

‘The Global Financial Crisis and Mortgage Fraud – The Untold Story’

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Introduction

The origins of the financial crisis can be traced to the United States (US) subprime mortgage sector. The subprime mortgage sector is supported by lenders providing subprime loans.¹ These types of mortgages place the debtor under severe pressure to repay the loan, due to irresponsible lending or even predatory lending practices. Subprime loans can be described as “non-traditional, higher risk loans that frequently carry above market interest rates and ... in some cases, the loans were made with less documentation and credit verification than traditional mortgages.”² It has been argued that financial crisis was ‘caused by the creeping levels of mortgage defaults in the subprime market in the US’.³ The losses incurred as a result of the collapse of the subprime mortgage sector were staggering. For example, according to the International Monetary Fund the total losses associated with subprime lending in 2008

¹ Fox, M. and David, H. ‘Lessons from the US subprime mortgage crisis’ (2008) *Journal of International Banking Law and Regulation*, 23(9), 449–457, at 449.

² Slevin, P. ‘Bad vibrations: subprime-sparked legal action’ (2007) *European Lawyer*, 72, 18–19, at 18.

³ Singh, D. and LaBrosse, J. ‘Northern Rock, depositors and deposit insurance coverage: some critical reflections’ (2010) *Journal of Business Law*, 2, 55–84, at 56.

initially totalled \$945m.⁴ The Wall Street Journal reported that the total losses from the financial crisis were \$15tn.⁵ The bursting of the subprime mortgage sector resulted in numerous corporate insolvencies and significant losses for both investors and banks.⁶ In 2010, it was estimated that losses attributed to banks from the financial crisis amounted to \$2.28bn.⁷ It has been suggested that the blame for the subprime crisis is associated with the actions of the Federal Reserve. For example, it has been suggested by one commentator, Doise that the actions of the Federal Reserve resulted in the determined and uncompromising sale of loans.⁸ Conversely, it has been suggested that debtors are to blame for the subprime lending by entering into financial agreements that they were unable to repay. The subprime mortgage sector collapsed when property prices began to decrease and the number of foreclosures began to increase.⁹ This was preceded by a period of economic growth when the average property price doubled, at a rate higher than the wages of many householders.¹⁰

These lending practices of subprime mortgage provides contributed to record levels of defaults, repossessions and an increase in consumer debt. Research suggests that the levels of household debt from mortgages in the US increased over a 25 year period from 1982. This resulted in a significant increase in levels of personal debt, and mortgage defaults, housing repossessions and reduction in house prices. Nguyen and Pontell stated that ‘as the crisis unfolds, a significant number of families have lost their homes or are financially trapped in

⁴ International Monetary Fund *Global financial stability report: containing systemic risks and restoring financial soundness* (International Monetary Fund: Washington DC, 2008) at 10.

⁵ Yoon, A. ‘Total global losses from financial crisis: \$15 trillion’, 1 October 2012, available from <http://blogs.wsj.com/economics/2012/10/01/total-global-losses-from-financial-crisis-15-trillion/>, accessed 13 July 2014.

⁶ Wen, S. ‘The magnitude of shareholder value as the overriding objective in the UK: the post-crisis perspective’ (2011) *Journal of International Banking Law and Regulation*, 26(7), 325–337, at 331.

⁷ Crutsinger, M. ‘IMF trims loss estimate from financial crisis’, 20 April 2010, available from <http://www.nbcnews.com/id/36662585/>, accessed 13 July 2014.

⁸ Doise, D. ‘Subprime: price of infringements’ (2008) *International Business Law Journal*, 4, 558–568, at 558.

⁹ Marshall, J. *US Congressional debates on the financial crisis: key players, policy and future regulation – House of Commons Research Paper 09/58* (House of Commons Library: London, 2009) at 2.

¹⁰ Marshall, J. *The financial crisis in the US: key events, causes and responses – House of Commons Research Paper 09/034* (House of Commons Library: London, 2009) at 10.

their current mortgages and simply waiting for their homes to be taken from them’.¹¹ The increase in the number of repossessions and mortgage defaults has resulted in an increase in mortgage fraud.

