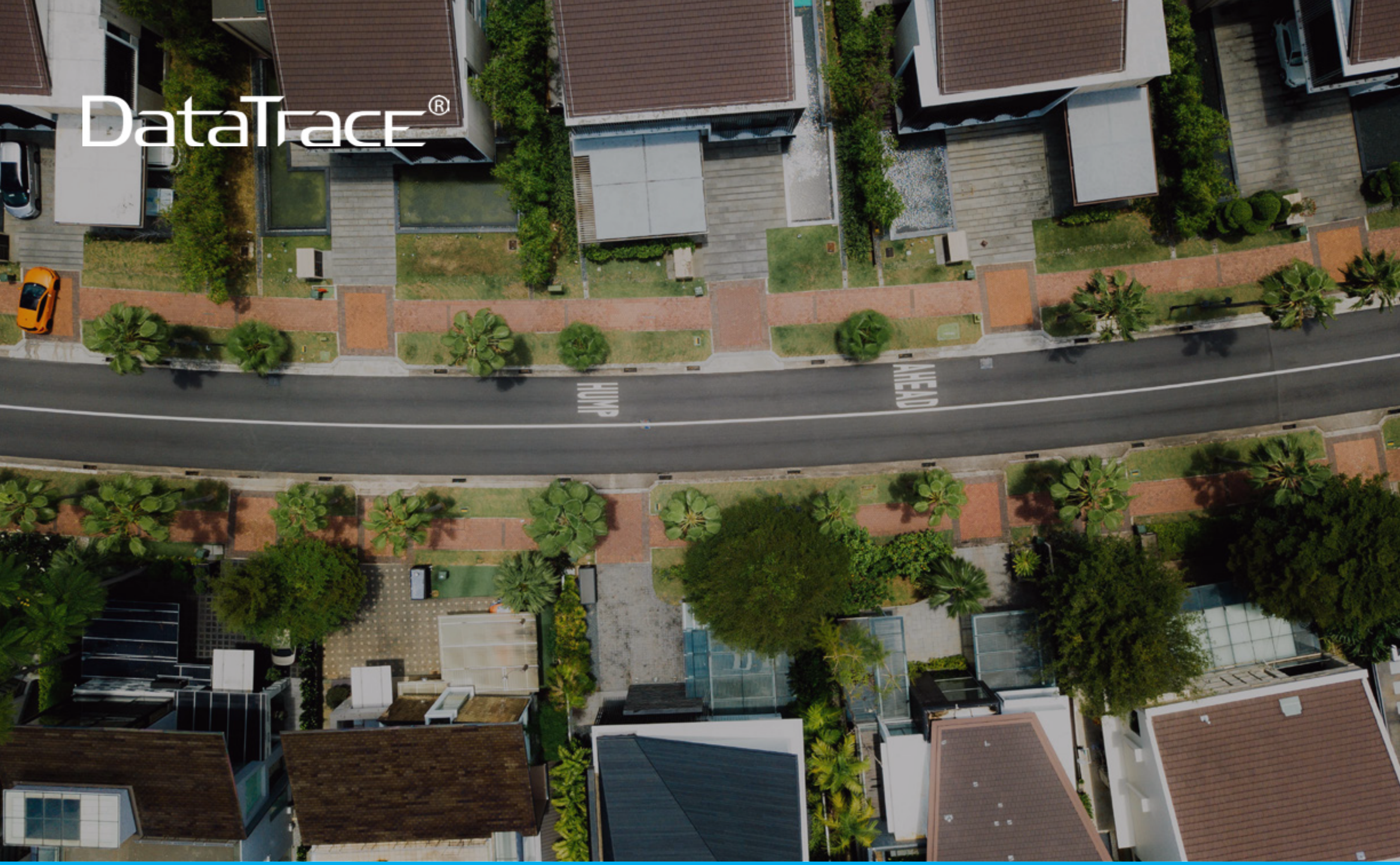


Escrow Theft and Mortgage Fraud White Paper

An Insider's Guide to Escrow Theft & Mortgage Fraud

> Mortgage fraud is an increasing problem, but thankfully not an unavoidable one.

