White Paper

The LexisNexis® 16th Annual Mortgage Fraud Report

December 2014

LexisNexis®

Risk Solutions
Financial Services

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Executive Summary

As the mortgage industry looks forward to 2015, the housing market is slowly showing signs of increased housing contract activity. Unfortunately, along with this increased economic activity in the mortgage industry comes increased opportunity for fraud and misconduct.

This is the LexisNexis® 16th Annual Mortgage Fraud Report, formerly known as the Mortgage Asset Research Institute Fraud Report. These annual reports, different from other studies of mortgage fraud, examine the current composition of proven residential mortgage fraud and misrepresentation involving industry professionals in the United States. This year's analysis also includes state specific statistics that reveal patterns of potential mortgage industry collusion. This report, used by industry professionals to gain insight and focus resources, began annually analyzing and sharing fraud findings in 1998.

The report yields surprising results this year. Despite relatively stable market conditions and continued low mortgage rates, strict credit conditions and requirements still exist for homebuyers. In September 2014, approximately 15 percent of realtors reported having customers that failed to close a pending sale due to the inability to qualify for financing. It is not difficult to recognize the connection between tight credit approval guidelines, industry professionals looking to make a profit, and mortgage application fraud, the most common type of reported mortgage fraud by far in 2013.

In addition to covering the composition of fraud, the report also ranks the states that have the most serious reported mortgage fraud problem based on industry-contributed mortgage fraud investigations. Topping the list in 2013 is Florida, a position that it has held for the past five years. New in the state rankings is Utah, which jumped 14 spots to rank seventh this year.

To investigate mortgage collusion on a grander scale, LexisNexis created the LexisNexis® Collusion Indicator Index (CII), which reflects potential collusion activity within a state. The most noticeable new state with a high percentage of potential non-arm's length transaction activity is California. Prior to 2013, California has not previously been in our rankings of the top ten states for potential collusion activity. In 2013, California is ranked ninth in the listing of properties transferred with a 20 - 95 percent loss and sixth in the listing of properties transferred with a 50 - 95 percent loss.

The report also shares good news, indicating that the industry has made progress in tackling certain types of fraud. For example, appraisal and property valuation fraud hit a five-year low with only 15 percent (compared to 26 percent last year) of reported loans being compromised by this activity in 2013. According to Tim Coyle, LexisNexis® Risk Solutions Senior Director of Financial Services and co-author of the Annual Mortgage Fraud Report, recent regulation has had a significant impact

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on progress to mitigate the mortgage industry of appraisal and property valuation fraud. "When the Home Valuation Code of Conduct (HVCC) went into effect in 2009, lenders could no longer work directly with appraisers," said Coyle. "This landmark regulation, which disrupted the historical appraisal process, has everything to do with the drop in this year's appraisal fraud. Although no longer in force, HVCC influenced the Appraiser Independence Requirements now found in The Dodd-Frank Wall Street Reform and Consumer Protection Act."

The LexisNexis examination of 2013 data identified that:

- Florida's LexisNexis® Mortgage Fraud Index (MFI) ranked first in the nation for loans investigated in 2013. The MFI is an indication of the amount of mortgage-related fraud and misrepresentation involving industry professionals found through LexisNexis® Mortgage Industry Data Exchange (MIDEX®) subscriber fraud investigations in various geographical areas within any particular year. Florida's reported MFI of 529 is more than five times the expected rate of fraud for the state, based on its origination volume.
- 2013 is the only year Utah has been in the top 10 during this five-year study. In 2009, 2010, 2011, and 2012 the Utah MFI was below 100.
- 209 is New Jersey's highest MFI during this five-year period. It is more than double the state's 2011 MFI of 86. Illinois and New York also saw higher MFIs in 2013 than in previous years.
- Properties in five Metropolitan Statistical Areas (MSAs)—Miami, Chicago, New York, Phoenix, and Orlando—make up a combined total 37.3 percent of all the loans investigated in 2013.
- Application fraud and misrepresentation has been climbing steadily over the past three years. Seventy-four percent of loans reported in 2013 involved some kind of fraud or misrepresentation on the loan application. In 2012, that number was 69 percent; and in 2011, 61 percent.
- The most notable increase for loans investigated in 2013 is for fraud and misrepresentation on credit documentation. This type of fraud, involving misrepresentation on the credit report or with credit history or references, increased to 17 percent in 2013 from five percent in 2012.
- Reported fraud on appraisals and property valuations was at a five-year low in 2013. Only 15 percent of loans reported in 2013 included these issues, compared to 26 percent in 2012, 31 percent in 2011, 33 percent in 2010, and 31 percent in 2009.
- Alabama, Louisiana, Pennsylvania, New York, New Jersey, Kentucky, and California rank in the top 10 for both CII lists.
- The most noticeable new state with a high percentage of potential non-arm's length transaction activity is California. Prior to 2013, California has not previously been in the top 10. California is ranked ninth in the