Mortgage Fraud

Mortgage fraud is the most prominent white collar crime associated with subprime lending and the financial crisis. The link between white collar crime and subprime loans was identified by Nguyen and Pontell who stated that ‘investigations have found that the growth of nonprime lending attracted a great deal of fraud’.¹² Furthermore, Harrell took the view that ‘no discussion of the housing boom of 1993–2006 and the great credit contraction that has followed would be complete without a discussion of mortgage fraud’.¹³ Dilley and Weller noted that ‘the origins of the credit crunch lie with the sub-prime lending and the ensuing house price bubble in the US. Mortgage fraud – by borrowers, brokers and appraisers – was a key contributor.’¹⁴ Similarly, the FBI stated that during the subprime mortgage crisis ‘mortgage fraud perpetrators ... [took] advantage of industry personnel attempting to generate loans to maintain current standards of living’.¹⁵ Therefore, the FBI concluded that ‘subprime mortgage issues remain a key factor in influencing mortgage fraud directly and indirectly’.¹⁶ According to McCann, ‘mortgage fraud perpetrated by these unregulated private mortgage brokers may have contributed to the instability and loss in the residential lending

¹¹ Nguyen, T. and Pontell, N. ‘Fraud and inequality in the subprime mortgage crisis’ in Deflem, M. (ed.) *Economic crisis and crime* (Emerald: Bingley, 2011) at 5.

¹² *Ibid.*

¹³ Harrell, A. ‘The great credit contraction: who, what, when, where and why?’ (2010) *Georgia State University Law Review*, Summer, 26, 1209–1258, at 1231.

¹⁴ Dilley, B. and Weller, F. ‘Mortgage fraud and the credit crunch’ (2008) *Fighting Fraud*, Summer, 35, 1–31, at 11.

¹⁵ Federal Bureau of Investigation ‘Swecker, C. former FBI Assistant Director, Criminal Investigative Division, introductory statement: House Financial Services Subcommittee on Housing and Community Opportunity’ 7 October 2004, available from <http://www.fbi.gov/news/testimony/fbis-efforts-in-combating-mortgage-fraud>, accessed 13 July 2014.

¹⁶ *Ibid.*

market that contributed to the mortgage crisis'.¹⁷ It is very interesting to note that the threat posed by mortgage fraud *was* recognised by the FBI in 2004, when it stated 'if fraudulent practices become systemic within the mortgage industry and mortgage fraud is allowed to become unrestrained, it will ultimately place financial institutions at risk and have adverse effects on the stock market'.¹⁸ Furthermore, the FBI warned that 'it [mortgage fraud] has the potential to be an epidemic'.¹⁹ Black stated that despite this blunt warning from the FBI, 'no one in the industry, including regulators, ranks of investors or creditors, or law enforcement personnel took effective action against the epidemic'.²⁰

Mortgage fraud has been defined by the FBI as 'the intentional misstatement, misrepresentation, or omission by an applicant or other interested parties, relied on by a lender or underwriter to provide funding for, to purchase, or to insure a mortgage loan'. It also includes providing misleading information when making a mortgage application.²¹ There are traditionally two types of mortgage fraud – fraud for property and fraud for profit,²² which can be divided into different subcategories.²³ For example, this includes misrepresentation, occupancy fraud, appraisal fraud, identity theft, straw purchasing and flipping.²⁴ Common mortgage fraud schemes include property flipping, straw buyers and

¹⁷ McCann, N. 'Federal law enforcement in the home mortgage lending market enhanced by the Fraud Enforcement Act and Recovery Act of 2009' (2010) *Loyola Consumer Law Review*, 22, 352–390, at 354.

¹⁸ Federal Bureau of Investigation 'John S. Pistole, Deputy Director Federal Bureau of Investigation, statement before the House Committee on the Judiciary', 1 April 2009, available from <http://www.fbi.gov/news/testimony/fbi-efforts-to-combat-mortgage-fraud-and-other-financial-frauds>, accessed 13 July 2014.

¹⁹ Frieden, T. 'FBI warns of mortgage fraud "epidemic"', 17 September 2004, available from <http://www.cnn.com/2004/LAW/09/17/mortgage.fraud/>, accessed 12 July 2014.

²⁰ Black, K. 'Neo-classical economic theories, methodology, and praxis optimize criminogenic environments and produce recurrent intensifying crisis' (2011) *Creighton Law Review*, 44, 597–644, at 622.

²¹ Vacco, P. 'RESPA and avoiding mortgage fraud: what goes on the HUD settlement statement?' (2008) *Illinois Bar Journal*, May, 96, 248–249, at 249.

²² O'Donnell, M. and Planer, K. 'If it sounds too good to be true: identifying and avoiding common mortgage fraud scams' (2008) *New Jersey Lawyer*, October, 254, 54–57, at 54.

