

## Recognizing Mortgage Fraud

Mortgage fraud is now a part of our lexicon, but few people understand what this means and the harm it causes. Mortgage fraud is a catch all phrase that encompasses schemes allowing one or more parties to a real estate transaction to obtain money through illegal or unethical means. Mortgage fraud cost us, as a society, somewhere between \$946 million and \$4.2 billion in 2006,<sup>1</sup> and the cost will increase.<sup>2</sup>

Residential mortgage transactions are particularly susceptible to fraud, since the mortgage lending industry relies on patterned transactions to simplify home sales and mortgage financing with as little cost and time as possible. In a “normal” residential sale transaction, the buyer, seller, and real estate broker(s) negotiate a sale using a model purchase agreement. The buyer meets with a loan officer from a mortgage broker or lender, and chooses a standard loan product to finance the transaction.<sup>3</sup> The lender obtains an appraisal of the property and a credit report for the borrower. An investor underwrites the loan with the assistance of an automated system, conditionally commits to purchase the loan after closing, and “locks” the loan terms. The mortgage broker or lender obtains a title insurance commitment and schedules the closing after the loan is approved. A closing agent (usually a title insurance agency) explains the closing documents, acknowledges the parties’ signatures, accounts for the parties’ funds, distributes the proceeds of the transaction, sends the deed and mortgage to the Register of Deeds for recording, and issues title insurance policies for the buyer and lender. The lender sells the loan to an investor, and the borrower makes monthly payments to the servicing agent selected by the investor.<sup>4</sup> Because the documents are standard, and the roles of the parties are very uniform, nobody spends the time or money to perform much due diligence on

the transaction.<sup>5</sup> Hence, it is relatively easy to interject false documents or parties into the transaction to obtain money.

Mortgage fraud schemes are extensive, ranging from the simple to the complex, and far too common.<sup>6</sup> It is possible to stop mortgage fraud if one of the parties recognizes the fraudulent features of a transaction before the proceeds of the transaction are disbursed. Some of the more common schemes are:

**Inflated income or assets:** Some of the most misrepresented facts on an application for credit are borrower income and assets. Recent audits by one lender found actual income was significantly overstated in two thirds of the applications submitted for credit on a “stated income” basis (i.e. the borrower’s income is not verifiable and the loan is approved based on the borrower’s credit score and statement of income).<sup>7</sup>

Assets are often misrepresented to make the lender believe that the buyer has funds to make a down payment and to pay closing costs. Sometimes the buyer borrows the down payment without revealing the obligation to repay the funds. A debt may be characterized on the settlement statement as an unrecorded lien, or an invoice for unidentified management services, to hide the fact that the down payment was borrowed.

Making false representations in a loan application, or providing false documents to verify income or assets, is a crime.<sup>8</sup> It is also a crime for a mortgage broker or lender to knowingly process a false loan application.<sup>9</sup>

**False Social Security Numbers:** Borrowers sometimes use the social security number of another person, or fake identification documents of a person with “good credit” to obtain a loan. More sophisticated thieves use a good social security number and a fake name (“synthetic ID theft”) to make it harder to detect and identify the thief. The first five digits of a social security number indicate the area of the country where the card was issued and the year of issue. These values can be checked against the area of the country where the borrower was raised and the age of the borrower.<sup>10</sup>

**Altered documents:** W-2 forms, bank statements, title commitments, leases, and all manner of documents used to verify income and asset information can be altered or forged. Fake employment verification forms can be purchased over the Internet.<sup>11</sup> Some borrowers forge discharges from their prior lender, or erase the loan from the schedule of exceptions on a title commitment, to avoid paying the balance of their prior loan. Accepting these documents or verification forms from the borrower saves time, but invites fraud. Asking the source of these documents for a separate copy is safer.

**Multiple loans:** Lenders rely on the credit report and title commitment to locate the borrower’s obligations. There is always a “gap period” between the date that documents are submitted to the Register of Deeds for recording, and the date that these documents are available for inspection. There is also a gap between the date of a loan payment (or a missed payment) and the date that information is listed in a credit report. Some borrowers will close two or three refinance loans on a property with different lenders during a “gap period,” knowing that the credit report and title commitment will not reveal recent loan transactions and missed payments.

