Fraud Mitigation Best Practices

Single-Family

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Freddie Mac

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Introduction

Freddie Mac's Financial Fraud Investigation Unit (FFIU) is responsible for the prevention, detection, investigation, resolution, and reporting of fraud and suspected fraud (including mortgage and other financial instrument fraud) and other suspicious activity (as defined in the Freddie Mac *Single-Family* and *Multifamily Seller/Servicer Guides*).

Reliable and effective fraud prevention and detection programs are essential to the mortgage industry and also to law enforcement for the investigation and prosecution of mortgage fraud-related crimes. Freddie Mac Seller/Servicers play an important role in preventing, detecting, and investigating potential mortgage fraud and other suspicious activity, and are expected to report such activity to Freddie Mac. We are providing suggested best practices in this document to assist you in establishing or improving your existing mortgage fraud program. In addition, these practices may help manage other suspicious activity risk at your institution.

This is not an exhaustive discussion of fraud prevention and detection practices. We encourage you to explore other resources and customize your fraud and suspicious activity prevention programs to reflect your company's organization, business operations, and needs.

Seller/Servicer Requirements

The information in this reference does not supersede or in any way alter the requirements in Freddie Mac's *Single-Family Seller/Servicer Guide* (Guide) or other Purchase Documents (as that term is defined in the Guide).

You must continue to meet all Guide requirements, including those related to fraud prevention, detection, and reporting, and Freddie Mac's Exclusionary List, as well as meet any applicable Bank Secrecy Act requirements. Refer to Guide Chapter 3201: *Fraud Prevention, Detection and Reporting; Reporting Other Suspicious Activity*, Guide Section 3101.1: *Freddie Mac Exclusionary List* and Guide Section 1301.2: *Compliance with applicable law*.

Preventing Fraud

Employee Training & Awareness

Employee training & awareness programs should include mortgage fraud awareness in the loan origination and servicing areas. Best practices include:

- **Fraud Risk Management Policies and Procedures:** Put sound and appropriate fraud detection, prevention, investigation, resolution, and reporting policies and procedures in place and communicate them to employees.
- **Regulatory Compliance:** Ensure appropriate policies and procedures are in place pertaining to your company's obligations under the Bank Secrecy Act, as applicable.
- **Ethical Conduct:** Familiarize employees with your company's standards for ethical conduct.
- **New Employee Awareness:** Incorporate mortgage fraud awareness in new employee orientation programs.
- **Training:** Ensure that employees receive mortgage fraud training appropriate for their roles and levels, including, but not limited to, those in the following business areas:
  (1) Initial loan application, underwriting, processing, and closing;
  (2) Prefunding and post funding quality control; and
  (3) Performing and non-performing loan servicing areas, including customer service, collection, loss mitigation, foreclosure, bankruptcy, and escrow.

Training should include:

- → Current and common fraud schemes and trends, including resources to recognize red flags that may signal the need for further review. In addition to this Best Practices reference, "*Mortgage Screening Process: Red Flags for Fraud*" includes supplemental information relating to red flags in application-related documentation.
- → Clear directives for employee responsibilities when possible fraud is suspected, including the process for escalating any red flags or suspicious incidents/activities within your organization and to Freddie Mac.

- Information to ensure employees are familiar with the responsibilities of participants in mortgage and real estate transactions, including, but not limited to:
  - Real estate brokers or agents
  - Property sellers
  - Property buyers
  - Loan officers
  - Mortgage brokers
  - Loan processors
  - Underwriters
  - Appraisers or other valuation providers
  - Builders and/or developers
  - Correspondents
  - Property inspectors
  - Title insurers
  - Closing or settlement agents
  - Third party service providers
  - Loan workout facilitators, e.g., short sale negotiators

To supplement your organization's employee training program, refer to Freddie Mac's fraud resources: www.FreddieMac.com/singlefamily/preventfraud/.

Prudent Underwriting

Prudent underwriting is often the cornerstone of your efforts to prevent fraud. At a high level, best practices include:

- Having well trained and qualified staff.
- Knowing your mortgage brokers. See Chapter 5 of the Wholesale Originations Best Practices (www.freddiemac.com/singlefamily/pdf/wholesale_practices.pdf).
- Knowing your appraisers, builder clients, real estate agents and others with whom you conduct business.
- Updating, maintaining, and following comprehensive written underwriting procedures.
- Performing due diligence reviews of loan files.
- Screening all loan parties through Freddie Mac's Exclusionary List (this is a Freddie Mac Seller/Servicer Guide requirement; see Guide Section 3101.1). To verify a potential match, contact the Financial Fraud Investigation Unit at EList_Confirmation@FreddieMac.com. The Exclusionary List is available through:

- Loan Product Advisor℠ – under the Business Tools tab.
- Single-Family Selling System – from the left navigation bar based upon your user role.
- Freddiemac.com Single-Family Learning Center – under Secured Resources for Servicers (requires Servicing Applications ID and password).

For additional information on underwriting, refer to the following resources:

- For underwriting requirements, review Guide Chapters 5100 through 5500, *Determining Borrower Eligibility through Assets (Borrower Funds and reserves)*; Guide Chapter 5601, *Property and Appraisal Requirements,* and any other relevant Purchase Documents.
- For underwriting best practices, access the Originate and Underwrite webpage and training resources on the Freddie Mac Learning Center.
- For red flags that may be identified in loan documents, see "*Mortgage Screening Process: Red Flags for Fraud*".