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listing of properties transferred with a 20 - 95 percent loss (CII of 141) and sixth in the listing of properties transferred with a 50 - 95 percent loss (CII of 184).

- Four states experienced CII decreases in both category lists: Pennsylvania, New York, New Jersey, and Kentucky. While remaining in the 2013 top 10, their CIIs all fell below 200.

The body of this report presents the data and analysis supporting the findings cited above. The information contained in this report is meant to provide insights into current mortgage industry activities.

The Mortgage Fraud Report Data and Information Sources

For over two decades, major mortgage lenders, agencies, and insurers have been submitting information describing incidents of subscriber-verified fraud and material misrepresentation involving industry professionals to an industry-contributed database known as MIDEX®. MIDEX's purpose is to share adverse experiences involving professionals operating within the mortgage industry.

Contributing subscribers use information services derived from the MIDEX database as a risk management tool to protect against mortgage fraud perpetrated by industry professionals. MIDEX enables subscribers to perform due diligence checks on mortgage professionals and companies as part of their business relationship credentialing processes. LexisNexis utilizes MIDEX submissions to develop representative statistics on a wide range of mortgage fraud and misrepresentation characteristics. Findings from this analysis are presented in Annual Mortgage Fraud Reports to provide key insight into mortgage fraud trends, as reported by the industry.

In addition to MIDEX incident data, the report utilizes Home Mortgage Disclosure Act (HMDA) data sourced by the Mortgage Bankers Association (MBA), a key component used for calculating a state's MFI value. Please refer to Appendix II for information on the MFI and its computation.

According to incident data from MIDEX submissions, over recent years there has been an increase in reported incidents of potential collusion involving multiple professionals. For this reason, we looked into LexisNexis public record data involving property transfers (among other data points) to investigate this potential collusion activity on a larger scale. Using proprietary algorithms, LexisNexis public record data has been used to calculate CII values, which reflect potential collusion activity within a state. Please refer to Appendix III for information on the CII and its computation.

The majority of MIDEX incidents involve Fraud for Profit, meaning fraud or misrepresentation involving industry professionals. Among these instances of Fraud for Profit, there is often a marked time lapse between

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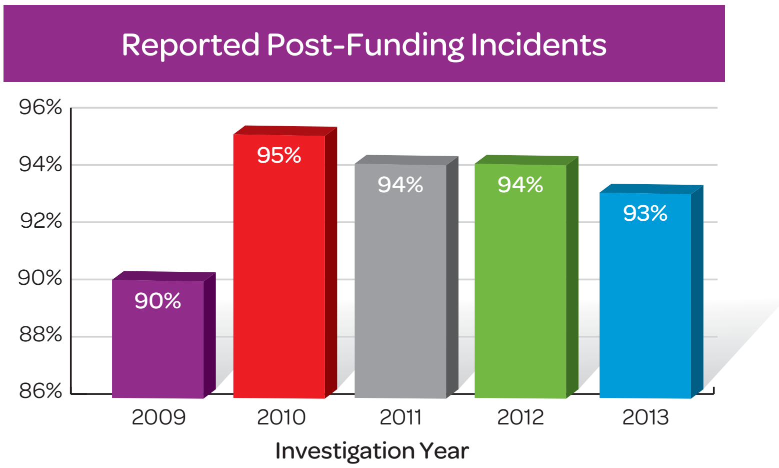
loan origination and submission of a post investigation report to MIDEX. As more loans are either investigated with mortgage fraud and/or misrepresentation that occurs later in the loan process or investigated once loans go into default, this reporting time lapse is not expected to shorten.