Mandatory electronic recording and universal reporting of consumer loan payments to credit bureaus may some day eliminate gap periods.<sup>12</sup>

**Inflated Deposits and Soft Second Mortgages:** Consumers who have an equity interest in their home are less likely to default on their mortgage payments. Hence, most loan programs require a minimum down payment.<sup>13</sup> A buyer may give a false purchase agreement to the lender, showing an earnest money deposit twice as large as the real deposit and an inflated purchase price. A buyer and seller sometimes inflate the purchase price of a home, and offer seller financing in lieu of a down payment, so that the buyer may obtain a larger loan than would be permitted by the lender's underwriting standards. The seller's note and mortgage are torn up after the closing. Insisting that all loans be documented and that mortgages must be recorded will reduce fraudulent seller financing.

**Identity theft:** The closing agent relies on the borrower's driver license or other forms of identification to verify that persons who physically sign the deed, note, mortgage, and other documents have the authority to sell the home and borrow money. Buyers, sellers and closing agents must remember that a forged mortgage is void.<sup>14</sup> Use a "black light" to locate the reflective seal on a valid driver license card. If a person's identity is stolen, it is important that one of the parties files a police report. The police report also entitles the victim to obtain a copy of any fraudulent financial documents that used the victim's identity.<sup>15</sup>

**Straw buyer:** A real estate investor may ask a friend or relative, or a stranger, to be a straw buyer (usually for compensation). The real estate investor promises to make monthly loan payments, and to pay off the loan within a year or two. In some cases, a land speculator purchases a home at a low price, and conspires with a straw buyer to sell a home for an excessive price. The net proceeds

are used to make monthly payments on the loan and/or the parties split the net sale proceeds and disappear. Besides the criminal liabilities mentioned above for making a false loan application, the straw buyer's credit rating is ruined when the real estate investor stops making loan payments.

**Inflated appraisal:** The homeowner, seller, or mortgage broker may have an illegal arrangement with an appraiser to inflate the true value of the property, or provide improper comparable sales information to the appraiser so that a loan will be approved for an amount that exceeds the home's market value.<sup>16</sup> Excessive valuations may be justified using fake pictures of the subject property or property values from other fraudulent transactions. Appraisers should thoroughly inspect the subject property and use comparable property data that they independently verify. Federally chartered lenders must review the appraisal if it is provided by another mortgage lender or by a mortgage broker.<sup>17</sup>

**Money laundering:** It is very easy to prepare and record a forged deed. To launder money, a straw buyer uses illegally obtained funds to buy the home. The title agency unknowingly takes the illegally obtained funds, and issues its own check to the fake seller with good funds. The object of exchanging tainted funds for good funds is to hide the trail of money from its illegal source. The property may be subject to a forfeiture action if the source of the purchase money is discovered.<sup>18</sup>

**Foreclosure rescue:** Avoid offers to "help" a homeowner in a difficult financial situation.<sup>19</sup> The purpose of "saving" a borrower that nobody else considers a fair credit risk is often to "strip" the homeowner's equity. A homeowner who is facing loss of a home through foreclosure may deed the home to a rescuer, who promises to sell it back at a higher price in a year or two through a land contract or lease with an option to purchase. The rescuer or a straw party (described above) obtains

a conventional loan to buy the home. The rescuer may even convince the homeowner to sign over the proceeds of the sale of the home with a promise to pay off other debts owed by the homeowner. The rescuer knows that the homeowner has no means of obtaining a new loan to buy the home back at its inflated price. The investor does not provide any disclosures required by law for these transactions. Courts have held that a deed given as security, and not as a true sale, must be treated as an equitable mortgage. The difference between the amount paid by the rescuer to buy the loan and the price demanded to repurchase the home is interest, subject to state usury laws. Furthermore, these transactions are subject to federal Truth-in-Lending Act disclosure requirements.<sup>20</sup> The homeowner may be able to rescind the transaction and seek the return of the home.

