

Red Flags and Rules for Detecting Fraud:

It has been estimated that between 10% and 15% of all mortgage applications involve fraud. When processing & underwriting applications, the review personnel have the responsibility of using their knowledge and experience in a good faith attempt to detect such fraud in the application and supporting documentation, etc. Hints that are a tip-off of possible fraud are called "red flags". The red flags could be the information or documentation provided, or the lack of it.

Proffering a falsified mortgage application or documentation is a crime and a violation of state and federal laws. The mortgage applicant can and will be prosecuted and, if the loan goes through, the lender could lose the money they lent out. But it is not only the lender (or investor who purchases the debt) that loses out...The subsequent borrowers also lose because lenders have to factor in the cost of fraud by raising the rates or fees that they charge.

One of the main ways of detecting fraud is by finding inconsistencies between multiples pieces of documentation and/or the application. It should be emphasized that the presence of one or more of these items is not positive of fraud. But, their presence indicates the need for additional review and documentation. These items can legitimate when viewed separately, but a pattern of deception may begin to emerge when multiple instances appear.

UNDERWRITING GUIDELINES

The general rules for detecting fraud are simple:

- ❑ Use common sense and go beyond the numbers: Does the loan file make sense?
 - Why does a real estate investor rent his home?
 - Why does a stockbroker not own any stock himself?
 - Why does a person with purportedly high income have no savings?
- ❑ Check document consistency. Is the information the same throughout the file? For example:
 - Compare the application to the purchase agreement
 - Compare the credit report to the application
 - Compare the employment/pay information to the bank statements
- ❑ Keep up with the latest fraud techniques and learn the common techniques that have been around for years:
 - Crossed out, or "whited out" documents
 - Only a portion of a document (such as a bank statement) is presented
 - Copies or Internet printouts are presented rather than original documents
 - All or most of a large amount of assets are "cash on hand"
- ❑ The processor/underwriter should trust their intuition. If they don't feel comfortable, it is their obligation to ask the right questions, ask for explanations and request further documentation that is needed to satisfy themselves of the completeness, legitimacy and accuracy of the loan request and application package? The loan application review staff should keep an open mind, because not everyone fits in the same mold. But, they should also be constantly aware of the proliferation of mortgage fraud and use their best judgment and follow their instincts.

Mortgage Screening Checklist

Compiled by Olen Soifer, July, 2010

Derived from information from the Washington State Department of Financial Institutions & other sources

Introduction

This mortgage screening checklist includes a wide variety of items that may, by their presence, be "Red Flags" indicating false or misleading information. The presence of one or more of these items is no absolute proof of fraud or fraudulent intent, but should prompt the reviewer to do a more intensive file review and, probably, seek explanation(s) and/or further documentation from the borrower:

Mortgage Loan Application

Down payment other than cash (rent credit, sale of personal property, repayment of loan, gift, etc.)

Non-purchasing spouse

Borrower buying investment property, but does not own current residence

New home is not large enough for proposed occupants

Post office box is the only address listed for employer (especially on the handwritten application)

Significant or unrealistic commute distance from subject property to employment (on owner-occupied transactions)

Number of years on the job/in that profession inconsistent with borrower's age

Borrower's level of education is inconsistent with employment

Borrower's office phone number is the same as home number (borrower is possibly self-employed) but the borrower does not claim to be self-employed

Assets inconsistent compared to liabilities (for example, significant assets, yet no credit or minimal credit)

Buyer is downgrading to smaller or less expensive home

Incomplete handwritten application

Borrower income inconsistent with type of employment

Non-transient job with company phone number identified as a cell phone

Incomplete Schedule of Real Estate Owned

Significant or contradictory changes in debt, employment, income or assets from the initial to the final application

Borrower is purchasing property from landlord or employer

Handwritten application lists debts in the same order as credit report

Credit Report

All credit reports and/or supplements are not included in the file

Personal data not consistent with handwritten application

Social security number is invalid or differs from loan application

Variance in residence data from other file documentation

Employment cannot be verified by a credit bureau

Variance in employment data from other file documentation

No credit (possible use of alias or different social security number)

Credit habits inconsistent with income/employment

All trade lines opened at the same time or opened recently
All accounts paid in full recently (possibly a new, undisclosed consolidation loan)
Refinance of recently originated loan (current lender may have accelerated for misrepresentation)
Length of time on credit bureau file inconsistent with buyer's age
Also Known As (AKA) or Doing Business As (DBA) indicated
Recent inquiries from other mortgage lenders
Handwritten application lists debts in the same order as credit report
Indebtedness disclosed on the mortgage application varies from that reflected on the credit report
Infile credit report on closing date shows additional debt
Credit report is from a different lender
Hawk alerts

Verification of Employment (VOE)