Quality Control

We recommend that you group and analyze your quality control results by the following areas, in order to identify potential trends for further review of possible fraud:

- Branch office
- Loan officer
- Broker
- Underwriter
- Processor
- Real estate agent
- Loan product
- Geographic area
- Closing/escrow agent
- Title company
- Appraiser
- Property seller

We also suggest you include the following in your quality control program (**Note:** Some of these are required by the Guide.):

→ Provide and require relevant training and education.
→ Conduct robust reporting for identification purposes and trending.
→ Review loans from new or low-volume counterparties, with whom you have not previously done business, at a higher frequency rate than established counterparties.
→ Use research tools to assist in the review process (e.g., collateral data records, public records, etc.).
→ Conduct pre-funding quality control for high-risk loans, eg., based on LTV ratios, FICO scores, etc.

- → Pull for review random QC loan samples, as well as targeted loan samples.
- → Re-verify and review all early payment defaults.
- → Update, maintain and follow your quality control policies and procedures.
- → Implement a well-defined escalation path for raising concerns and resolving issues
- → If you suspect possible fraud, report it:
  - to senior management, and
  - to Freddie Mac via the mortgage fraud reporting mailbox at mortgage_fraud_reporting@freddiemac.com.

In addition to a quality control program, best practices also include a quality assurance program for oversight and targeted training opportunities.

For quality control best practices, review the Quality Control Best Practices reference. You'll find a starting point for red flags in "*Mortgage Screening Process: Red Flags for Fraud*".

For quality control requirements, see Guide Chapter 3402. Also see Freddie Mac's training offering, *Seller's in-House Quality Control Program*.

Detecting Fraud

To help you identify mortgage fraud, we've described several common fraud elements and possible fraud schemes with their associated red flags in the sections below.

Please keep in mind that a red flag is not proof of fraud; it is an indicator that something doesn't make sense or is inconsistent with what is expected. Each individual red flag listed in this reference may not be problematic in and of itself, but may warrant additional scrutiny when reviewed together with other red flags. Red flags must be reviewed promptly to determine if something is, in fact, wrong. Mortgage fraud can occur at any stage of a loan – from application through servicing. Schemes can vary and often contain several of the same elements. This information is not intended to be all-inclusive. There are more types of fraud than we can describe in this section and new schemes are continually emerging.

Origination

Common Origination Fraud Elements

These are some common elements typically found in fraud schemes focused on loan origination:

Inflated Property Valuation

Inflated appraisals may contain fabricated or altered values and supporting information, or use inappropriate comparable sales (which may also contain false values and information).

See "*Mortgage Screening Process: Red Flags for Fraud*" for appraisal-related **red flags** that may occur when inflated appraisals are used in the transaction.

Loan-level Misrepresentations

The loan application and supporting documentation may contain misrepresentations regarding employment, income, occupancy, down payment or equity contribution, and/or source of assets. Other potential issues include undisclosed consumer or mortgage debts, undisclosed incentives, and the use of straw borrowers, alternative credit documentation, and/or invalid or misappropriated social security numbers.

See "*Mortgage Screening Process: Red Flags for Fraud*" for a list of qualifying documentation red flags.

Rapid Transfers of Title

There may be instances where inspection of the title documents may show that the borrower on a refinance or the Seller on a purchase is not the owner of record. For a purchase transaction, the property seller should be the owner of record listed on the contract, appraisal, and title documents. On a refinance transaction, ensure that the borrower on the loan application matches the owner of record on the title documents, and adhere to any applicable seasoning requirements. If the property seller or the borrower is not the owner of record, investigate to make sure the circumstances of - and parties to - the transaction are legitimate.

Unusual HUD-1 Payouts

Unusual payouts may be made in excessive amounts and/or to unknown entities - often the ones profiting from the scheme. Unusual payouts might also be made to cover phantom liens, false invoices for repairs, referral fees, and non-lien disbursements.

See "*Mortgage Screening Process: Red Flags for Fraud*" for a list of HUD-1 related red flags.

Identity Fraud

Identity fraud involves someone wrongfully obtaining and using another person's personal data, typically for economic gain. It may be used to impersonate real estate agents, loan officers, appraisers, and others in the mortgage industry; but borrowers are more frequently targeted, often with multiple mortgages taken out in their names without their knowledge. These schemes often rely on participation of a notary.[1]

Some common borrower identity theft **red flags** include:

- Borrower lives out of the area and the credit report does not indicate any ties to the area where the property is located.
- Payments on the loan are not remitted from the borrower.
- The borrower did not attend closing and a Power of Attorney was used.
- Social Security number has not been issued or was issued prior to the applicant's date of birth.
- The issue date of the Social Security number does not align with the number of years in the workforce.
- The borrower's name is not associated with the Social Security number.

Straw Borrowers

A straw borrower, also known as a "nominee borrower," is an individual whose name, social security number, and credit history are used to hide the identity of the actual borrower. Straw borrowers are chosen for their ability and willingness to qualify for the loan.

[1] This element can also be revealed through review of financial statements during loss mitigation efforts.

Straw borrowers could be used because the actual borrower may not qualify for the mortgage, intend to occupy the property as a primary residence, be eligible for a loan program, or even exist.