**Servicing transfers:** Federal law requires a lender to send a Notice of Transfer of Servicing to the borrower when mortgage payments must be sent to a different entity or address.<sup>21</sup> Since the content of this Notice is proscribed by federal regulations, a thief can send a convincing Notice of Transfer of Servicing to a borrower, instructing the borrower to send mortgage payments to the thief.

**Flipping:** Frequent sales of a property are not illegal. Higher sale prices may be justified when the property is rehabilitated. However, frequent sales at increasing prices between parties with a hidden relationship can make the property appear more valuable than it is. Sometimes the parties attempt to justify the price increase with cosmetic improvements that hide more serious problems. Flipping is often accomplished with the help of an improper appraisal, a false title commitment, or intentional misrepresentation of the condition of the property. The FBI website [highlights the case](#) of a collapsed Detroit home sold one day for \$25,000, and the next day for ten times that amount.<sup>22</sup>

**Occupancy fraud:** Mortgage lenders require higher down payments for second homes and investment properties than for a loan secured by a principal residence. To obtain better loan terms, borrowers will state that a second home or investment property is or will become their principal residence after the closing.

**Inflated Credit History** Borrowers with poor credit payment histories may purchase the right to become a “co-borrower” on good credit accounts (“tradelines”). Good tradelines dilute the impact of the borrower’s poor tradelines, and raise the borrower’s credit score. This scheme is not illegal (yet). Companies that produce credit scoring software are trying to identify these borrowers, to eliminate the impact of the purchased tradelines.

**Misleading Disclosures** Federal rules require disclosure of a good faith estimate of closing costs within three days after the mortgage broker or lender receives an application for a residential mortgage loan.<sup>23</sup> Borrowers also receive an estimate of the annual percentage rate and monthly payments within three days after providing a purchase money loan application to a lender.<sup>24</sup> However, there is no requirement that this information must be redisclosed if the actual closing costs are different.<sup>25</sup> Some brokers will arrange a subprime loan for the borrower, even though the borrower would qualify for a conventional conforming loan.<sup>26</sup> This does not violate federal law, and the borrower has nobody to blame but himself if he accepts a loan that is not advantageous.<sup>27</sup> However, engaging in fraud, deceit or material misrepresentation is illegal.<sup>28</sup> Providing an estimate of costs to originate a “prime” loan, knowing that the borrower will only qualify for a “subprime” loan with higher origination fees misrepresents closing costs and the cost of credit. A lender or broker violates state law if disclosures are provided for low cost credit, or low cost credit is promised, when such credit is not available to the applicants.<sup>29</sup>

**Required Use of Affiliates** A seller and his/her real estate broker cannot require the borrower to use a particular title agency for the lender's title policy if the buyer pays the insurance premium.<sup>30</sup> Hence, it is illegal for a real estate broker or for the seller to require a documentation fee solely if the buyer does not use the seller's preferred title agency. It is also illegal to require a borrower to use the services of an affiliated settlement service provider if the borrower will pay for the services.<sup>31</sup>

**Illegal Kickbacks** It is illegal to directly or indirectly pay or receive something of value under an agreement or understanding that the payment is for the referral of settlement service business.<sup>32</sup> It is also illegal to split a fee for settlement services without doing any work to earn a portion of the fee.<sup>33</sup> Some mortgage brokers, lenders and title agencies find it more expedient to pay kickbacks "under the table" to assure business referrals than to generate business based on the merit of their services. These kickbacks, in theory, increase the cost of credit.<sup>34</sup>

**Failing to Disburse** Some lenders wait until after the loan has closed to finish underwriting a loan. If the borrower fails to meet underwriting requirements, or the loan cannot be sold at a profit, the lender refuses to fund the loan. State law requires that a lender satisfy its lending commitments.<sup>35</sup>

**Selling Fake Loans** Some unscrupulous lenders create documents for loans that do not exist, and sell the loans to raise capital or hide losses. A lender may also sell a loan more than once to hide losses at the company, or to satisfy credit obligations. The proceeds of the sale may be used to make monthly payments on behalf of a non-existent borrower. Perpetrators of these schemes typically receive stiff prison sentences.<sup>36</sup>

**Closing Agent Defalcation** Licensed title insurance agencies are required to keep transaction funds in a trust account. There is no requirement that a notary closing service (a “signing service”) maintain trust accounts. Employees may steal these funds, resulting in the failure of the closing agent to pay transaction proceeds.

