



# ROUNDING UP REPURCHASES

These days you need to enlist third party verification tools to avoid mortgage repurchases.

Mortgage repurchases have significantly increased since 2007 and continue to make their way into national headlines. Bank of America is currently in negotiations with investors to repurchase \$16.5 billion in bonds, and has agreed to pay nearly \$3 billion to Fannie Mae and Freddie Mac to resolve outstanding repurchase requests on loans from Countrywide Financial Corp, according to The Wall Street Journal.

**By Jay Meadows**

Although repurchases have always been a fact of life in the mortgage industry, the industry is now seeing substantial increases due to the loose standards that dominated the subprime era. According to research of the Top Five Lenders conducted by Equifax, each repurchase, on average, costs lenders around \$50,000. This is a serious issue for the housing industry and our economy at large.

Prior to 2007, borrowers could state their income on a loan application if they were employed. In some instances, if the borrower had a high enough credit score, they weren't even required to include an income on the loan application. That era ended in 2008, but the industry is still dealing with the millions of under-documented loans made between 2004-2007 – not coincidentally, a period in which loan originations hit record numbers.

Repurchases that are currently coming back to lenders are the very “no-doc,” “low-doc” and “stated-doc” loans of the

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2004-2007 era. Unfortunately, there is nothing that can be done about those loans retroactively, but there is something the industry can do about loans being made today. Mitigating risk with third-party verification providers on all elements of the loan is crucial to avoiding future repurchases. If lenders can prove that they did everything possible to verify the loan information and ensure the borrower's ability to repay, investors will have a much more difficult time forcing them into repayments later.

According to Fannie Mae's 2009-2010 loan review, income and employment misrepresentation on both performing and non-performing loans were among the top three factors leading to repurchase requests. Lenders cannot afford to ignore the issue of continued fraudulent activ-

ity leading to repurchases, and now must require proof that due diligence was performed in the underwriting process.

**How Did This Happen?**

Not so long ago, Fannie Mae and Freddie Mac purchased a host of “low-doc” or “no-doc” loans from Wall Street that unfortunately, contained loan documentation that has proven to be untruthful. When Congress finally addresses these two bankrupt behemoths, it will be hard to ignore this issue and put the responsibility of dealing with the losses onto American taxpayers. The large Wall Street institutions, which sold the majority of these fraudulent loans to Fannie and Freddie, are more likely to ultimately be held responsible.

This occurrence was not just a result of the greed of Wall Street, but also the greed of rating agencies, mortgage brokers, bankers and underwriters. Now, the industry must stop writing bad loans and focus on quality —not quantity—by en-

listing verification tools that boost confidence levels for lenders and investors.

**Mitigating Risk**

The Financial Crimes Enforcement Network (FinCEN) reported in December that suspicious activity reports (SARs) indicating mortgage loan fraud increased seven percent in the first half of 2010. As long as there is money moving, fraud is likely to continue, along with repurchases.

To justify a repurchase letter, lenders must show they are doing everything possible to mitigate risk. Areas that have historically been susceptible to fraud include collateral, identity, income and employment; however, the industry is now starting to see even more creative fraudulent methods such as borrowers claiming lower levels of income to ap-

ply for certain programs.

Lenders must demand accurate data upon which to base sound and quality lending decisions. Removing automated valuations or full appraisals from the hands of people who might commit fraud or make a mistake is how the industry will increase consumer and investor confidence. Looking more closely at the need to verify collateral, identity, income and employment improves the overall lending process.

Collateral is a critical component. Lenders must check stated collateral from the selling entity or appraisal through Automated Valuation Models (AVMs). AVMs, however, tend to work best in a market that is selling because the lender has more properties from which to base their estimate. Cascading AVMs deliver a better value and estimate for the lender. In addition, there are tools available that identify foreclosures and short sales, enabling lenders to remove them from the model and assign a more accurate value.

Identity: Perhaps more than any other area, identity has become a fraudster's favorite target. According to Equifax' findings, more than five percent of loan applicants are not who they say they are. While some do not see this as an important issue, or even consider falsifying identity on a loan application a crime, it is absolutely crippling to a lender's portfolio.

The Colorado Supreme Court threw out a conviction in November 2010 against a man who used a stolen Social Security Number to get a loan. The court found that because the man used his own address, name, birth date and other identifying information, the use of the stolen Social Security number did not constitute false identity.