Figure 1



As is clear from the chart above, a majority of loans investigated and submitted to LexisNexis are for loans originated during years prior to their investigation. For the past five years, over 90 percent of loans have fallen into this category. In 2013, 93 percent of reported loans were for loans originated prior to 2013.

Geographic Distribution of Mortgage Fraud

Table 1 and Figure 2 on the next page present the states with the highest mortgage fraud indices based on incident reports submitted to LexisNexis. The first three columns of Table 1 show the rankings of states with the most serious mortgage fraud problems in loans investigated during 2013. These loans could have been originated in any year. The remaining columns of the table show the rankings and a numerical measure for the same 10 states in preceding years, back to 2009.

The numerical measure of each state's fraud problem is represented by the MFI. An MFI of 0 would indicate no reported fraud to MIDEX for a state. An MFI of 100 would indicate that the reported fraud for a state is level with expectations specific to fraud rates, given the number of loan originations for that state. That is, a state that has five percent of the incident reports submitted to MIDEX for 2013 and also has five percent of the country's loan originations in the same year would have an MFI of 100. Appendix II at the end of this report explains in detail how the MFI is calculated.

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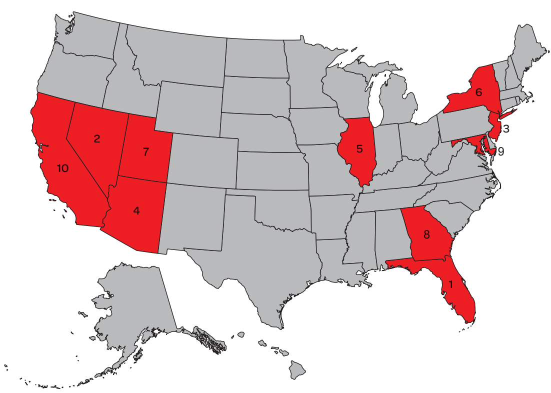
Based on incident reports submitted to LexisNexis, Florida's MFI ranked first in the nation for loans investigated in 2013. As is clear in the table below, Florida's reported fraud rate, 529, is over five times the expected rate of fraud for the state, based on its origination volume. It is over five times that of California for investigated loans.

Table 1

Mortgage Fraud Index (MFI) By State (2009-2013 All Forensic Investigations)										
State	2013		2012		2011		2010		2009	
	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	529	1	698	1	705	1	711	1	717
Nevada	2	221	2	232	2	294	2	247	3	220
New Jersey	3	209	6	130	9	86	13	70	13	71
Arizona	4	201	5	144	3	214	3	244	4	196
Illinois	5	180	4	156	8	103	7	118	10	116
New York	6	151	7	114	11	80	15	63	8	121
Utah	7	149	21	44	12	78	11	73	36	27
Georgia	8	110	8	108	6	132	4	196	5	149
Maryland	9	110	12	84	13	76	9	84	11	103
California	10	95	9	106	7	119	6	124	6	130

Figure 2
2013 Investigations – Top 10 States



It should be noted that the 2009 through 2013 MFI values for all states listed in Table 1 differ somewhat from those shown in the same tables of last year's Annual Mortgage Fraud Report. This is due to the fact that this year's tables are based on an additional year of submissions, some of which were reported on loans investigated and originated in years 2009 through 2013.

Further analysis of Table 1 and the map in Figure 2 demonstrate that:

- Florida's 2013 MFI, though the highest of all states, has fallen to 529 from a high 717 in 2009.
- 2013 is the only year Utah has been in the top 10 during this five-year study. In 2009, 2010, 2011, and 2012 its MFI was below 100.
- 209 is New Jersey's highest MFI during this five-year period. It is more than double the state's 2011 MFI, 86. Illinois and New York also saw higher MFIs in 2013 than in previous years.
- Though ranked in the top 10, California has a 2013 MFI of 95, which means that it has a slightly lower reported fraud rate than what would be expected based on its number of loan originations.