Appearance that the VOE may have been hand-carried (i.e., folded, not creased)
Name of employer incorporates some form of borrower's name (for example, borrower is John Doe and employer is J.D. Enterprises)
Employer uses mail drop or post office box address
Typed by employer
Date of hire is a weekend or holiday
Generic job titles (for example, manager, general manager, accountant, consultant)
Income is out of line with the type of employment
Commission-type position with "base" salary only (and vice versa)
Round dollar amounts in (i.e., year-to-date or prior year's earnings)
"Squeezed-in" numbers
YTD past year's income says, "See W-2s and Paystubs"
VOE shows company car and application shows auto loan
Illegible signature with no further identification
Co-borrower's maiden name is the same as the signature of employer (self-employed)
Person verifying employment appears to be related to the borrower
VOE completed same day as ordered
White-outs or cross-outs
Credit explanation indicates that borrower was late due to illness/layoff, but income on VOE is not lower during that time period
Business entity is not in good standing or not registered with the appropriate regulatory agencies
Handwritten paystubs or W-2 forms
Company phone number is identified as a cell phone number
"Personnel" is misspelled
Person verifying income is not in a proper position to sign the VOE

Paystubs

Form is handwritten
Not computer-generated from large employer

Check numbers do not increase chronologically
Round dollar amounts
Amounts withheld for Social Security, Medicare and other government programs are inconsistent with the level required
Debts reflected as deduction from pay (credit union loans, etc.) not disclosed on application
Year-to-date totals do not total accurately from paycheck to paycheck
Social Security number is not consistent with other loan file documents
Type/fonts are inconsistent
Number of dependents is inaccurate based on loan application

Form W-2/1099

Form is handwritten
Not computer-generated from large employer
W-2 is typed, but paystubs are computer-generated
Different type/font within the form
Employer identification number is formatted other than XX-XXXXXXX (two digits, hyphen, seven digits) and/or other than numeric (could be invalid)
Employer and employee names or addresses are inaccurate
Round dollar amounts
Income reflected on W-2 statements is different than income reported on mortgage application, VOE and tax returns
FICA and Medicare wages/taxes and local taxes, where applicable, exceed ceilings/set percentages
Copy submitted is not "Employee's Copy" (Copy C)
Withholdings are inconsistent with paystub

Tax Returns (Form 1040)

No taxpayer label used, yet residence has not changed
Address and/or profession does not agree with other information submitted on the mortgage application
Type of handwriting varies within return
Evidence of "white-out" or other alterations
Unemployment compensation reported, but no gap in employment is disclosed
No estimated tax payments by self-employed borrower (Schedule SE required); or self-employment tax claimed, but self-employment not disclosed
Tax returns are not signed/dated by borrower
Paid preparer signs taxpayer's copy

Schedule A (Itemized Deductions)

Real estate taxes and/or mortgage interest is paid but no property is owned (or vice versa)
Tax preparation fee is deducted, yet prior year's return is prepared by borrower
Few or no deductions for a high-income borrower

Schedule B (Interest and Dividend Income)

Borrower with substantial cash in the bank shows little or no related interest income

No dividends are earned on stocks owned
Amount or source of income does not agree with the information submitted on the mortgage application

Schedule C (Profit/Loss from Business Owned)

Business code is inconsistent with type of business
Gross income does not agree with total income on Form 1099s
No "cost of goods sold" on retail or similar type of business
Borrower takes a depreciation deduction for real estate not disclosed (or vice versa)
Borrower shows interest expense but no related loan (possibly business loans with personal liability)
No deductions for taxes and licenses
Wages are paid, but no tax expense is claimed
Wages are paid, but there is no employer identification number
Salaries paid are inconsistent with the type of business
Business expenses are inconsistent with type of business (for example, truck driver with no car and truck expense)
No IRA or Keogh deduction
Income significantly higher than from previous years

Schedule E (Rents and Royalties)

Additional properties are listed, but not shown, on the mortgage application
Mortgage interest is deducted but no mortgage is disclosed
Net income from rents plus depreciation does not equal the cash flow submitted by borrower
Borrower shows partnership income (may be liable as a general partner for partnership's debts)

Verification of Deposit (VOD)

Source of funds consists of (unverified) note, equity exchange, sale of residence
Evidence that VOD may have been hand-carried (i.e., folded, not creased)
Post office box for depository (if not typical for area or company)
Cash in the bank is not sufficient to close
Round dollar amounts (especially on interest-bearing accounts)
New bank account (verify previous account)
Significant changes in balance from previous two months to date of verification
Savings account with average two-month balance exactly equal to present balance (no interest accumulation)
Excessive balance in checking account vs. savings account
"Squeezed-in" numbers
Loan secured by checking or savings account
Bank account not in borrower's name
Bank account or bank statements reflect additional, non-borrowing account holders
Illegible signature with no further identification
VOD is completed the same day it is ordered

Date of verification by the bank is a weekend or holiday
“White-outs,” cross-outs
Gift letter that is not backed up by written transfer of funds
Bank statements reflect periodic deposits at odds with reported income
Bank statements include insufficient funds fees
Bank statements reflect periodic withdrawals at odds with debts
Bank statements reflect daily balances inconsistent with opening/closing balances
Bank statements do not reflect withdrawal of earnest-money deposit
Deposit money made in multiple transactions
Closing check drawn on a different bank
VOD signed by bank officer, or someone who ordinarily would not verify an account
Bank statement does not reconcile
Bank logo on statement is suspicious