**Mortgage Elimination** Some borrowers send an “International Commercial Claim in Admiralty Administrative Remedy” to their lender, and file a frivolous lawsuit<sup>37</sup> to discharge their mortgage. This scheme evolved from the repudiated "Bonded Bill of Exchange" given to payoff mortgage loans.<sup>38</sup>

**What to do?** Mortgage fraud succeeds because consumers do not understand residential transactions. Consumer education will help prevent consumers from falling into these schemes:

- We can teach financial literacy to all consumers. Financial literacy training could be included in the mandatory public school curriculum. Financial literacy course materials (the [Money Smart program](#)) and teacher reference guides are freely available from the FDIC.
- The FBI and the Mortgage Bankers Association recommend that lenders post a sign<sup>39</sup> to warn borrowers that mortgage fraud is illegal.<sup>40</sup>
- Interthinx produced a video, [Fraud Scheme Investigation](#), to help consumers and industry employees recognize mortgage fraud.

We can implement safeguards to prevent mortgage fraud, and to guard against repeat offenders:

- The Mortgage Bankers Association is sponsoring a committee to draft uniform residential closing instructions. These instructions will require the closing agent to be a gatekeeper against mortgage fraud.
- Data mining techniques are used by many lenders to evaluate loan application characteristics against a pool of previously closed loans. These computer programs look for similar transactions that might reveal repeat fraud attempts.

We should prosecute individuals who break the law. The [Conference of State Bank Supervisors](#) and the American Association of American Association of Residential Mortgage Regulators recently proposed a [uniform mortgage company and mortgage company employee licensing program](#) to make licensing in multiple states easier and less costly, and to allow states to share information about bad actors within the mortgage industry.<sup>41</sup>

Finally, we should draft consumer disclosures that are understandable and meaningful. The Federal Trade Commission released a Bureau of Economics [report](#) finding that mandatory mortgage disclosures fail to convey key mortgage costs and terms. Our legislatures must simplify disclosure laws. Disclosures should highlight information that really matters to the average home buyer. Some legislatures are proposing to prohibit unsafe or unsound lending practices, and practices that mislead consumers.<sup>42</sup> Better disclosures, and safer lending practices, may help consumers avoid inappropriate real estate and loan transactions.

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<http://www.lipsonneilson.com/news.html>.

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<sup>1</sup> Information posted by the FBI on its [website](#) citing MBA sources.

<sup>2</sup> The FBI's mortgage fraud case load more than doubled in the last five years. Half of these cases involve losses over one million dollar each. See the [Mortgage Fraud](#) section of the FBI's [2006 Financial Crimes Report to the Public](#) .

<sup>3</sup> Loan products are divided into “prime” and “subprime” categories, depending on credit underwriting characteristics. Prime loans are qualified for sale to the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Government National Mortgage Association (Ginnie Mae) (these federal corporations are referred to as “Government Sponsored Enterprises” or “GSEs”).

<sup>4</sup> Lenders that originate and fund loans operate in the “primary” mortgage market. This market is divided into retail originators (lenders that employ loan officers to solicit consumers for loans), and wholesale originators (lenders that employ “account executives” that call on mortgage brokers that solicit loans funded by the lender). Primary lenders are funded by warehouse lines of credit that permit the lender to hold the loan for up to 90 days. The investors that buy these loans operate in the “secondary” mortgage market. Secondary market lenders package the loans into pools and issue mortgage backed securities. Secondary market lenders include the GSE's, as well as banks and investment bankers that are able to raise funds from the Federal Reserve Board, the Federal Home Loan Bank, corporate bonds, hedge funds, etc., and issue their own mortgage backed securities.