When reviewing a title, your day-to-day activities would ideally focus on both your customers and the (true) numbers behind them. But for many title examiners and escrow officers, another big part of the job is looking out for deception in the very data that you would normally trust. Defined by the FBI as any "misstatement, misrepresentation or omission in relation to a mortgage loan which is then relied upon by a lender," mortgage fraud is an increasing problem, but thankfully not an unavoidable one.

So why exactly is mortgage fraud on the rise?

- Rising demand for homeownership. As of January 2018, U.S. homeownership rates hit 64.2 percent. The increasing demand for housing, combined with shrinking inventories, can lead to more fraudulent mortgage applications as buyers compete for homes.
- Interest rate increases are putting pressure on home buyers to get into a home before they continue to rise. Also, home sellers want to sell their homes before the pool of qualified buyers dries up.
- Strong home values tempt some buyers and/or investors to fudge their loan applications to obtain a property that could be profitable.

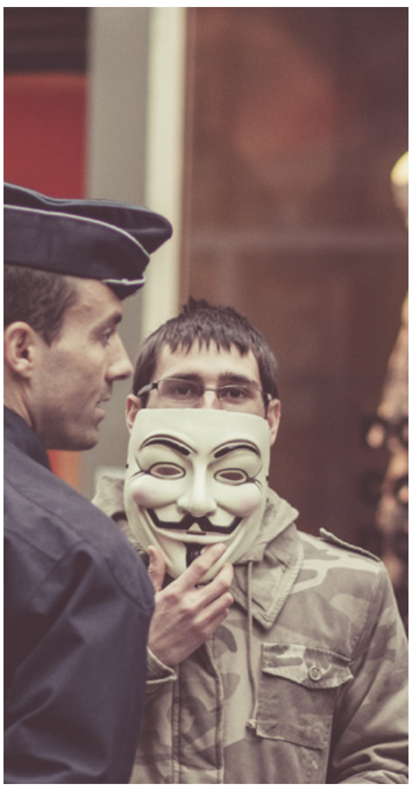
A massive increase from 2016 wherein $19 million in wire transfer frauds affected homebuyers.

- Greed. Shady home sellers will attempt to deceive in order to get more than their home is really worth, and buyers who lack the credit and/or funds to buy a home resort to underhanded tactics such as using a straw buyer and/or lying about their income and other criteria used by underwriters to determine whether or not to lend.

Adding to that, 2017 numbers released by the FBI showed that "$969 million was 'diverted or attempted to be diverted' from real estate transactions and wired to accounts under criminal control." This was a massive increase from 2016 wherein $19 million in wire transfer frauds affected homebuyers.

While some of the difference could be accounted for by more individuals reporting fraud, it still shows a growing increase in fraudulent activity. And, law enforcement agencies are stretched to the brink trying to solve these crimes. This presents a real challenge for title companies and their agents. To compound the problem, much of the fraud is international, with thieves hiding their identities, making it difficult to retrieve stolen funds.

That's why it's important to use cutting-edge tools and technology that both prevent escrow theft and fraud from happening, as well as help discover the fraud before permanent damage is done and funds are unable to be recovered.



The State of Escrow Theft & Fraud in 2018

There are many way to commit both escrow theft and fraud, many of them not well known to the average Joe. In 2018 they included:

- Wire fraud
- Fraud for housing
- Straw buyers
- Illegal property flipping
- Silent seconds
- Equity skimming
- Wire fraud

And for many people, it may seem like these types of situations won't necessarily affect them, but consider the following:

Childhood sweethearts Tom and Beth Parrish had been married for five years. They'd put off growing their family until they could buy their own home in the same neighborhood they'd both grown up in. After many hours of overtime and income from second jobs, they finally had saved enough for a down payment on the perfect starter home just three blocks from the elementary school they'd attended as children. Beth had envisioned many happy years living in the beautiful Cape Cod-style house that she and Tom had

The faster escrow theft and fraud are detected, the more likely law enforcement will be able to retrieve some or all of the stolen funds by initiating a "kill chain" to stop the monies from completely disappearing.