Bank Checks

Numbers, payee or other information appear to be altered
Bank and/or account number is inconsistent with the information on application
Low check number (indicates newly opened account)
Check is not canceled
Dollar amount is not encoded correctly on check
Check number does not agree with encoded number
Endorsement dates are inconsistent with the date the check was written
Check numbers from single account do not increase chronologically
Checks reflect additional signers for the account
Cashiers check for funds to close mentions an entity on non-interested party as “remittee”
(possible flip)

Sales Contract

Borrower is not shown as purchaser
Names are deleted from, or added to, the purchase contract
Seller is a realtor, relative or employer
Earnest-money deposit consists of the entire downpayment, or is an odd amount
Sales price is substantially below market value
Second mortgage is indicated
No realtor involved
Name and address on earnest-money deposit check is different from that of the buyer
Earnest-money deposit checks have inconsistent dates; for example,

- Check #111 dated November 1
- Check #113 dated September 1
- Check #114 dated October 1

Multiple contracts exist
Earnest-money check is not cashed
Sales contract date is after the appraisal date

Escrow/Closing Instructions

- “Fill in the blank” escrow instructions
- Change of sales prices to “fit” the appraisal
- Odd amounts paid as a deposit/downpayment
- Downpayment is paid into escrow upon opening
- Cash is paid outside of escrow to property seller
- Sale is subject to property seller acquiring title
- Business entity acting as the property seller is controlled by or related to borrower
- Buyer is required to use a specific broker/lender
- Reference to another (double) escrow
- Unusual credits with no economic substance
- Demands paid off to undisclosed third parties (potential obligations)
- Purchase not subject to inspection
- Right of assignment (who is the actual borrower?)
- Related parties involved in the transaction
- Power of attorney used with no explanation (why can't borrower execute documents?)
- Power of attorney is not properly documented/recorded
- No amendments to escrow
- Unusual amendments to the original transaction
- Seller on HUD I different than seller on preliminary title report

Appraisal

- Ordered by any party to the transaction other than lender (buyer, property seller, realtor)
- Owner's name does not agree with other information disclosed in the loan file
- Spaces where requesting information is left blank (borrower, client, occupant, etc.)
- Appreciation in stable or declining area
- Most recent sale on subject and comps is missing
- Date of appraisal is prior to date of sales contract
- New home is not large enough for proposed occupants
- High land value in urban areas (consider the area)
- Comps not verified as recorded (data source MLS, sales office, SREA, CMDC, real estate agent, etc.)
- Excessive distance of comps from subject property
- Excessive adjustments in urban or suburban area where marketing time is under six months
- Income approach is not used on tenant-occupied, single-family dwellings
- Ordered before sales contract written
- Photos do not match description of property
- Photos of subject property taken from odd angles
- Photos reveal items not disclosed in appraisal (for example, commercial property next door, railroad tracks, another structure on premises, etc.)
- “For rent, for sale” sign in photo of subject property on owner-occupant refinance application
- Photos of subject or comps look familiar
- Appraiser is located outside of subject property county

Weather conditions in photo of property are not appropriate for the date of the appraisal
(i.e., July photo shows snow on the ground for a property in Illinois)
Occupant is identified as a tenant on an owner-occupied application
Occupants are unknown
House number in photo does not match property address

Preliminary Title Report/Title Search

- Prepared for/mailed to a party other than the lender
- Property seller not on the title (double escrow)
- Property seller-owned property for a short time with cash out on the sale
- Notice of default is recorded (possible cash-out refinance with a straw buyer)
- Delinquent property taxes
- Judgment against borrower is not shown on credit report
- Modification agreement on existing loan(s)
- Suspicious transfer

HUD-1/Settlement Statement

- Names and addresses of property seller and buyer vary from other loan documentation
- Date of settlement is delayed without explanation
- Sales price differs from sales contract
- Reference is made to undisclosed secondary financing or double escrow
- Rent prorated on owner-occupied transactions
- Cash proceeds to buyer in excess of \$300
- Zero amount due to/from buyer
- HUD-1 or escrow instructions contain unusual credits, disbursements, related parties, delinquent loans paid off, or multiple mortgages paid off
- Excessive fees

Additional

- Type, spacing, and/or font varies within document from a single source
- Inconsistent borrowers' names, phone numbers, addresses, Social Security numbers, or handwriting throughout file
- More than one mortgage lender is reflected throughout the file
- Parties to the transaction have more than one role (for example, realtor is landlord, employer is gift donor)
- Borrower appears to be related to any other party reflected in the file except the gift donor (for example, verifier of funds or employment, appraiser, escrow officer, etc.)
- Borrowers' signatures differ throughout the loan package
- Unusually long or unusually short loan processing time (brokered loans)
- Patterns or similarities in loan packages received from a specific broker, loan originator, realtor or property seller