



Getting Rid of Fraud for Good

A new business model holds the key to revolutionizing the mortgage industry and ending all mortgage fraud.

FRAUD IS EXPENSIVE AND NOT JUST FOR ITS IMMEDIATE VICTIMS.

Recent data indicate that it costs us all a lot more than previously thought. In fact, fraud is at the core of the whole housing crisis. Fraud costs lenders hundreds of thousands of dollars every time they are forced to repurchase a bad loan. Add to that the cost to hedge funds and other Wall Street players, which has been hundreds of millions in lost equity when the value of their holdings collapsed in the wake of the liar loan defaults. Subprime lenders and the technology firms that supported them lost everything when those companies went out of business. And that's just the beginning. The FBI has estimated that mortgage fraud costs the industry \$4 billion to \$6 billion annually. Those of us in the industry know it's more than that.

Right now, we have the opportunity to stop mortgage fraud forever. But as soon as the industry is moving again, lender attention will shift. Before the clock runs out, we

must act to create a new industry utility, one that can provide a nationwide registry of every loan application and then apply proven fraud screen analytics to uncover fraud before funding. Currently, no single vendor has both the industrywide infrastructure and the proven fraud screening technology platform to become this new utility. A new pairing will make this a reality.

The stars are currently aligned, but it won't last for long. It will take coordinated action on the part of the entire industry to capitalize on this opportunity, but it can be led by a few companies willing to try something new. There are firms that recognize that now is the time lenders can afford to focus on this problem and are even now perfecting a solution.

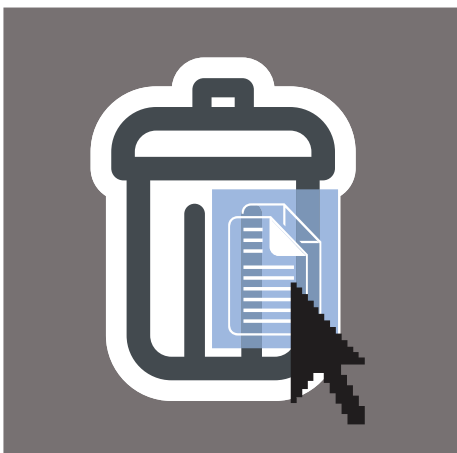
The subprime crash and the economic problems that followed it uncovered so much mortgage fraud that it became impossible for the industry, consumers or the government to ignore the growing problem. What was once a nasty little secret mostly confined to

the underwriting department has been fully uncovered.

According to the FBI, Suspicious Activity Reports were up 23% between 2006 and 2007. At the same time, their mortgage fraud caseload was up 47%. In 2007, the FBI received nearly 47,000 SARs but was only able to open files and begin investigating about 1,200 of them. It's a runaway problem.

In July, the FBI, in conjunction with the U.S. attorney's office and a number of other federal and state agencies, announced a new mortgage fraud task force, primarily to deal with foreclosure and short-sale fraud schemes. Since then, state governments have been lining up to get on board.

Our research indicates that fraud doesn't just impact those involved in risky



mortgage lending. A new team of data analysts at Interthinx has analyzed over five years worth of data gleaned from our well-known fraud screening product. There is a clear and incontrovertible correlation between fraud risk and foreclosure activity 12-18 months in the future. Those communities that ranked highest on our fraud risk index 18 months ago are today the most active foreclosure markets. The communities with a high fraud risk index today will see property values damaged by high foreclosure activity within two years. That hurts everyone.

That's why it's not just law enforcement and the government that are now taking fraud seriously. We've seen a spike in our fraud screening business over the past 12 months and I'm sure others working in our

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space have also observed lenders being more proactive in screening loan applications. Loan file reviews after funding are also on the rise as investors are driving those who sell loans to check their files for signs of fraud before they agree to complete the deal. Our projections indicate that fraud will continue to pose a high risk through 2012, as the rest of the ARMs reset.

Dan McLaughlin, executive vice president of MERSCORP Inc., better known as MERS, put it well when he wrote, "Never in my 25 years in the mortgage industry has this much attention been paid to the negative impacts of fraudulent practices," Mr. McLaughlin wrote. "This is an opportunity that may last another year or two. Right now, fraud is an overwhelming problem that the mortgage

industry is serious about taking on."

He continued by observing that when the downturn ends, lenders will concentrate on incoming volume and postpone solving the structural problems that enable fraudsters to succeed. He's right and that's what makes this issue so time-sensitive. When the industry rebounds in earnest, lenders will have little time to adjust their workflows in ways that make sense for stopping fraud.

We have become very good, as an industry, at identifying the red flags that indicate a mortgage loan file contains fraudulent information. We're very proud of the tools we've developed and they have been very well received. But if we really want to stop fraud, we're going to need an almost unprecedented level of industry-wide cooperation. I say almost be-

cause we're fortunate enough to have a couple of really good examples.

First, I would point to MISMO. The Mortgage Industry Standards Maintenance Organization is a shining example of how firms from all over the space can come together for the good of the industry as a whole. Even after the Mortgage Bankers Association spun the organization off, the initiative is still moving forward.

The other example is MERS. As developer of the universal identification number used by the industry to simplify the complex tasks associated with transferring interests in mortgage loans, MERS reports that nearly 60 million loans now have a MERS Identification Number. While the company revolutionized the mortgage business, it would not have been possible if the industry had not

embraced the system and made it the utility it has become.

To really stamp out mortgage fraud, the industry needs to do that again. We need an industrywide utility that will stop fraud before funding.

Loan-level fraud screening tools are great at identifying fraud in a single lender's shop and should always be used, but other lenders who do not have access to this information can still get burned by the same criminal when simultaneous submissions for loans are made using the same real estate as collateral.

To stop that, we must create a single industry database where all mortgage loan applications for both existing loans and those in other lenders' pipelines can be screened to detect systemic fraud across the industry. By using existing fraud screening tools on a broader set of industry files, we can catch virtually all mortgage fraud before the loans are funded.

That is why MERS and Interthinx are launching the MERS FraudALERT, Powered by Interthinx in 4Q 2009. It's an industrywide utility backed by powerful fraud screening analytics that will provide cooperating lenders with access to better fraud screening information than ever before possible. To effectively use this new utility, lenders across the country should register all new loan applications in the database as early in the process as possible.

It's time for lenders to take action and protect themselves and their peers from a systemic risk that is even now threatening the mortgage industry. Our future depends on our ability to act now. **MT**

Kevin Coop is president of Agoura Hills, Calif.-based Interthinx, where he oversees the company's day-to-day operations. In 2002, prior to joining the Interthinx team, Mr. Coop served as president and CEO for Los Angeles-based Sysdome, a provider of fraud management technology.