Some of the following **red flags** may occur when a straw borrower is used in the transaction:

- Multiple properties are purchased by the same borrower within a short period of time.
- A quit claim deed is used either right before, or soon after, loan closing.
- Investment property is represented as owner-occupied or a second home.
- Someone signed on the borrower's behalf using a Power of Attorney.
- Names were added to the purchase contract or it was assigned to another party.
- Purchase contract addenda adjust the sales price.
- Purchase contract or HUD-1 contains references to subordinate or secondary financing.
- Sale involves a relative or related party.
- No real estate sales agent is involved.
- Property seller may be in default on their mortgage loan.
- High FICO score. Significant amount of assets, but gift used as down payment instead.
- Sources of funds are questionable.
- Repository alerts on credit report.
- Mortgage payments are remitted by a party other than the borrower.

Affinity Fraud

Affinity fraud exploits the trust and friendship that exist among individuals in groups with something in common. Fraudsters who promote affinity scams frequently are (or pretend to be) members of the group, often preying on their own community of friends, family and co-workers. Affinity fraud has been found in many different types of groups, such as religious, military, ethnic, professional, workplace, elderly, and fitness/gym. Investment property schemes and foreclosure rescue frauds often take root within affinity groups.

Affinity fraud is often successful due to the immediate level of trust within the group. Some members may have invested and made high returns, becoming advocates for the scheme. Loyalty to the group or embarrassment may deter members from reporting schemes or monetary losses to authorities.

Common Origination Fraud Schemes

Fraud schemes can cycle depending upon the environment in the real estate and mortgage markets.

Air Loans

The term "air loan" refers to a loan with no underlying collateral to secure the loan. In essence, there is nothing but "air" securing the loan. Air loans involve material misrepresentation of some or all underwriting documentation, including a fictitious borrower, appraisal report, borrower equity contribution, and/or title work. The intent is to deceive the lender into funding a loan based on the material misrepresentations. This scheme typically involves numerous loans originated within a short period of time, with the perpetrator and/or funds disappearing before the loans go into default. As a result, air loans typically do not perform for very long. When the loan does go into default, the lender (or investor) suffers a 100% loss as there is no collateral to offset the loss.

Some of the following **red flags** may be indicative of an air loan:

- A pattern of early payment default in loans with similar originators, origination dates, and location.
- Delayed note delivery to note custodian.
- Loan payments remitted by someone other than the borrower.
- Inability to contact borrower or returned mail shortly after origination.
- QC re-verifications indicate misrepresentation of income, employment and/or debts.
- Public record search shows no improvements on property.
- Mortgage and/or warranty deed never recorded.

Improper Property Flips

Property flipping can be a legitimate activity and occurs when ownership of a property changes more than once in a brief period of time. Property flipping becomes improper when a home is purchased and resold at an artificially inflated value, often within a short timeframe. The flip typically involves an inflated appraisal, which may indicate that renovations were made to the property when, in fact, there were none, or the renovations consisted only of minor cosmetic improvements. Based on the inflated appraisal, the property sellers are able to re-sell the property for more than what might otherwise be possible. One way to help protect against improper property flipping is to include strong language in closing instructions that prohibits back-to-back transactions from occurring within a certain period of time.

The following **red flags** may indicate improper property flips:

- Ownership changes two or more times in a brief period of time, with an unsupported increase in property value.
- Two or more closings occur almost simultaneously.
- The property has been owned for an unusually short time by the seller.
- The property seller is not on the title.
- There is a reference to a double escrow or secondary HUD-1.
- Parties to the transaction are affiliated.
- There's an up-and-down fluctuation of sales price over a short period of time.
- Multiple investment properties are obtained by same buyer within a short time frame.
- "Purchases" are disguised as "refinances" to circumvent a down payment.
- Property seller is an LLC/entity/corporation.
- There are unusual cash payouts at closing on the seller side of the HUD-I to non-lien holders.
- Appraisal indicates recent sale/listing activity at a significantly lower price.
- Comparable sales on appraisal are previously flipped properties.

Investment Property Scheme

Investment property schemes have been linked to builder bailouts and condominium conversion bailouts, as well as the resale of distressed properties in declining neighborhoods. Affinity groups may be targeted.

An investment property scheme commonly involves:

- Investment clubs or seminars to promote an investment opportunity.
- "No-money-down" offers on multiple properties being sold to one investor/buyer.
- Excessive seller-side HUD-1 payouts, which may indicate undisclosed buyer incentives or payment to recruiters who found investors/buyers.
- Cash back to buyer(s) at closing.
- Out-of-state property purchases where investors/buyers did not have a chance to look at the property (or properties) prior to closing. In most instances, the buyer is unaware of the distressed condition of the property.

- Loan-level misrepresentations to qualify the borrowers.
- Artificially inflated values.
- Purchases that are disguised as refinances to circumvent a down payment.
- Rushed closings to avoid exposure before the scheme unfolds.

Purchase Loans Disguised as Refinances

These schemes involve loans that are disguised as refinances to circumvent down payment requirements.

Some of the following **red flags** may occur when a purchase is disguised as a refinance:

- Borrower is not in title on the title commitment.
- Land contracts are executed shortly before or after application.
- Land contract is dated a significant period of time back, but has only recently been recorded.
- Borrowers are unfamiliar with terms/conditions of a land contract or unaware of the existence of a land contract.
- There is no payment history on land contract or no payments applied to the balance.
- There are recent transfers of the subject property — was the property recently flipped?
- Multiple investment properties are purchased within a short time frame.
- There are artificially inflated appraised values.
- Borrower is not listed as the owner of record on the appraisal.
- Property is refinanced immediately after a purchase on the property.