<sup>5</sup> The mortgage investor typically reviews closed loan files when a pool of loans is purchased, but minimal post closing due diligence is performed when loans are purchased one at a time. Investors rely on repurchase and

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indemnification clauses in the contract with the lender or mortgage broker to protect the investor against mortgage fraud. Recent market conditions show that the typical originating lender or mortgage broker is thinly capitalized and minimally insured and, therefore, rights to demand repurchase of a loan and indemnification by the originating lender or mortgage broker may not protect the investor from fraud losses. Mortgage loan purchasers employ fraud detection services that utilize data mining software to identify potentially fraudulent transactions.

<sup>6</sup> The [FBI's 2006 Mortgage Fraud Report](#) lists Michigan as one of the top ten states for mortgage fraud. Many of the publicized cases of mortgage fraud are detailed at the [Mortgage Fraud Blog website](#).

<sup>7</sup> The Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association by the Mortgage Asset Research Institute, Inc. (MARI) dated April 2006 states:

“One of MARI’s customers recently reviewed a sample of 100 stated income loans upon which they had IRS Forms 4506. When the stated incomes were compared to the IRS figures, the resulting differences were dramatic. Ninety percent of the stated incomes were exaggerated by 5% or more. More disturbingly, almost 60% of the stated amounts were exaggerated by more than 50%. These results suggest that the stated income loan deserves the nickname used by many in the industry, the “liar’s loan.””

The report is found at <http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf> . Extreme fraud cases are referred to as “NINJA loans” – No Income, No Job or Assets.

<sup>8</sup> [MCL 750.219](#). Providing false information on an application for a closed end loan secured by a principal residence also exposes the borrower (or any other person) to civil penalties. [MCL 445.1634](#); [MCL 445.1640](#). In addition, the Federal False Claims Act applies when the loan application is provided to a depository institution, the loan is insured or guaranteed by a federal agency, or the loan is assisted with federal funds. [18 USC §1014](#).

<sup>9</sup> [MCL 750.219e](#). See also [MCL 445.1634](#); [MCL 445.1640](#).

<sup>10</sup> Using a fake social security card for identification is a crime. [18 USC §1028](#). Using someone else’s social security card is also a crime. [18 USC §1028A](#). See also [42 USC §408\(a\)\(7\)](#).

<sup>11</sup> A [story in the Washington Post](#) discusses businesses that sell the right to be a co-borrower on a current line of credit. [Hearsay.com reports](#) that NoveltyPayStubs.com was selling fake pay stubs with the ADP logo on them. [Fakecheckstub.com](#) still offers novelty pay stubs. [Click2Houston.com reports](#) of a raid on Mr. ID, Whiotv.com [reports](#) that police raided a fake ID business operating near the Butler County, Ohio jail. The Chicago Tribune [reports](#) that police raided a Chicago fake ID business making \$2 million a year. A [Washington grand jury indicted](#) a group of insiders at a mortgage company for ID theft.

<sup>12</sup> See, for example, the [Uniform Real Property Electronic Recording Act](#) . The Fair Credit Reporting Act (FCRA) requires loan servicers to report complete payment information, i.e. all loan payments.

<sup>13</sup> The maximum loan amount is typically a percentage of the smaller of the purchase price or the appraised value of a home. FHA insured loans and most conventional and subprime loans permit the buyer to obtain “down payment assistance” though a charitable organization or a limited amount of seller concessions for closing costs. FHA has experienced larger defaults and losses when borrowers utilize down payment assistance compared to loans that do not use this assistance. This may be attributable, in part, to inflated sales prices (and appraisals) to cover the seller’s “contribution” to the charitable organization that qualifies the buyer for a similar amount of “down payment assistance.” IRS threatened to terminate the charitable tax exemption of down payment assistance programs because the organization’s funds are only available to buyers designated by their donors. See HUD’s [partial list](#) of down payment assistance companies that lost their IRS charitable status designation. Congress is considering eliminating HUD’s authority to permit down payment assistance, or requiring risk based pricing of FHA mortgage insurance. In the meantime, HUD published a final rule eliminating down payment assistance programs for FHA loans that are funded by sellers. Buyers are still eligible to receive gifts from family members, government agencies, and charitable organizations that do not receive funds from the seller.