Additionally, according to the Federal Trade Commission (FTC), they receive approximately 3,000 calls each week regarding identity theft. Lenders simply must take identity theft more seriously. There is clearly not much in the way of repercussions to steer fraudsters away from such crimes, so lenders must work to ensure it does not impact lending and result

in costly repurchases down the road.

Income is critical to reducing fraud and must be based on two factors: current income from W-2 forms and historical income. As witnessed by the housing collapse, lenders can no longer base a decision on a single piece of information.

Moving forward, loans will be based on multiple pieces of information to ensure that a more complete picture of a borrower can be formed and that the information is consistent over time. For example, did a borrower make \$250,000 this year but \$50,000 the previous three years, simply because this year was a good year?

4506-T tax transcripts have been mandated in the housing bill and are being strongly considered by Fannie Mae and Freddie Mac. As Congress continues to look at the bailout and how much taxpayers are paying, the focus will remain on income verification.

Employment is one of the biggest fraud vehicles, according to the FBI. Lenders must prove they have a system in place that can combat this type of fraud, and enlisting instant and researched verification tools can help.

Researched verification is necessary to verify borrowers' information on 1003 forms, including employment. Lenders can no longer afford to take the borrower's word at face value. Lenders must check the address of the employer, if the phone numbers match and other information to verify employment.

Verbal verification of employment is one of the most passed over elements in the lending process today. Typically a very faulty system, it is done by an insider, which can often lead to errors.

New Variations of Fraud: We have always seen instances of borrowers claiming inflated levels of income and collateral, but now we are actually seeing the pendulum swing in the opposite direction. This includes borrowers applying for new mortgages prior to executing strategic defaults on existing ones; borrowers applying for loans immediately following some negative change in employment or

income; and some borrowers are actually fabricating lower levels of income in order to qualify for government loan modification programs.

**Mortgage Fraud**

According to the FBI, 80% of all mortgage fraud involves an insider who is intimately acquainted with the mortgage transaction – either by submission or omission. Too often, lenders are relying on internal processes and personnel to self-police fraud, which often creates a natural conflict of interest because the originating company has a vested interest in seeing loans closed. After all, insiders are ultimately in business to complete loans.

Additionally, there is little, if any, accountability for the person that processes the loan, regardless of whether it is a repurchase or not. If the loan is repurchased, the person that originated the loan is rarely considered as being potentially guilty of fraud.

According to a November/December 2010 survey by Aite Group, more than half of financial services firms surveyed attribute at least 5% of their total fraud losses to internal fraud, costing the industry hundreds of millions of dollars. But what's surprising is that these institutions rarely prosecute the fraudsters. In fact, 35% of survey respondents prosecute 10% or less.

**What the Future Holds**

Investors are going to get more aggressive as we move forward, making it increasingly important to prove that at the time the loan was made, the borrower had both the capacity and ability to repay the loan. In fact, Fannie Mae and Freddie Mac have

reportedly started kicking back loans that performed for two to three years, which is not going to sit well with the lenders receiving the repurchase requests.

The entire lending system is based on risk, however. At some point, the investor cannot be upset that their oil well is dry. Loans are risk-based investments, and life events are the risks they are assuming. Lenders fully understand that they are going to lose money when someone passes away or gets divorced.

If an investor has a loan that was truthfully made and three years later the borrower tragically dies, that risk should have been considered. The loan was fairly made and should not be repurchased. However, for a loan made without verifying information and it was not proven at that time the borrower could repay it, that loan should be bought back.

Since investors are buying packages of loans rather than individually, there is a lot of fault to be shared. Why, for example, would Standard & Poor's give a good rating on a pool of loans more bad than good? The pool was purchased under a false sense of security as a result.

The only way to prevent this in the future is to verify information and focus on the quality of loans. Today, lenders are turning down loans and are more serious about verifications and reducing risk in their portfolios, which is a good thing.

Despite stricter lending requirements, mortgage fraud continues to grow and is still a lucrative business for criminals. In order to preserve the stability of a fragile market, lenders must become even more aggressive in preventing fraud, and data verification is the key to that prevention. ♦

**About The Author**

Jay Meadows is senior vice president of Mortgage Services, The Work Number, a service of Equifax. Meadows is responsible for selling and servicing The Work Number's verifier solutions to mortgage originators. Meadows previously founded Ft. Worth, Texas-based Rapid Reporting Verification Company, which was acquired by St. Louis-based The Work Number, a service of Equifax, in 2010. Prior to founding Rapid Reporting, Meadows was a successful broker in the securities industry for 11 years.