Multi-Lien Fraud

A multi-lien fraud occurs when multiple loans for the same property are obtained simultaneously for a total amount greatly in excess of the actual value of the property. The purpose for acquiring these multiple loans is to conceal other liens that are already held or are about to be filed against the property. These schemes leave lenders exposed to large losses because the subsequent mortgages are junior to the first mortgage to be recorded and the property value is insufficient for the subsequent lenders to collect against the property in foreclosure.

The following are characteristics of a multi-lien fraud:

- The borrower has extensive knowledge of how the mortgage industry works or knows someone that does.

- Large national retail lenders are targeted via their loan origination call centers or through their internet banking conduit.
- There are usually no appraisal issues with the subject properties.
- Different appraisers and closing agents are used.

Some of the following **red flags** may occur in multi-lien fraud:

- A single borrower has recently purchased the subject property in cash within the last 3-6 months.
- Borrower is disinterested in rate and/or fees associated with loan.
- A MERS search uncovers multiple Mortgage Identification Numbers (MIN) for the same property.

Improper Cash-out Purchases

A cash-out purchase scheme often occurs when properties have been on the market for an extended length of time and a desperate seller is unable to find a qualified buyer.

The seller may be offered a way out of the situation with an offer that exceeds the selling price of the property and an agreement to make a refund to the buyer after closing. The property appraisal is inflated and a straw buyer is used to purchase the property. The loan often goes into early payment default and ends in a foreclosure.

The following **red flags** may indicate an improper cash-out purchase:

- The sales price is higher than the list price.
- The home may have been on the market for an extended period of time.
- The sales contract may have been modified or may include an addendum regarding the payment to the borrower or buyer.
- The appraisal may include red flags symptomatic of an inflated value.
- Many of the same red flags that accompany an improper flip also apply to cash-out purchase fraud – straw buyer, false source of funds, and false occupancy.
- The preliminary HUD-1 Settlement Statement may already indicate a portion of the net proceeds going back to the borrower or buyer.

Rapid Refinance Scheme

A rapid refinance scheme involves a pattern of repeated refinances within a tight timeframe in order to generate fees for the originator, or payment avoidance for the borrower. There are usually no property valuation issues.

The following **red flags** may indicate a rapid refinance scheme:

- Large lender or broker credit to borrower on HUD-1 (may exceed actual closing costs for which borrower is liable).
- Borrower’s disinterest in rate and/or fees associated with loan.
- Credit report reflects multiple mortgages with similar loan amounts paid off within a brief period of time.
- Multiple credit inquiries by the same loan originator within a brief period of time.
- Review of transaction will fail any genuine borrower benefit test.

Builder Bailout Scheme

Builder bailouts occur when a builder or developer is motivated to move excess inventories when the market has slowed and sales have begun to lag.

A variation on this scheme includes condominium conversions. These involve apartment complexes typically located in areas that have declining renter interest. Appraisals will often falsely indicate a fully rehabilitated property.

Misrepresentations may include:

- False income and employment.
- False down payment.
- False intent to occupy the property.
- Straw buyers.
- Inflated appraisals – usually just enough to create equity for the borrower or to cover the down payment.
- Seller-held financing with a short-term loan or unusual language written into the note.
- Invalid or undisclosed subordinate financing – such as seller-carried subordinate financing that is forgiven after closing.

The following **red flags** may suggest a builder-bailout or condominium conversion:

- The builder is desperate / willing to "do anything" to sell.
- The borrower is barely qualified or unqualified for the loan.
- There are indicators of straw buyer involvement (see "Red Flags of Straw Borrowers on page 10).
- The sales price and appraisal show signs of inflation.
- "No money down" sales are heavily promoted.
- "Silent" second mortgages are involved.
- Incentives, such as buy-down funds, appear excessive.
- The mortgage is for a second home and relies on secondary financing.
- The source of secondary financing on the HUD-1 or purchase contract is unclear or indeterminable.
- Parties to the transaction are affiliated or the transaction does not appear to be an arms-length transaction.
- The neighborhood where the property is located had lagging sales followed by a sudden spike in volume and price.
- There are out-of-state borrowers with strong credit scores.
- Payments are made by someone other the borrower.
- Large numbers of condominium conversions exist in a particular area.
- Source of down payment funds is questionable or the funds are provided by someone other than the borrower.
- There is no real estate commission on the HUD-1.
- Large incentives and non-lien disbursements are on the HUD-1.
- There are excessive real estate, marketing, or consulting fees.
- Multiple sales to the same person occur and/or several loans close within a short period of time within the same project or subdivision.
- Appraiser uses only builder comparable sales from within the subject development.