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<sup>14</sup> Under Michigan law, a forged signature on a mortgage renders it void and unenforceable. McGinn v Tobey, 62 Mich 252; 28 NW 818 (1886). See also Forge v Smith, 458 Mich 198, 206; 580 NW2d 876 (1998) (the absence of an owner's signature renders a conveyance void).

<sup>15</sup> The brochure, "Take Charge: Fighting Back Against Identity Theft," published by the FTC at <http://www.ftc.gov/bcp/online/pubs/credit/idtheft.htm> is a good source of information for consumers. The booklet is about 50 pages long.

<sup>16</sup> It is illegal to influence an appraiser to provide an appraisal for a predetermined amount in a closed end loan secured by a primary residence. [MCL 445.1634](#); [MCL 445.1640](#).

<sup>17</sup> See the [Interagency Guideline on Independent Appraisal And Evaluation Functions](#) (October 28, 2003), and [Frequently Asked Questions on Residential Tract Development Lending](#) (September 8, 2005).

<sup>18</sup> See, generally, 18 USC §§ [1956](#), [1957](#), [981](#) and [982](#).

<sup>19</sup> See the [Better Business Bureau warning](#).

<sup>20</sup> See Bryce v Jones, [394 Mich 425](#), 230 NW2d 272 (1975), *rev'ing* [54 Mich App 709](#), 221 NW2d 433 (1974) and Moore v Cycon Enters, No 1:04-CV-800, 2006 US Dist LEXIS 57452 (WD Mich Aug 16, 2006). See also "[Mortgage Fraud Mess](#)," ABA Journal, July 2007, pp. 50-56. Rescission under the Truth in Lending Act is only available if the homeowner tenders the net proceeds of the transaction back to the lender.

<sup>21</sup> See [24 CFR 3500.21\(d\)](#).

<sup>22</sup> See also the [May 17, 1999 story in Investment News](#) explaining an example of flipping between entities affiliated with MCA Mortgage Corporation.

<sup>23</sup> See Section 5(c) of the Real Estate Settlement Procedures Act (RESPA), [12 U.S.C. 2604\(c\)](#), and HUD's implementing regulations at [24 CFR 3500.7](#).

<sup>24</sup> See [12 C.F.R. 226.18](#) and 12 [C.F.R. 226.19\(a\)](#).

<sup>25</sup> Informal advice given to the Massachusetts Bankers Association by HUD published as Attachment A to FDIC Financial Institution Letter 45-2000 (July 12, 2000) at <http://www.fdic.gov/news/news/financial/2000/fil0045a.html>.

<sup>26</sup> Mortgage brokers have an incentive to steer consumers toward higher priced credit products. The primary mortgage market presumes that subprime loans are harder to originate than prime loans. Hence, lenders pay higher mortgage broker fees for subprime loans.

<sup>27</sup> In McCartney v. Lakeside Community Bank, Court of Appeals No. 272131 (3/27/07), an unpublished decision, the Court upheld summary judgment for the bank against the borrower's claim that the bank made a "predatory" loan to the borrower. Citing Isbell v Anderson Carriage Co, 170 Mich 304, 312; 136 NW 457 (1912), the Court stated that it "cannot relieve a party from the consequences of her contract simply because the agreement was ill advised."

<sup>28</sup> [MCL 445.1672\(b\)](#).