admired as teenagers. So, when Tom got off the phone with their realtor she couldn't wait to hear when they would finally be able to start moving in. But all of those dreams came crashing down around her when Tom told her they'd been victims of wirefraud. All of their hard work, all of their money was gone … just like that. And, while everyone was assuring them that they were doing everything they could do to recover the stolen funds, Beth couldn't help telling herself that they'd never see their hard-earned savings again. Fortunately for Tom and Beth, their lender was able to help them recover nearly all of their funds. But, the picture isn't quite as rosy for thousands of other buyers and sellers across the country.

It's an unfortunate fact that this scenario is becoming an all too common reality for many individuals across the country. Hackers break into email systems for an escrow company, real estate agent or title company, and then target an upcoming mortgage transaction. Then, posing as the closing agent, the thieves will send wiring instructions to the bank, substituting their own bank accounts for the escrow agents' account. Once the funds have been retrieved by the fraudsters they quickly move the money from one account to the other across state lines before anyone realizes the fraud.

All parties to a real estate transaction are susceptible to this type of fraud as hackers will use any and all information they obtain to facilitate their activities. That's why prevention is the best way to protect yourself and your clients from becoming victims of cyber thieves who are becoming more and more sophisticated in their methods.

In an effort to combat this growing menace, the Federal Bureau of Investigation has created the Financial Fraud Kill Chain (FFKC). This reporting system gives consumers and U.S. Financial institutions a central location to report stolen wire transfers, which the FBI can then investigate in an effort to retrieve the funds and bring the perpetrators to justice.

The following criteria needs to be met to use the FFKC system:

- The transfer is $50,000 or more
- The transfer is international
- A SWIFT (Stop and Recall Payment) notice was initiated
- The FBI is informed of the details within 72 hours

Even if a wire fraud doesn't fit the parameters listed above, the financial institution should report the crime to law enforcement. The faster escrow theft and fraud are detected, the more likely law enforcement will be able to retrieve some or all of the stolen funds by initiating a "kill chain" to stop the monies from completely disappearing.

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Email correspondence that's earmarked "secret", "confidential" or "urgent"...

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Interactions that are solely electronic in nature (no auditory or physical verification of parties involved)

What to look for

- Requests for or changes to wiring instructions (a common method used by thieves.) Any other last minute changes (addition or subtraction of closing parties, addresses, financial changes, etc.)
- Change in language, timing, etc. from prior correspondence
- Slightly different email addresses
- Wiring instructions to a foreign bank that's received numerous customer complaints indicating fraudulent transactions
- Email correspondence that's earmarked "secret," "confidential" or "urgent"
- An employee who is a newly authorized individual on a customer's account and who has not sent wire transfer instructions previously
- Interactions that are solely electronic in nature (no auditory or physical verification of parties involved)
- Requests for additional funds to pay vendors/suppliers immediately after such a payment has already been made (the original funds were likely sent to the thief instead of the vendor/supplier)
- Wire transfer that names a beneficiary who is not the same as the account owner of record
- Rapid title transfers that may show a different borrower for a refinance or an individual as a seller who is different than the owner of record
- HUD-1 payouts that are odd in the following ways:
    - Excessive amounts paid to unknown entities to cover liens (that you didn't see in the title chain)
    - False invoices for repairs
    - Referral fees
    - Non-lien disbursements

...Not all mortgage fraud originates with buyers...

Fraud for Housing

Like wire fraud, housing fraud is growing every year. Some ways this scheme is carried out by a buyer include:

- Misrepresenting their income and assets
- Claiming the home will be owner-occupied
- Bribing an appraiser to overvalue the home

However, not all mortgage fraud originates with buyers. Meet George B. Larsen, formerly of San Rafael, California. After finding him guilty of conspiracy and bank fraud, the court sentenced him to 10 years and 1 month, and ordered him to pay restitution of $1,759,100. Larsen and the homeowners he conspired with defrauded lenders by running a mortgage elimination program that purported to help distressed homeowners, but in reality created a false chain of title that indicated all liens had been paid off when in fact they hadn't. The homes were sold with what appeared to be clear title, giving Larsen and the former homeowners proceeds of the sale, while giving the new property owner a lien they didn't know they had. A situation which, of course, the title company was responsible for as they'd relied on a chain of title that was a lie when issuing the new owner's policy.