Closer analysis of the loan origination locations appearing most commonly on MIDEX reports for loans reported in 2013 yields five MSAs that contain the largest percentages of reported fraud and misrepresentation.

Table 2

Top National MSAs	Percentage of All MIDEX Reports Received
Miami-Fort Lauderdale-Pompano Beach, FL	12.3%
Chicago-Joliet-Naperville, IL-IN-WI	8.1%
New York-Northern New Jersey-Long Island, NY-NJ-PA	7.7%
Phoenix-Mesa-Glendale, AZ	4.8%
Orlando-Kissimmee-Sanford, FL	4.4%

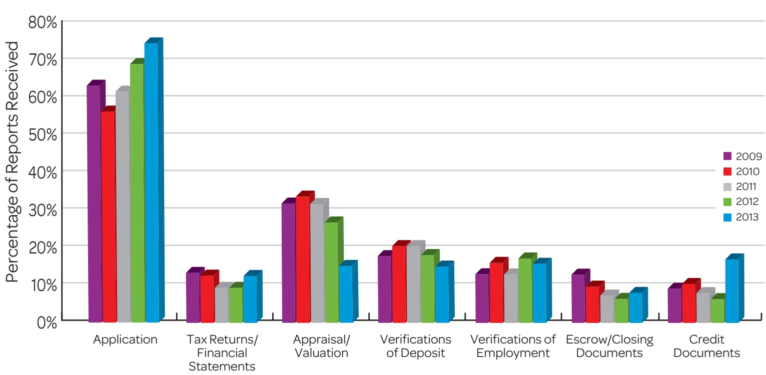
Properties in five MSAs make up a combined total 37.3 percent of all the loans investigated in 2013. Two MSAs in Florida—Miami-Fort Lauderdale-Pompano Beach and Orlando-Kissimmee-Sanford—rank in the top five in the nation with 12.3 percent and 4.4 percent, respectively. MSAs in the Chicago and New York areas rank a close second and third. The Phoenix-Mesa-Glendale, Arizona MSA is new to the top list with 4.4 percent of all properties reported in 2013.

Types of Fraud Reported

The MIDEX system classifies the types of subscriber verified fraud and misrepresentation involved in each incident reported by its subscribers. These classifications are shown in Figure 3 for loans reported during the five-year period from 2009 through 2013. These numbers will change from year to year, as fraud perpetrated in each of these years will continue to surface and be reported for another three years or more.

Figure 3

Mortgage Fraud and Misrepresentation Types (All States)



In a five-year fraud assessment, Figure 3 shows each type of fraud and misrepresentation as a percentage of all incidents submitted to the MIDEX database. Note that the total percentage for each year exceeds 100 percent because most reported incidents involve more than one type of fraud or misrepresentation.

Application fraud and misrepresentation has been climbing steadily over the past three years. Seventy-four percent of loans reported in 2013 involved some kind of fraud or misrepresentation on the loan application. In 2012, that number was 69 percent; and in 2011, 61 percent. The application form is comprehensive in collecting borrower personal identity, employment, asset, and liability information (all of which present verification challenges). Application fraud and misrepresentation includes, but is not limited to, the following categories on the loan application: incorrect name(s) used for the borrower(s); occupancy, income, employment, debt and asset misrepresentation; different signature(s) for the same name(s); invalid Social Security number(s); misrepresented citizen/alien status; incorrect address(es) or address history; and incorrect transaction type.

Other trends include:

- The most notable increase for loans investigated in 2013 is for fraud and misrepresentation on credit documentation. This type of fraud, involving misrepresentation on the credit report or with credit history or references, increased to 17 percent in 2013 from five percent in 2012.
- Reported fraud on the appraisal and with property valuation was at a five-year low in 2013. Only 15 percent of loans reported in 2013 included these issues, compared to 26 percent in 2012, 31 percent in 2011, 33 percent in 2010, and 31 percent in 2009.
- Twelve percent of loans reported in 2013 included tax return or financial statement fraud.
- Verification of deposit and verification of employment fraud and misrepresentation decreased to 15 percent each in 2013.