Servicing

Detecting Fraud during Servicing of a Loan

Even the most diligent pre-funding reviews and post-funding quality control audits offer no guarantee of absolute fraud prevention and detection, as the methods in which fraud is perpetrated change over time and most reviews are based on sampling techniques. However, a number of actions can be taken in the servicing area to help you detect fraud. These include:

- Due diligence reviews before loan servicing acquisition.
- Portfolio analysis to monitor for suspicious or abnormal activity that may uncover patterns of mortgage fraud:
  - First and early payment defaults
  - Branches or loan officers whose loan default rates are above average
  - Monthly production to identify geographical concentrations
  - Branches or loan officers whose monthly production have dramatically increased within a short period of time
  - Adverse default trends
  - High volume producers (periodically)
  - Pre-payment speeds

Additionally, these **red flags** may be identified during the servicing of a loan:

- Changes in person/entity making payments on loans.
- No valid home or work phone number – collector is unable to contact borrower.
- Returned mail with no forwarding address.
- Mortgage payments received from individual/entity who is not the borrower.
- Social Security number change requests.
- Address change requested on owner-occupied properties.
- Insurance changed from occupant to investor.
- Borrower's listed employer does not know borrower or borrower was terminated prior to the closing date.
- Loan is coded owner-occupied, but the borrower's reason for default is "tenant not paying rents."
- Unusual prepayment or curtailment activity.

- "Suspicious" collection or customer service calls that may indicate fraud occurred at origination, such as:
  - "This isn't my loan. I let someone use my name."
  - "My broker/realtor/seller is supposed to be making the payments."
  - "I'm not responsible for the payment. I only purchased the house for a friend/relative."
  - "I deeded/sold this property to_ . Contact them for the payment."
  - "This isn't my loan. I never owned property at that address."
  - "I bought multiple investment properties from the same person and they are all vacant and in disrepair."
  - "I paid someone a fee to help me out of foreclosure and they ran off with my money."
  - "I paid a foreclosure rescue company to help me out of foreclosure and they stole my deed."

Common Servicing Fraud Elements

Below are some common elements typically found in fraud schemes during loan servicing:

Strategic Defaults

A strategic default is the decision by a borrower to stop making payments and default on a debt, despite having the financial ability to make the payments. Strategic defaults are often triggered by homeowners who owe more on their homes than the properties are worth. Borrowers may strategically default to qualify for workouts or to walk away from their mortgage obligations after having bought new homes.

Some of the following **red flags** may occur when a borrower strategically defaults on a loan:

- Sudden borrower default with no prior delinquency history, which the borrower cannot adequately explain, often followed by a request for a loan workout.
- A new mortgage appears on the credit report shortly before the default.
- The borrower is current on all other obligations.
- The borrower's financial information indicates conflicting spending, saving, and credit patterns that do not fit a delinquency profile.

Influenced Broker Price Opinions (BPO)

Property value is a critical factor in the decision to approve or deny a short sale request. Short sale flippers / investors / facilitators understand that the lower the price approved by the short sale lender, the more profit they will realize when the property is resold. Accordingly, they may try to influence or manipulate the BPO to an artificially low price.

Even with a robust valuation method, it is a good practice to utilize publicly available information (including real estate databases such as Trulia.com, Realtor.com, or Zillow.com) to research the real estate listing with pictures in their "staged" condition and compare them with the reverse staging that may await the BPO broker upon inspection. These sites may also be used to help ensure the property was actually marketed through the Multiple Listing Service. Be mindful of using a BPO completed by an agent who may be affiliated with other participants, including the other real estate professionals involved in the transaction; in this situation, a deeper dive into the BPO may be warranted.

To spot red flags, carefully read the BPO agent's comments about the property condition, location, etc., and compare those comments to other BPOs received and to other resources, such as the real estate databases identified above.

Some **red flags** to keep in mind when reviewing a BPO include:

- The BPO order form contains a point of contact for interior access who is not the listing agent or borrower and/or the phone number is not local to the subject property.
- When comparing all BPOs received on the property, the value and/or value ranges appear to be lower in more recent, drive-by or full interior BPOs.
- The interior pictures in the BPO show a property in worse condition than the online listing pictures.
- Comparable sales and current listings used in the BPO are not similar to the subject property, including when they are:
  - distressed or valued less than the subject property; or
  - an excessive distance from the subject property, especially in a densely populated area.
- The BPO uses excessive, unreasonable, or unsupported adjustments of comparable properties.

- Reported attributes of the subject property (e.g., lot size, age, room count) do not match origination appraisal and/or public records.
- Final value of subject property is not bracketed between the highest and lowest sold comparable adjusted values.

If you believe you have a questionable valuation, email a request for a value reconciliation to BPOD_Escalations@FreddieMac.com.

Borrower Financial Statement Misrepresentations

To be considered for a workout, borrowers are often required to submit a financial package to the Servicer, which includes a financial statement, bank statements, pay stubs, tax returns/W-2's, and a hardship form. Some borrowers may misrepresent their incomes, household expenses, occupancy of the properties, or claim hardships that do not exist.

Some of the following **red flags** may occur if the borrower misrepresents his or her financial situation:

- A borrower's qualifying financial package is sent through a third party.
- Pay stubs, bank statements, and W-2's may have different fonts, round dollar amounts, or balance inconsistencies.
- Net pay on the pay stub is inconsistent with deposits on the bank statements.
- Retail and installment debts listed on the borrower's financial statement do not match the credit report.
- The borrower claims owner occupancy, but the credit report, bank statements, or pay stubs indicate the borrower resides at an address other than the subject property.
- The borrower recently purchased another home within 50 miles.

The Short Sale HUD-1 – Questionable Payouts

Questionable fees and/or payouts on the short sale HUD-1 statements may be made to parties with no apparent connection to the transaction. These payouts may be made to unknown entities, often the ones profiting from the transaction. The HUD-1 payouts might be made to cover unrecorded liens, non-mortgage lien disbursements, and administrative, marketing, processing, or unapproved short sale facilitator fees.