²³ Gans, K. 'Anatomy of a mortgage meltdown: the story of the subprime crisis, the role of fraud, and the efficacy of the Idaho Safe Act' (2011) *Idaho Law Review*, 48, 123–174, at 146.

²⁴ *Ibid.*

equity skimming.²⁵ Other mortgage fraud systems include builder bailout, buy and bail, chunking, double selling, fictitious loan, phantom sale, reverse mortgage fraud and short sale fraud.²⁶ The FBI noted that other types of mortgage fraud scams ‘involve material misstatement, misrepresentation, or omission relating to a real estate transaction which is relied on by one or more parties to the transaction’.²⁷ They added that these schemes include ‘foreclosure rescue schemes, loan modification schemes, illegal property flipping, builder bailout/condo conversions, equity skimming, silent second, home equity conversion mortgage, commercial real estate loans and air loans’.²⁸

The extent of mortgage fraud is difficult, if not impossible, to determine. For example, the FBI estimated that the extent of mortgage fraud in 2006 was \$4.2bn.²⁹ In 2007 it described mortgage fraud as ‘an escalating problem’,³⁰ yet the total amount of mortgage fraud related losses dropped to \$813m.³¹ Nonetheless, in 2008 the reported losses from mortgage fraud increased by 83.4 per cent to \$1.4bn.³² In its 2009 Mortgage Fraud Report, the FBI cited figures from CoreLogic, which estimated that the total amount of losses related to mortgage fraud had increased to \$14bn.³³ CoreLogic estimated that the extent of mortgage fraud in 2011 was \$12bn.³⁴ In its 2012 mortgage fraud report CoreLogic projected that the level of

²⁵ Jacobsen, B. and Barnhill, M. ‘Drawing the short straw – mortgage fraud and straw buyers’ (2008) Utah Bar Journal, July/August, 21, 9–13, at 11–12.

²⁶ Anon. ‘Banking and financial services policy report’ (2010) The Monitor, 29(4), 19–23, at 21.

²⁷ Federal Bureau of Investigation ‘Financial crimes report to the public – fiscal years 2010–2011’, n/d, available from <http://www.fbi.gov/stats-services/publications/financial-crimes-report-2010-2011/financial-crimes-report-2010-2011#Mortgage>, accessed 13 July 2014.

²⁸ *Ibid.*

²⁹ Federal Bureau of Investigation ‘Mortgage fraud report 2006’, May 2007, available from <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2006/2006-mortgage-fraud-report>, accessed 13 July 2014.

³⁰ Federal Bureau of Investigation ‘Mortgage fraud report 2007’, April 2008, available from <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2007>, accessed 13 July 2014.

³¹ *Ibid.*

³² Federal Bureau of Investigation ‘Mortgage fraud report 2008’, 2009, available from <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2008/2008-mortgage-fraud-report>, accessed July 13 2014.

³³ Federal Bureau of Investigation ‘2009 mortgage fraud report year in review’, n/d, available from <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2009>, accessed 13 July 2014.

³⁴ CoreLogic *2011 Mortgage fraud trends report* (CoreLogic: Irvine, 2011) at 1.

mortgage fraud had increased to \$13bn.³⁵ These statistical data are supported by research conducted by the Mortgage Asset Research Institute, which advised that ‘mortgage fraud is more prevalent now than in the heyday of the origination boom and ... it will continue to rise’.³⁶

The link between mortgage fraud and the financial crisis is clearly illustrated by the significant increase in the number of related SARs submitted to FinCEN. For example, between 1996 and 2006 FinCEN received 82,851 mortgage fraud related SARs.³⁷ During this period the number of suspected instances of mortgage fraud reported to FinCEN increased by approximately 1,400 per cent.³⁸ Furthermore, in 2008 FinCEN stated that between 2006 and 2007 it received 37,313 mortgage fraud SARs.³⁹ This figure represented 45 per cent of the total mortgage fraud related reports it received between 1996 and 2006. In 2010 the number of mortgage fraud related SARs received by FinCEN numbered 70,472.⁴⁰ The number of SARs increased significantly to 92,028 in 2011.⁴¹ Lexis Nexis reported that in 2011 FinCEN received 93,508 mortgage fraud related SARs from 2010, an increase of approximately 33 per cent.⁴² This position was succinctly summarised by Smith, who concluded: ‘the past decade has witnessed an explosion of mortgage fraud, with reports to the federal government of suspected criminal behaviour rising by a magnitude of over eighteen times from 2000 to

³⁵ *Ibid.*

³⁶ Creseney, A., Eng, G.E. and Nuttal, S. ‘Regulatory investigations and the credit crisis: the search for villains’ (2009) *American Criminal Law Review*, Spring, 46, 225–273, at 226.