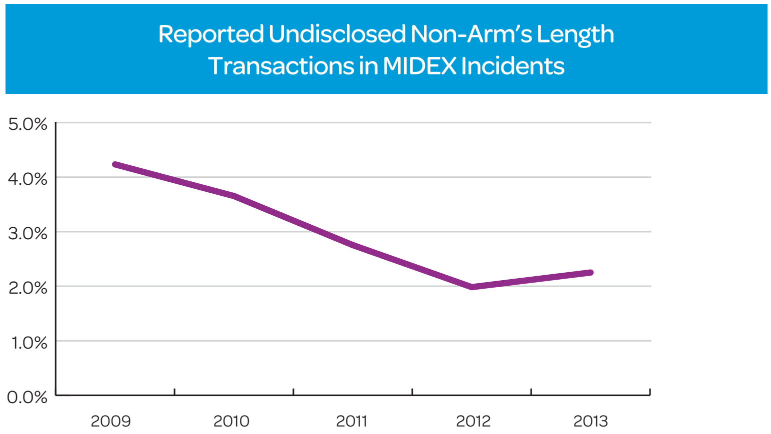
Of the seven fraud categories measured, four of them saw increases over last year and three of them reached five-year high levels.

Geographic Distribution of Potential Collusion Fraud

In recent years, LexisNexis has produced an analysis of potential collusion activity. Our analysis of this activity is two-fold. First, using incidents reported to MIDEX (Figure 4), we are able to distinguish the percentage of loans reported in 2013 with verified undisclosed non-arm's length transactions. In Figure 4 and the discussion of subscriber-reported collusion in MIDEX incidents, "collusion" refers to incidents of subscriber-verified undisclosed non-arm's length transactions.

The most notable increase for loans investigated in 2013 is for fraud and misrepresentation on credit documentation. This type of fraud, involving misrepresentation on the credit report or with credit history or references, increased to 17 percent in 2013 from five percent in 2012.

Figure 4



In 2013, 2.2 percent of all loans investigated and submitted to MIDEX included at least one verified undisclosed non-arm's length transaction. This is a slight increase from 2 percent of loans in 2012 and a decrease from those reported in the three previous years.

The CII was created to help the mortgage industry better understand and pinpoint areas of potential collusion amongst buyers and sellers, saving them time and resources in investigations to detect and prevent mortgage fraud. The CII is a ranking of states based on factors indicative of potential collusion activity. Whereas the MIDEX data discussed above includes reported collusion activity perpetrated by mortgage industry professionals, data used in the CII highlights potential collusion activity by individuals without regard to profession. This data is an analysis of deed transfers where it has been determined that there is a potential relationship between the borrower and the seller—particularly, when a property has been transferred at a loss between relatives and known associates. These relationships are indicative of potential undisclosed non-arm's length transactions. It should be noted that a fraction of them could be disclosed and legitimate; however, these transactions often have a higher fraud risk element because of these relationships. Thus, the CII does not rank the amount of actual collusion activity in a state, but rather, the potential for collusion based on the existence of relationships between parties involved in a transaction. The calculation of these relationships utilizes factors such as cohabitation, shared assets, business connections, as well as other complex criteria derived from public record data.

Using relationship data in conjunction with deed transfer data, LexisNexis is able to identify the states with the highest potential collusion over the most recent five-year period. This is accomplished in two ways, which are represented in Tables 3 and 4 on the following page. First, a wide-angle look at deeds where properties were transferred among individuals likely to be related with a 20 - 95 percent decrease in price; and second, a more focused look at deeds where properties were transferred among individuals likely to be related with a 50 - 95 percent decrease in price.

The first three columns of Tables 3 and 4 show the ranking of states with the highest potential for collusion activity. The remaining columns of the tables show the rankings and a numerical measure for the same 10 states in preceding years, back to 2009. The numerical measure of each state's potential collusion activity is represented by the CII. A CII of 0 would indicate no discernible collusion for a state. A CII of 100 would indicate that the potential collusion for a state is level with expectations, given the number of recorded deed transfers for that state. Appendix III at the end of this report explains how the CII is calculated.