You can improve the loss mitigation effort by ensuring closing costs associated with the short sale are usual and customary in the specific market and by researching a non-mortgage lien payment before the short sale is approved. If there is a non-mortgage lien listed as a closing cost, obtain a copy of the lien to see when it was filed/recorded. Check Secretary of State business records to learn more about the purported lien holder. Ask questions. What is the lien for? Do the principals of the company or LLC match any of the transaction parties?

Review the **buyer's side** of the HUD-1 to ensure that: 1) there are no disbursements being paid to the second lien holders – this would indicate the sales price was reduced to cover additional monies paid to the second, and 2) any seller's closing cost credit with a disbursement to an unknown individual or entity is equal to the amount of the seller's credit.

Some of the following **red flags** may be present on a questionable HUD-1:

- The lien was filed and/or recorded after the loan defaulted or around the timeframe the offer was made.
- The contract sales price is the same as the minimum net proceeds and there are no buyers' closing costs showing on the HUD-1.
- The lien holder is an LLC.
- HUD-1 reflects closing costs or disbursements outside what is geographically usual and customary.

Common Servicing Fraud Schemes

Foreclosure Rescue / Loss Mitigation Fraud

A foreclosure rescue or loss mitigation scheme is a type of fraud that takes advantage of homeowners who have fallen behind on their mortgage payments by promising to save their homes, but ultimately involves theft of equity the homeowner may have and/or theft of title to the property. There are several variations of the scheme:

The advance fee consulting service - Perpetrators typically require an up-front fee from homeowners to participate in a loan modification program and may also require a monthly fee to remain in the program. Other perpetrators falsely claim affiliations with lenders to convince distressed homeowners to pay large advance fees for modification services, but fail to take any action on the homeowners' behalf.

The lease/buy back - Homeowners are asked to deed the property to the perpetrator, and sign a lease with an option to buy it back later. The homeowners are promised they can continue to live in the house and pay rent, which will be applied toward an eventual buyback. Often, however, the rent is so high that the homeowners cannot afford the payments. Additionally, the buyback price is set far above fair market value, making it impossible for the homeowner to re-purchase the property.

Equity Stripping - At closing, a homeowner surrenders the title (usually unaware they are doing so) to a straw buyer, who may have been recruited by the perpetrator. The proceeds are used to pay off the defaulted loan, but the remaining equity is paid out to the "rescuer." The borrower then rents the property from the new owner, but has surrendered the title to his home, and lost his/her equity.

Forensic loan audits - Forensic loan audit companies audit a homeowner's mortgage loan, searching for predatory lending violations. Once the review is completed, the companies state they will work on the homeowner's behalf to eliminate the mortgage debt and/or negotiate loss mitigation alternatives. These forensic loan audit companies may try to collect upfront fees that are prohibited in many states.

Some of the following **red flags** may occur with a foreclosure rescue scam:

- Servicer receives a third party authorization/agreement form to release information from an individual or entity.
- Servicer is verbally contacted by a third party on the borrower's behalf.
- Borrower refuses to speak to the servicer, but refers collection or loss mitigation calls to a third party.
- Borrower contacts servicer regarding receipt of an eviction notice.

False Preservation and Maintenance Billing on Distressed Properties

In this scheme, vendors will submit bogus or altered invoices for work on properties that are in default or otherwise distressed. Knowing with whom you do business is key to preventing such fraud.

The following **red flags** may indicate false preservation and maintenance billing on distressed properties:

- Anomalies exist in preservation and maintenance expenses, such as: 1) excessive lawn maintenance, 2) pool maintenance on a property with no pool, 3) duplicate invoices for a new roof on same property.
- Invoices include suspicious alterations, charges, dates, etc.
- Invoices from different vendors contain the same font, style and/or amounts.
- There are commonalities in vendor's represented address and vendor's employees' addresses.

Short Sale / Short Payoff Fraud

A short sale is an alternative to foreclosure that allows the borrower to sell his/her property for less than the total amount owed on the mortgage, with the lender often forgiving the remaining debt. Fraud may occur when the borrower or third-party facilitator makes material misrepresentations or omissions to the lender/servicer which impact the decision to accept the short sale.

There are several variations of a short sale fraud:

Buy and Bail - In this scenario, a borrower purchases a new home and then defaults on the loan payments for his/her existing home. Usually, the existing property is "underwater" or worth less than the mortgage. The borrower keeps payments current on his/her existing home until the closing on the new home so as not to compromise his/her credit rating. After the closing on the new home, the borrower will then purposefully default on the existing home loan.

Red Flags:

During the origination of the new mortgage loan:

- An active mortgage loan for a local property may show up on the credit report.
- There may be a falsified lease agreement in the file if the borrowers don't qualify for their new mortgage loan with the old loan still active.

During the servicing of the existing mortgage loan:

- A new mortgage loan for a local property will show up on the credit report.

- The default date of the existing mortgage loan will coincide with the closing date of the new mortgage loan.
- The borrower may request a short sale on his/her existing loan and the listing of the existing property will also coincide with the closing date of the new mortgage loan.

Short Sale and Stay - In this scenario, a borrower is seeking to stay in his or her home, but with a lower mortgage payment. To do so, the borrower may orchestrate a sale of his/her home to straw buyers with the assistance of a real estate agent, securing the equivalent of a principal reduction. These straw buyers can be a family member, friend, or unknown third party who agrees to lease or sell the property back to the borrower.