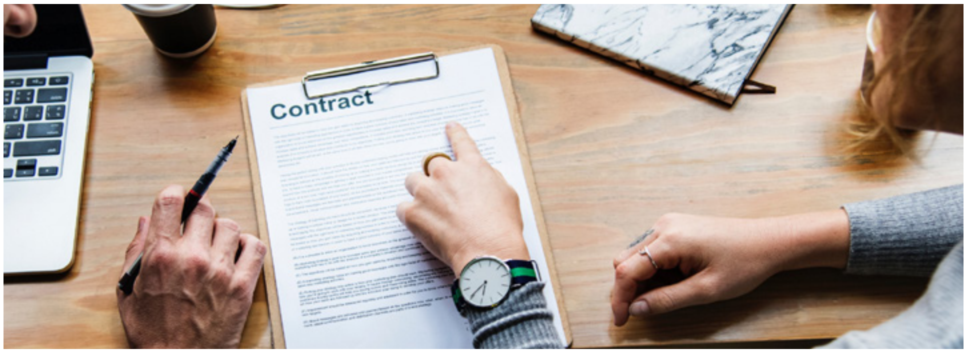
As you can see, the lengths that criminals will go to in order to defraud can be quite extensive.

Sketchy employment verifications (an individual's instead of a business name)

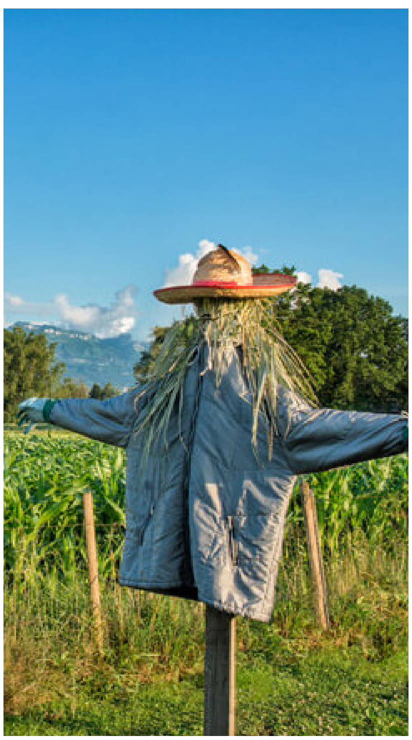
What to look for

- Inconsistencies with the appraisal
- Unsatisfactory explanations for discrepancies
- Sketchy employment verifications (an individual's instead of a business name)
- A purchaser buying a home that's a significant distance from their existing residence

While each of these factors isn't uncommon in a legitimate transaction, it's still important to verify and then verify again before closing the deal.



A straw buyer is someone who applies for mortgages and buys a home on behalf of someone else...



Straw Buyers

A straw buyer is someone who applies for mortgages and buys a home on behalf of someone else. In some cases, the real owner has bad credit and cannot qualify for a home loan. However, in other scenarios, the true buyer is attempting to manipulate the home buying system for financial gain.

A straw buyer typically has good credit, but not a lot of money. As these buyers are often motivated by financial gain, they will often accept the risk of ruining their credit and will agree to become involved in a fraudulent transaction.

Paul Watterson was a New Jersey property manager. Together with John Bingaman, who acted as a straw buyer, the two defrauded lenders in order to secure mortgages on condominiums. By using their good credit ratings, but lying about their income, assets and employment history, they fraudulently obtained mortgage funds which were then split between the two.