<sup>29</sup> Few mortgage brokers provide a written loan commitment to their applicants. Thus, the first time that the borrowers learn of the loan product and rate offered to them is at the closing table, when it is too late to find alternative financing to complete a purchase. The mortgage broker may have promised to find a low cost loan for the borrowers; however, the mortgage broker has no responsibility to provide a written loan commitment. The Mortgage Origination Agreement signed by most borrowers is based on the [model form published by the National Association of Mortgage Brokers](#). Most borrowers do not read this agreement and, therefore, they do not know that the mortgage broker is not a fiduciary and is not the borrower's agent. Furthermore, borrowers are not entitled to rely on the

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mortgage broker's oral representations. See [MCL 566.132\(2\)](#). Section 615(h) of the Federal Fair Credit Reporting Act, [15 U.S.C. § 1681m](#), will require lenders to notify borrowers if they are not receiving the best credit terms that the lender has to offer once the FTC drafts rules to implement this disclosure. Please also note that [12 CFR 226.16\(a\)](#) and [12 CFR 226.24\(a\)](#) permits a creditor to advertise "only those terms that actually are or will be arranged or offered by the creditor." Hence, a "bait and switch" scheme might violate the Truth-in-Lending Act.

<sup>30</sup> See Section 9 of RESPA, [12 U.S.C. 2608](#).

<sup>31</sup> See Section 8(c) of RESPA, [12 U.S.C. 2607\(c\)](#), and HUD's implementing regulations at [24 CFR 3500.15](#). Note, however, that a bundle of services offered at a discount from the aggregate price of the individual services does not require the borrower to use the services of any of the settlement service providers in the bundle. See the definition of "required use" in [24 CFR 3500.2](#).

<sup>32</sup> See Section 8(a) of RESPA, [12 U.S.C. 2607\(a\)](#), and HUD's implementing regulations at [24 CFR 3500.14](#). A rebate to the borrower for accepting a loan is not prohibited by RESPA. State laws prohibit rebates by insurance companies and agencies, [MCL 500.2066](#), [MCL 500.2070](#). Both the buyer and seller must consent to a closing that deviates from the terms of a written purchase agreement when a real estate broker gives a rebate to one party ([AACSR 339.22311\(3\)](#)) and the rebate should be disclosed on the HUD-1 Settlement Statement.

<sup>33</sup> See Section 8(b) of RESPA, [12 U.S.C. 2607\(b\)](#). HUD takes the position that marking up a fee is illegal. See Informal advice published as Attachment B to FDIC Financial Institution Letter 45-2000 (July 12, 2000) at <http://www.fdic.gov/news/news/financial/2000/fil0045b.html>. Courts of Appeals for Fourth, Seventh, and Eighth Circuits disagreed with HUD and held that a markup of a third party fee without an agreement with the third party is not illegal. See [Boulware v. Crossland Mortgage Corp.](#), 291 F.3d 261 (4th Cir. 2002); [Echevarria v. Chicago Title & Trust Company](#), 256 F.3d 623 (7th Cir. 2001); and [Haug v. Bank of America, N.A.](#), 317 F.3d 832 (8th Cir. 2003). The Second, Third, and Eleventh Circuits held that identifying a third party in agreement with the markup is not needed to find a violation of Section 8(b) of RESPA. See [Kruse v. Wells Fargo Home Mortgage, Inc.](#), 383 F.3d 49 (2d Cir. 2004); [Santiago v. GMAC Mortgage Group, Inc.](#), 417 F.3d 384 (3d Cir. 2005); and [Sosa v. Chase Manhattan Mortgage Corp.](#), 348 F.3d 979 (11th Cir. 2003).

<sup>34</sup> Someone has to pay for the kickback. Hence, the cost of a hidden referral fee is built into the cost of the service. However, some argue that kickbacks actually reduce costs, since referral fees cost less than the 20% or more of the service provider's gross revenue spent on marketing. Nevertheless, Congress made a value judgment when it enacted Section 8 of RESPA to prohibit kickbacks, and backed up the law with criminal penalties.

<sup>35</sup> Section 22(k) of the Michigan Mortgage Brokers, Lenders, and Servicers Licensing Act, [MCL 445.1672](#), provides that it is a violation of the statute to "fail to make a mortgage loan in accordance with a written commitment to make a mortgage loan issued to, and accepted by, a person when the person has timely and completely satisfied all the conditions of the commitment before the expiration of the commitment." Section 24(2)(h) of the Michigan Secondary Mortgage Loan Act, [MCL 493.74](#), contains a substantively identical provision. It is the position of the Michigan Office of Financial and Insurance Services (OFIS) that a lender is responsible to ensure that the proceeds of a loan are disbursed to the borrower. See OFIS Bulletin No. 2004-05-CF at [http://www.mich.gov/cis/0.1607.7-154-10555\\_12900\\_12919-99084--.00.html](http://www.mich.gov/cis/0.1607.7-154-10555_12900_12919-99084--.00.html). These statutes only apply to state chartered mortgage companies.