Red Flags:

- There is a reference to a leaseback in the purchase and sale documents.
- The property may not have been listed in the Multiple Listing Service (Google the property address to determine if the property has been listed) or it was listed just long enough to establish a listing identification number.
- The buyer of the property is related to the borrower or knows the borrower.
- There is no evidence in BPO photos that the original borrower is moving.

Short Sale Flipping - a short sale flip is improper when the property seller or his/her agent receives a higher offer than the short sale offer made to the Servicer, and that offer was not disclosed to the Servicer during the negotiation and approval period. The Freddie Mac Short Sale Affidavit requires that any/all offers be disclosed to the Servicer.

Red Flags:

- The title to the property has been transferred to a trust, LLC, or corporation, prior to the short sale closing.
- The buyer of the property is a trust, LLC, or corporation.
- The purchase contract contains language that indicates the buyer's intent to resell the property.
- An "Option Contract" is utilized, which gives the short sale buyer an option to walk away.
- A buyer's proof of funds letter is from a non-traditional lender or a transactional funding company.

Phantom Short Sale - A phantom short sale scheme is a variation of an improper short sale flip and is done to circumvent the paper trail of an improper back-to-back flip. The perpetrator leads the Servicer and/or Freddie Mac to believe that the property was sold to person A (who is fictitious) at an agreed upon sales price when, in fact, the property was sold to person B at a higher amount. All the documentation provided to the Servicer is fabricated (e.g., purchase contract, HUD-1, etc.) and the perpetrator receives the difference between the sales price disclosed to the Servicer and the actual sales price.

Red Flags:

- The title report shows a recent transfer to a trust, LLC, or corporation, prior to the short sale closing.
- The buyer of the property is a trust, LLC, or corporation.
- The property is not listed for sale in the MLS or listed in the right geographic market.
- The transaction may include dual agency.

We recommend the following protective measures to detect and mitigate the impact of short sale fraud:

- → Verify that the borrower provided a written authorization to help determine validity of any third party's role. Short sale requests that originate from a third party inherently contain more risks. These transactions should be scrutinized more closely.
- → Know the value of the collateral – look at all automated values and the BPOs available, not just the most recent BPO ordered for the short sale, to determine a value range.
- → Use the internet to search the subject property or use websites such as Realtor.com, Trulia.com, or Zillow.com to re-verify listing information and review the subject property pictures, condition, and listing history.
- → Employ the short sale affidavit as required in Guide Section 9208.7(h). The parties required to execute the affidavit are: the buyer, seller, listing agent, selling agent, short sale negotiator(s)/facilitator(s), and closing agent.
- → Look for hidden contracts, side agreements or contract addenda by looking at the fax headers and ensuring all pages are included.

→ Review transactions for involvement of loss mitigation companies, short sale facilitators / investors, realtors, and closing agents who have been proven to be involved in deceptive behavior.
→ Check the names of all short sale participants against the Freddie Mac Exclusionary List.
→ Prior to the short sale closing, check for any sales price variances or potential short sale flips that may have been undisclosed to the Servicer.
→ Incorporate a quality control review checklist, which includes risk-based questions as well as public record property searches.
→ Review all short payoff documentation carefully, including the sale contract, Freddie Mac's short sale approval letter, and your short sale approval letter mailed to the borrower. This helps determine if there is an option clause to resell the property at a higher price without overtly "notifying" the lender.

Investigating Fraud

List of Investigative Resources

You should provide your staff with the education, training and other resources necessary to investigate suspected misrepresentation and/or fraud. Some resources include:

Freddie Mac Resources

- Freddie Mac Fraud Hotline: 1-800 4 FRAUD 8
- Freddie Mac Fraud Mailbox: mortgage_fraud_reporting@FreddieMac.com
- Freddie Mac's main Mortgage Fraud Web page: http://www.FreddieMac.com/singlefamily/preventfraud/
- Freddie Mac's Exclusionary List email for match confirmation: Elist_Confirmation@FreddieMac.com
- Quality Control Web page: www.FreddieMac.com/singlefamily/quality_control.html
- Freddie Mac Fraud Prevention Resources Web page: http://www.FreddieMac.com/singlefamily/preventfraud/resources.html
- Freddie Mac Fraud Prevention Toolkit: www.FreddieMac.com/singlefamily/preventfraud/toolkit.html

External Investigative Resources

- Internet: Search and access records/information. The internet is an ally; don't be afraid to use it. Freddie Mac does not endorse any particular vendor or website, but websites that may be helpful include:
  - www.accurint.com (Accurint records database)
  - www.lexisnexis.com (LexisNexis records database)
  - https://clear.thomsonreuters.com (CLEAR records database)
  - https://risk.nexis.com/realestate (LexisNexis Real Estate Solutions)
  - http://www.pacer.gov (case and docket information on federal court cases)
  - www.searchsystems.net (public information)
  - http://www.escrowhelp.com/state-by-state-closing-guide.html (state-by-state guide to real estate closings)
  - www.searchbug.net (people and company finder)
  - www.salary.com (salary benchmarks)
  - www.zillow.com (real estate database)
  - www.trulia.com (real estate database)
  - www.realtor.com (real estate database)
  - http://www.whois.net/ (internet domain registry)