Table 3

Collusion Indicator Index (CII) By State Properties with a 20 - 95% Decrease in Sales Price										
State	2013		2012		2011		2010		2009	
	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index
Alabama	1	345	2	330	2	368	2	392	3	443
Louisiana	2	236	5	231	4	285	7	239	7	283
Pennsylvania	3	192	6	215	6	262	4	291	6	328
New York	4	191	3	256	3	314	5	285	5	330
Iowa	5	163	9	189	9	206	12	203	10	211
New Jersey	6	147	13	159	10	202	8	225	9	244
Nebraska	7	144	10	171	13	176	9	224	11	196
Kentucky	8	143	8	191	8	213	13	189	18	163
California	9	141	21	107	34	97	35	96	43	75
Wisconsin	10	125	14	156	12	194	11	205	12	195

Table 4

Collusion Indicator Index (CII) By State Properties with a 50 - 95% Decrease in Sales Price										
State	2013		2012		2011		2010		2009	
	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index
Alabama	1	315	2	347	2	423	6	365	3	479
Vermont	2	232	1	420	1	517	2	429	1	612
Louisiana	3	196	10	212	7	252	16	175	9	355
Pennsylvania	4	196	3	290	3	397	5	371	6	390
New York	5	190	4	282	4	384	8	324	8	366
California	6	184	20	113	36	98	37	98	44	70
New Jersey	7	182	8	229	5	314	9	310	7	389
Oregon	8	175	11	167	9	237	12	258	5	449
Kentucky	9	174	7	234	6	286	11	264	12	310
Massachusetts	10	162	21	110	12	220	14	237	16	220

Further analysis of Tables 3 and 4 shows that:

- Alabama, Louisiana, Pennsylvania, New York, New Jersey, Kentucky, and California rank in the top 10 for both CII lists.
- The most noticeable new state with a high percentage of potential non-arm's length transaction activity is California. Prior to 2013, California has not previously been in the top 10. California is ranked ninth in the listing of properties transferred with a 20 - 95 percent loss (CII of 141) and sixth in the listing of properties transferred with a 50 - 95 percent loss (CII of 184).
- Four states experienced CII decreases in both category lists: Pennsylvania, New York, New Jersey, and Kentucky. While remaining in the 2013 top 10, their CIIs all fell below 200.
- With a CII of 162, Massachusetts appears in the top 10 for the first time for properties transferred with a 50 - 95 percent decrease in sales price.

The CII report is particularly telling because it identifies a type of fraud that requires planning, intention, and collusion among a minimum of two parties that are likely to repeat the fraudulent behavior on a regular basis.

Final Remarks

With application fraud and misrepresentation being present on almost 75 percent of reported mortgage loan investigations involving industry professionals, it is clear that the financial environment resulting from the 2008 housing market crises remains a breeding ground for origination fraud. The reduced volume of consumers who are able to qualify for mortgage loans has led to a fiercely competitive and, in some ways, familiar Fraud for Profit marketplace in which fraudsters resort to dishonest practices in order to fabricate creditworthiness and close deals. Ultimately, fraud and misrepresentation, especially in the mortgage application process, is likely to remain a serious and ongoing national problem.

Appendix I
Source and Analysis of the LexisNexis Mortgage Fraud Data

The statistical data presented in Figures 1 - 4 and Tables 1 - 2 of this report were derived from information in a cooperative mortgage fraud database operated by LexisNexis. MIDEX contains information about licensing, public sanctions, and incidents of alleged fraud and misrepresentation by mortgage industry professionals reported by MIDEX subscribers.

The MIDEX statistical data discussed in this document is derived from incidents that MIDEX subscribers report to LexisNexis. (Agreeing to submit reports describing their fraud investigation findings to the non-public section of the MIDEX system is required for those who wish to access other subscribers' non-public reports.) Only material misrepresentations are permitted to be included in these reports. That is, companies only submit reports to MIDEX in those cases where, knowing what they know after thorough investigations, they would not have originated, bought, or insured the loans in question.