³⁷ Financial Crimes Enforcement Network *Mortgage loan fraud: an industry assessment based upon suspicious activity report analysis* (Financial Crimes Enforcement Network: Washington DC, 2006) at 4.

³⁸ Mahallati, N. ‘Chapter 174: California’s dedicated mortgage fraud statute’ (2010) *McGeorge Law Review*, 41, 712–724, at 717.

³⁹ Financial Crimes Enforcement Network *Mortgage loan fraud: an update on trends based on analysis of suspicious activity reports April 2008* (Financial Crimes Enforcement Network: Washington DC, 2008) at 4.

⁴⁰ Financial Crimes Enforcement Network *Mortgage loan fraud update – suspicious activity report filings from January –December 31 2010* (Financial Crime Enforcement Network: Washington DC, 2011) at 2.

⁴¹ Financial Crimes Enforcement Network *Mortgage loan fraud* (Financial Crime Enforcement Network: Washington DC, 2012) at 2.

⁴² Lexis Nexis *The Lexis Nexis 14th annual mortgage fraud report* (Lexis Nexis: London, 2012) at 3.

2008'.⁴³ However, it has been argued that the figures from FinCEN represent only a small percentage of the true extent of mortgage fraud. For example, Black took the view that 'the total SARs figure is only a faint indication of the true incidence of mortgage fraud'.⁴⁴ It is also interesting to note that 'mortgage fraud, far from abating, has only expanded since the foreclosure crisis began'.⁴⁵ Further evidence of the link between mortgage fraud and the financial crisis is also illustrated by an increase in the investigative and enforcement activities of the FBI. For example, since the start of the financial crisis we have witnessed a 400 per cent increase in the number of mortgage fraud investigations undertaken by the FBI.⁴⁶ Furthermore, in response to the increase in mortgage fraud the FBI has established 84 mortgage fraud task forces; there have been approximately 2,000 investigations, over 1,000 indictments and over 1,100 convictions.⁴⁷ Moye summarised the overall impact of mortgage fraud from a law enforcement perspective:

"From 2007 through 2010, the number of federal mortgage fraud cases increased from 1,200 to over 3,000. Almost 70 per cent of those fraud cases involved losses exceeding \$1m. In June 2010, the Department of Justice announced the results of Operation Stolen Dreams, the largest mortgage fraud sweep in history. The sweep lasted three and a half months, involved 1,517 defendants, 863 indictments, 525 arrests, and involved over \$3.05bn in losses. Finally, the sweep resulted in over 191 civil enforcement actions and \$196m in recoveries".⁴⁸

Conclusion

The association between the 2008 Global Financial Crisis and white collar crime continues to gather momentum. This article has attempted to demonstrate that mortgage fraud in

⁴³ Smith, J. 'The structural causes of mortgage fraud' (2010) *Syracuse Law Review*, 60, 473–500, at 473.

⁴⁴ Black, K. 'Neo-classical economic theories, methodology, and praxis optimize criminogenic environments and produce recurrent intensifying crisis' (2011) *Creighton Law Review*, 44, 597–644, at 623.

⁴⁵ Fisher, L. 'Target marketing of subprime loans: racialised consumer fraud and reverse redlining' (2009) *Journal of Law and Policy*, 18, 121–155, at 144.

⁴⁶ Heroy, J. 'Other people's money: how a time-gap in credit reporting may lead to fraud' (2008) *North Carolina Banking Institute*, 12, 321–351, at 322.

⁴⁷ Federal Bureau of Investigation 'Mortgage fraud', n/d, available from http://www.fbi.gov/about-us/investigate/white_collar/mortgage-fraud/mortgage_fraud, accessed 23 May 2013. Also see Dooley, D. and Radke, M. 'Does severe punishment deter financial crimes?' (2010) *Charleston Law Review*, 4, 619–659, at 624–626.

⁴⁸ Moye, J. 'Let's put the fear in the FERA! Suggestions to make the Fraud Enforcement and Recovery Act of 2009 a strong fraud deterrent' (2011) *Southern Illinois University Law Journal*, Spring, 35, 421–432, at 421–422.

particular, played a key role in the most recent financial crisis and the continued enforcement activities by the Federal Bureau of Investigation clearly illustrate this point.