<sup>36</sup> MCA Mortgage collapsed in 1999 when it was discovered that MCA Mortgage Company committed the same mortgage loans as collateral for various loans and/or sold the same loans more than once. Several officers of MCA Mortgage were [sentenced to jail terms](#) for bank fraud.

<sup>37</sup> In [Hibben v. Countrywide Home Loans, Inc.](#), NO. 05-64265, (N.D. Ill Nov. 29, 2005), the court held an International Commercial Claim in Admiralty Administrative Remedy to be "legally frivolous, void, and a nullity...." See the [Debt Elimination Fraud Alert by the U.S. Comptroller of the Currency](#) for further descriptions of mortgage elimination schemes. See also the following decisions:

*U. S. Bank v. Phillips*, 366 Ill.App.3d 593, 852 N.E.2d 380 (2006); *Pierce v. Ocwen Loan Servicing* Not Reported in F.Supp.2d, 2006 WL 1994571 (M.D.N.C., 2006); *McElroy v. Chase Manhattan Mortgage Corp.*, 134 Cal.App.4th

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388, 36 Cal.Rptr.3d 176 (2005); *Frances Kenny Family Trust v. World Sav. Bank FSB*, not reported in F.Supp.2d, 2005 WL 106792 (N.D.Cal.,2005); *Thiel v. First Federal Sav. & Loan Ass'n*, 646 F.Supp. 592 (N.D.Ind.1986), *dismissed & aff'd. in part without opinion*, 828 F.2d 21 (7th Cir.1987); *Nixon v. Individual Head of St. Joseph Mortg. Co.*, 615 F.Supp. 898 (D.C.Ind.1985), *affirmed without opinion*, 792 F.2d 142 (7th Cir.1986).

<sup>38</sup> For example, in [Phillips v. US Bank](#), the Court threw out a lawsuit against New Century Mortgage Corp. for failing to honor the borrower's fabricated security (payable by the US Treasury). The Court held that the borrower could not make up his own security, and also found that the security was not a valid payment since it was not a "negotiable instrument" as required by the loan documents.

<sup>39</sup> The Mortgage Bankers Association (MBA) and the FBI promote the use of a [mortgage fraud poster](#) by members of the MBA.

<sup>40</sup> The Uniform Residential Loan Application ([FNMA Form 1003](#)) used by all mortgage brokers and mortgage lenders includes the following required acknowledgment on page 4 of the form:

“Each of the undersigned specifically represents to Lender and to Lender's actual or potential agents, brokers, processors, attorneys, insurers, servicers, successors and assigns and agrees and acknowledges that: (1) the information provided in this application is true and correct as of the date set forth opposite my signature and that any intentional or negligent misrepresentation of this information contained in this application may result in civil liability, including monetary damages, to any person who may suffer any loss due to reliance upon any misrepresentation that I have made on this application, and/or in criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Sec. 1001, et seq.; (2)...”

The following acknowledgement is found on the Continuation Page (page 5) of the same form:

“I/We fully understand that it is a Federal crime punishable by fine or imprisonment, or both, to knowingly make any false statements concerning any of the above facts as applicable under the provisions of Title 18, United States Code, Section 1001, et seq.”

The deterrent effect of these warnings and the posters suggested by the MBA is unproven.

<sup>41</sup> See the Conference of State Bank supervisors [FAQ](#) for more information about this proposal.

<sup>42</sup> See, for example, the proposed [Fair Mortgage Practices Act \(H.R. 3012\)](#). Recent proposed and enacted legislation is collected and reviewed by [Butera & Andrews](#).