fraud prevention program. The following are proven tools and techniques compiled from a variety of industry players. We encourage you to consider these additional precautions to help combat fraud.



### Fraud Education/Training

It is crucial for an organization to have a zero fraud tolerance policy. All management and staff levels within a company, as well as outside partners (such as those providing credit, title and appraisal services), must understand this policy and the consequences for noncompliance.

Training should be administered formally and frequently. Fraud schemes change rapidly and prevention training must keep pace. Although many automated tools and databases exist to help detect potential fraud, some red flags can only be caught by knowledgeable, well-trained, alert staff – including underwriters, processors, closers and quality control specialists. Successful companies enforce the need for expertise by providing frequent training sessions and sharing of case studies. Fraud prevention training should also include sales associates for all channels of business.

### Monitoring

Knowing who you do business with has a significant impact on the quality of business and level of fraud. Broker approvals usually entail a review of financials, references and MARI report. Far more important than these is monitoring. Monitoring of third-party originators should include the gathering of statistics in the following areas, as well as a written policy of how to escalate attention to brokers who demonstrate anomalies in these areas:

- Early Payment Defaults (EPDs)
- Repurchases
- Delinquency rates
- Declination and suspense ratios
- Post-close QC results and pre-funding QA results

### Identity Validation

Validation of identity through a social security database or enhanced credit report (e.g., Equifax's SAFESCAN®, Experian's Fraud Shield<sup>SM</sup>, or TransUnion's High Risk Fraud Alert) should be obtained on every file. Social Security numbers should be checked for validity, checked against date of issuance to determine if they are reasonable based on the age of the borrower, and checked against the SSN Death Master file.

The photo identification required at closing should be checked against the information on the loan application to verify that the borrower's present address, age, sex, and race/national origin match. Also, if the borrower is using a state identification card instead of a driver's license, and the borrower states ownership of an automobile on the loan application, question the document.

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## IRS 4506-T

Use of the IRS 4506-T to obtain transcripts of tax returns is an important deterrent to fraud on full doc files. "Best in class" lenders obtain the signed 4506-T early in the loan process, and receive and validate the tax transcripts prior to closing. At a minimum, validate tax transcripts prior to closing on a selection of loans, so that brokers are aware that you use them.

## Verbal Verification of Employment (VVOE)

A VVOE should be completed on all full, limited, stated, no ratio and NINA transactions. The VVOE must be made via a number that is independently verified by an Internet- or print-based phone number service, or other independent source. The borrower's current position/job title should also be verified. For transactions involving self-employed individuals, CPA letters or attorney letters should be obtained and, if possible, the individuals' companies should be researched through Licensing Boards or the Department of Corporations.

## Chain of Title

A review of the 24-month chain of title should be completed on all loan transactions, looking for rapid transfers of title which may indicate flips. Automated fraud detection tools, available through companies such as Interthinx™, Lexis Nexis®, ChoicePoint®, and CoreLogic, may be helpful in completing this task.

## HUD-1 Settlement and Closing Documents

Review of the estimated HUD-1 settlement statement, obtained from the settlement agent prior to close, can help detect payoffs to parties that do not hold a lien, possibly indicating an inflated value situation. When there are unusual payoffs from the seller's funds to a non lienholder, there is often an appraisal issue. These payoffs can be disguised in numerous ways, but are commonly made to look like payments to a home improvement contractor. The settlement statement should also be reviewed for unacceptable credits to the borrower, such as decorator's allowances, gifts of equity, excessive seller contributions or other unauthorized credits given by an interested party to the transaction (e.g., a realtor).

Where possible, prior to funding, the closing staff should check the signature on the loan closing documents signed by the borrower (obtained from the settlement agent) against the initial loan application, the up-front disclosures in the underwriting package, and the photo identification. Discrepancies in signatures may indicate a "strawbuyer."



### Closing Precautions

Closing instruction language should direct the settlement agent to contact the lender if there are indications of any of the following:

- the downpayment did not come from the borrower
- the property changed hands within the past 180 days
- the new mortgage represents an increase of over 25% of a previous mortgage made within the past 180 days
- the new agent has knowledge of a previous, concurrent or subsequent transaction involving the subject property or the borrower

### Watch Lists

Make sure to verify that the parties on the transaction are not on any internal or external watch lists such as the Office of Foreign Assets Control (OFAC) watch list, HUD's Limited Denial of Participation (LDP) list, Freddie Mac's Exclusionary List and investor watch lists.

### Loan Origination Systems (LOS)

An LOS that checks to see if other transactions with the same borrower exist is helpful in determining if there are conflicts in data (e.g., several owner-occupied transactions at a time, materially different income used within the same year). It is also important to check against compliance concerns such as predatory lending guidelines.

### Automated Fraud Detection

Automated fraud detection provides a sophisticated screening of many data points and allows underwriters and QA specialists to focus their manual review on specific areas of concern.



# fraud

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## Independent, Automatic Valuation to Confirm Appraised Value

Automated valuation models (AVMs) should be used as back-up valuations on all loans, or at least on a robust sampling of loans selected by loan characteristic, by broker, or by geographic area with high concentration of fraud. If an AVM is not available, or is not considered valid or usable, an alternative process escalating the review should be in place. This process should require the minimum standard desk review, but may require a Broker Price Opinion (BPO), a field review, or a second appraisal.

## Independent & Sufficient Pre-Closing Fraud Detection

Pre-closing fraud detection tends to be most effective when performed by a separate QA department, rather than incorporating the checks into the standard process (processor or wholesale coordinator > underwriter > closer). Ideally, automated QA filters (SSN checks, AVMs, etc.) occur as early as loan registration or lock in, prior to receiving the actual hard copy file. If problems are identified, the QA analyst flags the LOS systems with specific conditions that the underwriter must address prior to approving the loan. In some cases, only the QA staff can clear the flags.

The most effective fraud prevention programs include pre-closing quality control audits on employment and income, credit, assets, identity, title work and appraised value on 100% of loans. Realizing that this entails significant cost and time, some lenders have been able to carefully monitor where they are most exposed to potential fraud and scale back the pre-close audit percentage. The use of automated fraud detection can also help focus a pre-close audit sampling on fewer loans with good results. The decision to scale back a pre-close audit to less than 100% should be carefully researched and evaluated.



## What to Do in the Event of Fraud

Organizations must establish a formal process to address fraud when it is identified. The policy should not stop at dictating the process of what to do with the loan, but should also provide direction related to what to do with the source of misrepresentation (e.g., appraiser, originator). Depending on the situation, a variety of actions may be taken. For example, a loan may be declined, or a broker may be put on a watch list or even terminated. Lenders should also have a process to address fraud found within retail or consumer direct channels, such as borrower misrepresentation. It is critical that the process for treating detected misrepresentation is clear and consistent throughout the organization.

Fraud hurts everyone involved in the mortgage process, from originators to lenders to borrowers. PMI's customers experience the negative impact of fraud, as it reduces the quality of their originations and increases the level of risk in their portfolios. By sharing best practices regarding fraud prevention, we hope to raise the level of awareness and significantly reduce the occurrence of fraud.

For additional information and resources, please visit [www.pmigroup.com](http://www.pmigroup.com) and click on the "Fraud Prevention" link.



**Fraud** is a reality.

Get informed.

Be prepared.



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