The reports submitted to LexisNexis include the following information about each incident:

- Location of the collateral (state, city and address, to the extent known)
- Names of the originating entity and the loan officer who took the application
- Date the misrepresentation(s) took place
- The method used to verify the existence of the reported misrepresentation(s)
- A short narrative description of the misrepresentation(s) found during the MIDEX subscriber's investigation
- Names of any other professionals who appear to be in a position to influence the accuracy of the information found to be misrepresented; e.g., the name of the appraiser and appraisal firm in cases where the property value is found to be significantly inflated
- A certification from an authorized individual at the submitting mortgage entity that the report is, to the best of his/her knowledge, complete, and accurate

LexisNexis staff reviews the reports to assure they meet submission standards for severity and consistency. Submissions are input directly by MIDEX subscribers via an online form or bulk submission. After reading the report's narrative description, LexisNexis classifies the incident as involving one or more of the types of misrepresentations listed in Figure 3.

If LexisNexis makes any changes to a submitted report, it is returned to the submitting subscriber for review prior to its being entered into the system.

The subscribers participating in the MIDEX system represent a wide range of mortgage entities. They include secondary market agencies, major private mortgage insurance companies, and lenders who account for the vast majority of wholesale lending in the country.

Appendix II
Computation of the MFI

The Mortgage Fraud Index, or MFI, is an indication of the amount of mortgage-related fraud and misrepresentation involving industry professionals found through MIDEX subscriber fraud investigations in various geographical areas within any particular year. It involves very straightforward calculations.

To come up with Table 1's MFI for loans investigated in 2013 in a sample state (for example, Nevada) LexisNexis staff determines the percentage of all MIDEX fraud reports that were submitted for loans originated on properties located in Nevada. They determined that, to date, 2.05 percent of MIDEX reports submitted from across the country by subscribers in 2013 involved loans on Nevada properties. But according to HMDA data, Nevada had 0.93 percent of the nation's total 2012 mortgage originations—the most recent year such data are available.

If mortgage fraud and misrepresentation by industry professionals were distributed throughout the country like originations, then we would expect approximately 0.93 percent of such mortgage fraud to occur in Nevada. But the 2.05 percent MIDEX fraud figure for Nevada in 2013 was higher than its origination figure. Therefore, the 2013 MFI for Nevada, as of this report's date, is:

MFI NV/2013 = (2.05/0.93) x 100 = 221

This is, of course, a dynamic figure. Often, a fraud investigation is not completed until a year or two after the loan was originated. LexisNexis will continue to receive Nevada fraud reports for another two to five years from its MIDEX subscribers that find misrepresentation in their 2009 -2013 books of business. Therefore, Nevada's (and all other states') MFI figures will continue to change somewhat in future Periodic Reports, especially those containing recent years like 2012 and 2013.

It should be noted that the MFI is based on the number of fraud and misrepresentation incidents reported for each state, and not the dollar amounts of those mortgages. Therefore, a fraud on a $100,000 loan in Florence, Kentucky, is counted the same as a fraud on a $900,000 loan in Portland, Oregon. Also, there is currently no distinction made between purchases, refinances, or home improvement loans in these figures.

Appendix III
Source of the CII

Identifying potential relationships between borrower and seller entities connected with a property transaction is a calculation that leverages a parallel-processing computing platform from HPCC Systems to perform large scale graph analytics and contains roughly 4 billion relationships between 269 million active identities. During the analytics process that calculates potential collusion, it expands to 140 billion data points.

The CIIs in Tables 3 and 4 are determined by the percentage of deeds believed to involve individuals in non-arm's length relationships using the data described on the prior pages. For example, for properties with a 20 - 95 percent decrease in sales price in 2013, Alabama's CII is 345. To date, 2.52 percent of deeds with potential collusion identified across the country involved Alabama properties. But according to recorded deed transfer data, Alabama had .73 percent of the nation's total deed transfers in 2013. If this potential collusion activity were evenly distributed among states, we would expect approximately .73 percent of potential collusion activity to occur in Alabama. But the 2.52 percent collusion figure is over three times its deed transfer figure. Therefore, the 2013 CII for Alabama, as of this report's date, is:

CII AL/2013 = 2.52/.73) X 100 = 345

Foreclosures and quit claims have been excluded from calculations, as have any transactions under $10,000.

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For more information:

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