What to look for

- Purchase doesn't make sense for the buyer (buying very close to or far away from their current residence)
- Borrowing is buying way beyond, or below, their price range
- Contract includes (or used to include) a non-borrower
- Gift funds for down payment with minimum contribution by the borrower
- Mortgage inquiries for other properties (recent)
- Collateral appears inflated
- No real estate agent
- Income is overstated (too high salary for the position)
- Employment information looks sketchy
- The borrower appears to be "coached"

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Property Flippers

While it is not illegal for a buyer to purchase a house, renovate and then resell it for a profit, it is illegal when the property is purchased, erroneously appraised at a higher value and then sold quickly. For this scam to work, the following things need to happen:

- Fraudulent appraisals via bribes/kickbacks
- Inflated buyer income and/or assets
- Falsified loan documentation

Individuals involved in this type of scheme include straw buyers, investors, mortgage brokers and title company employees. Here's how it works:

In a cash-out purchase or refinance, the buyer/borrower will make an offer that's well above the listing price, stipulating that the additional monies over the asking price will be given to the buyer/borrower at closing. This stipulation will often be added as an addendum to the contract rather than on the contract itself. This helps the fraudsters avoid tipping off the title company and/or loan company employees. Then, an inflated value of home improvements (that didn't/won't happen) is used to substantiate the higher loan amount.

For example, let's say a home is listed for $150,000. An offer is made and accepted for $199,000. At closing, the seller receives their $150,000 and the borrower/buyer receives the $49,000. What often happens in this scenario is these loans quickly end up in default and foreclosure. This type of cash-out fraud happens most often in the following markets:

- Areas where property values are rapidly appreciating. The fraudsters take advantage of the rapid market growth to deceive the lender about the property's true value. And they often work their schemes when closers are busy and under pressure in the hope that their fraud will be missed.
- Slow, stagnant markets where the property has been listed for sale for a long time. Sellers become desperate and agree to the cash-out purchase arrangement.

The fraudsters take advantage of the rapid market growth to deceive the lender about the property's true value...

Unfortunately, illegal house flipping — like all areas of escrow theft and real estate — shows no signs of stopping. And, it doesn't resign itself to seedy back alleys. Even prominent members of society have been caught up in mortgage fraud.

A Boone County attorney was indicted on seven counts of bank fraud by a grand jury, along with a group of businessmen in the Des Moines area on charges of participating in an illegal property-flipping scheme. The attorney who was charged, Jason Springer, testified that the banks who claimed they were defrauded in the scheme came out ahead, as did the others who participated in the fraud.

"My clients were going to make a little money. The sellers were going to get out of bad debt. And the buyers were happy they were getting a new home. I didn't mean for anybody to get hurt, especially the banks. I thought I was actually helping them — giving them money."

The problem lay in the fact that Springer allegedly helped two men, who were also charged, to negotiate "short sales," deceiving the lenders into believing the sale prices was the fair market value for the homes (however they were worth much more). The buyers did not have enough money in the bank to cover the checks they'd written to purchase the properties. Immediately after the sale by the banks, the group resold the homes at a higher price — typically on the same day they were purchased — without the knowledge of the lender. Funds received from the second sale were then used to cover the checks written for the first purchases, with the perpetrators pocketing the difference. An amount the court records say was more than $200,000 dollars.

Inconsistencies between photos, property description and amenities

What to look for

- Sellers who are an entity
- Missing data on appraisals
- Property is said to be completely renovated
- Inconsistencies between photos, property description and amenities
- Occupant field of appraisal is left blank or listed as "tenant," "unknown" or not identified properly

Again, sometimes these discrepancies are a simple matter of human error, so don't automatically assume that when you spot one of these signs that you're seeing fraud. As the saying goes, "Trust, but verify." In fact, this should be every title agent's mantra to help fight escrow fraud.

Silent Seconds

A silent second happens when a buyer and a seller agree to hide a second mortgage from the primary mortgage lender...

A silent second happens when a buyer and a seller agree to hide a second mortgage from the primary mortgage lender. The seller agrees to lend the buyer money for the down payment after they agree to a sales price that's well in excess of the property's value. At closing, the buyer obtains a home with little, if any, of his own funds, and the seller receives funds in excess of what his home is truly worth. As a result, the lender holds a lien that's more than what the property is valued at.