- Government and Industry Resources:
  - www.fbi.gov/hq/mortgage_fraud.htm (Federal Bureau of Investigation)
  - www.fincen.gov/news_room/rp/mortgagefraud_suspectedMortageFraud.html (Financial Crimes Enforcement Network)
  - www.fhfaoig.gov/ (Federal Housing Finance Agency – Office of the Inspector General)
  - www.ftc.gov/bcp/edu/microsites/idtheft/ (Federal Trade Commission's Identify Theft site)
  - http://www.mba.org/IndustryResources/ResourceCenters/MortgageFraudDetectionandPreventionResourceCenter.htm (Mortgage Bankers Association Mortgage Fraud Prevention and Resource Center)
  - www.nmlsconsumeraccess.org/ (Nationwide Mortgage Licensing System)
  - http://www.realmarketing.com (Assessor Links USA – has links to most states' regulatory agency's license lookup websites, such as state Real Estate Boards, Real Estate Appraisal Boards, and tax assessor websites)

- www.preventloanscams.org/ (A Project of the Lawyers Committee for Civil Rights Under Law)
- www.stopfraud.gov (Financial Fraud Enforcement Task Force)
- www.asc.gov/ (Appraisal Subcommittee)
- www.mortgagefraudblog.com (recent fraud cases)
- www.loanscamalert.org/ (loan modification scam alert)
- www.fraud.org (National Consumer League's Fraud Center)

Reporting Fraud and Other Suspicious Activity

You must meet all of the requirements of the Guide relating to fraud and other suspicious activity reporting. To ensure you meet all of these requirements, please refer to our Guide - in particular, Chapter 3201: *Fraud Prevention, Detection and Reporting; Reporting other Suspicious Activity*.

When a Seller/Servicer reasonably believes that fraud or possible fraud or other suspicious activity has occurred or is occurring in connection with a mortgage sold to, or serviced for, Freddie Mac at any time, the Seller/Servicer must report certain required information to Freddie Mac within 60 days by submitting the *Mortgage Fraud Reporting Form - Origination* or the *Mortgage Fraud Reporting Form – Servicing*, as appropriate, located at http://FreddieMac.com/singlefamily/preventfraud/, or by submitting the information required in the form.

The form, or required information, can be submitted via fax, e-mail or regular mail:

- Fax: (571) 382-4883
- Email: Mortgage_Fraud_Reporting@FreddieMac.com
- Regular Mail: Mortgage Fraud Reporting, Freddie Mac,
  8200 Jones Branch Drive,
  McLean, VA
  22102

In addition, as detailed in Guide Sections 3201.2, Freddie Mac must be notified of the following circumstances **immediately**:

- Theft of custodial funds.
- Lack of collateral.
- Non-remittance of pay-off funds.
- Multiple deliveries of the same mortgage.
- A substantial likelihood that the fraud or possible fraud or other suspicious activity will receive significant public exposure or publicity.
- Notification of a civil judgment, guilty plea, or criminal conviction indicating lack of integrity and relating to a participant in a mortgage or related real estate transaction, or relating to a board member, officer, employee or contractor of the Seller/Servicer.
- Notification by law enforcement or another governmental authority that such authority is conducting an investigation or prosecution of fraud relating to mortgages owned by, or serviced for, Freddie Mac or relating to a board member, officer, employee or contractor of the Seller/Servicer.
- A scheme or pattern of (i) more than 25 mortgages sold to, or serviced for, Freddie Mac, or (ii) mortgages sold to, or serviced for Freddie Mac with an aggregate unpaid principal balance of at least $2.5 million.
- Actual or possible terrorist financing or ongoing or possible money laundering schemes or activity.

To notify Freddie Mac immediately, call the Freddie Mac fraud hotline at 800-4FRAUD8 (800-437-2838). Following notification via the fraud hotline, you are required to submit the appropriate Fraud Reporting Form, as detailed in Guide Section 3201.2.

We'd also like to remind Seller/Servicers of their continuing obligation to comply with all applicable federal, State and local laws and regulations, including those relating to fraud, anti-money laundering, and anti-terrorist financing.

Resolving Fraud

In appropriate circumstances, some industry best practices include:

- Enforcing representations and warranties with the mortgage broker.
- Beginning foreclosure proceedings or acceleration of the Note in accordance with the mortgage documents.

- → Terminating business or employment relationships.
- → Initiating civil actions.
- → Filing deficiency judgments against borrowers who perpetrate fraud.
- → Referring the matter to state or local regulators.
- → Referring the matter to local, state or federal authorities for criminal action.
- → Filing a Suspicious Activity Report with the Financial Crimes Enforcement Network (FinCEN), if required by regulation.
- → Conducting a comprehensive review of responsible parties including a determination of overall exposure levels.
- → Filing an incident report with the Mortgage Asset Research Institute (MARI).

Freddie Mac Exclusionary List

Confidentiality of the Exclusionary List
The Exclusionary List is available to approved Freddie Mac Sellers and Servicers. As stated in Guide Section 3101.1, the information in the Exclusionary List is not publicly available and is to be kept strictly confidential. You are not permitted to share the Exclusionary List or your access to the Exclusionary List with any unauthorized individual or company.

Access to the Exclusionary List
The Exclusionary List is updated and released at least once every month on these platforms and websites:

- Loan Product Advisor[SM] – under the Business Tools tab, Access Exclusionary List.
- Single-Family Selling System – from the left navigation bar based upon your user role.
- Freddiemac.com Single-Family Learning Center – under Secured Resources for Servicers (requires Servicing Applications ID and password).