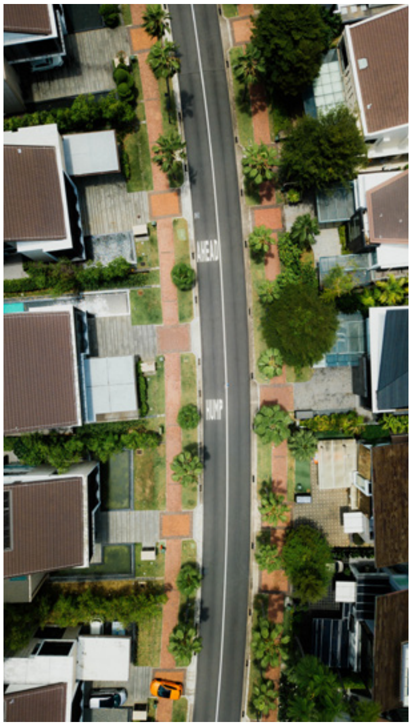
What to look for

- Borrower's job title is generic
- Inability to reach the employer
- Employer and employee names not printed on checks
- Assets and credit profile don't fit with stated income
- An appraisal that's out of sync with what's happening in the market

Equity Skimming

Equity skimming requires the participation of both a straw buyer and an investor. Using false income and credit reports, the straw buyer obtains a loan on a property. After closing, the buyer signs the property over to the investor in a quit claim deed, relinquishing all rights and providing no guaranty. The investor then rents out the property but fails to make the mortgage payments, pocketing rents until the property is foreclosed.

Signs of Appraisal Fraud



For many escrow theft and fraud schemes, conspirators require an appraisal to fit the scenario they're trying to create. The following red flags should alert closers to the possibility that something is amiss in the deal they're preparing to close:

- The purchase price is significantly more than area market values
- Adjustments to comparable properties are significantly positive
- Sales prices of comparable properties don't bracket the subject's adjusted value
- Size, style and amenity of comparable sales are widely different than subject property
- All comparables lie within the same development as the subject property
- Comparables and subject property are significantly distant from each other or located across neighborhood boundaries, such as waterways or main arteries
- The scale of the map distorts the true distance between properties
- Photos are taken from awkward or unusual positions
- Values have grown significantly over a short time since the last sale
- Little to no explanation for comparable choices
- Address inaccuracies
- The subject's and comparables' characteristics and conditions don't match with the real estate agents' descriptions
- The valuation doesn't make sense, given the sales price history

Being diligent and having procedures in place to verify all aspects of a transaction is key to protecting your business and your customers...

DataTrace®: Your Partner in Escrow Theft Protection

Prevention is, without question, the best way to deal with escrow theft and all forms of mortgage fraud. Being diligent and having procedures in place to verify all aspects of a transaction is key to protecting your business and your customers. Employee training and awareness should include the following guidelines:

- Never sign blank documents.
- Pay attention to inconsistencies. It's often the first sign of potential fraud.
- If something sounds too good to be true, it probably is.
- Always look very closely at all email communication, even when you're in a rush to close. Fraudsters often use a very slight variation of a legitimate email address to commit their crimes.
- Always verify every wire transfer request or change by phone.

When used in tandem with fraud prevention training and procedures, DataTrace is a great tool for preventing escrow theft and mortgage fraud. We provide a real estate transaction system wherein we deliver recorded documents (e.g., grant deeds, quitclaim deeds, notices of default or trust deeds) directly to the homeowner. This alerts the homeowner to potential fraudulent recordings and provides the contact information of their local District Attorney's office to begin an investigation if they've been defrauded. We work on behalf of the counties within a state to provide:

- Notices to homeowners of the transfer to confirm its validity
- Record searches for similar fraudulent transfers helping to spot victims, patterns and perpetrators
- A deterrent, as scam artists avoid operating in counties that are protected within the DataTrace system
- Information about misfiled recordings, returned mail and cross-validation

All of the above make DataTrace an essential tool for preventing escrow theft and mortgage fraud.

Ready to enhance your market share with DataTrace?
Our experts are ready to help.

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