MORTGAGE BANKERS ASSOCIATION

MORTGAGE FRAUD

STRENGTHENING FEDERAL AND STATE MORTGAGE FRAUD PREVENTION EFFORTS

Mortgage Fraud

Executive Summary

Mortgage fraud is a large and growing problem and warrants significant attention. The mortgage lending industry has lost billions of dollars as a result of fraud, and the sum is believed to have risen steadily in recent years. Though the lender is the direct victim of mortgage fraud, fraud harms honest homeowners and homebuyers as well, through increased housing costs. Schemes that involve artificially inflated appraisals, for example, drive up property tax assessments and foreclosures resulting from fraud depress surrounding home prices. Clearly steps need to be taken to make the prosecution and prevention of mortgage fraud more effective. To date, however, there has been little agreement on which steps need to be taken.

It is critical to recognize the difference between mortgage fraud and predatory lending. "Mortgage fraud," as understood by law enforcement and the real estate finance industry, is the "material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase or insure a loan."[1] A lending institution is deliberately deceived by another actor in the real estate purchase process — such as a borrower, broker, appraiser or one of its own employees — into funding a mortgage it would not otherwise have funded, had all the facts been known. "Predatory lending," on the other hand, is a term used to describe a range of lending practices harmful to borrowers, including equity stripping[2] and lending based solely on the foreclosure value of the property. Some of these practices can be fraudulent, but defining an exact set of predatory lending practices has been difficult. This paper seeks to separate the issue of mortgage fraud from predatory lending and to provide policymakers with a roadmap to effectively combat mortgage fraud that is distinct from policy decisions made to address predatory lending.

While some anti-mortgage fraud proposals have focused on amending federal law, federal law currently empowers law enforcement officials with sufficient authority and tools to combat mortgage fraud. The federal mail and wire fraud statutes, which are broadly phrased and have been broadly interpreted, reach all possible cases of mortgage fraud. Additional federal statutes apply to certain instances of mortgage fraud committed against federally regulated or insured institutions, providing federal law enforcement officials with additional avenues to combat mortgage fraud. Unlike new legislation, which always carries with it the risk of unexpected interpretations, existing law is tested by years of judicial precedent and can be applied by federal law enforcement officers with confidence.

1 Federal Bureau of Investigations, *Financial Crimes Report to the Public,* at 20 (Mar. 2007), available at *http://www.fbi.gov/publications/financial/fcs_report2006/publicrpt06.pdf.*

2 "Equity stripping," as a predatory lending practice, generally refers to foreclosure "rescue" schemes where an owner sells the house and leases it back at a higher monthly payment to stave off foreclosure. Once the individual falls behind on those new payments, the house is taken away and any equity built up in the home is lost.

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Some legislative proposals have sought to create a federal private right of action[3] for mortgage fraud. Such proposals, however, have the potential to harm mortgage lenders — the very entities that are the primary victims of mortgage fraud. While a statute must be phrased broadly to allow law enforcement officials to combat all forms of mortgage fraud that may arise, broadly phrased statutes could easily be abused in the hands of private litigants who may not exercise the same restraint as law enforcement personnel in pursuing remedies. Private litigants have no long-term stake in protecting fraud statutes from being unduly narrowed by judicial interpretation to avoid overreaching.

Rather than drafting new legislation, the focus should be on providing the structure and resources needed by law enforcement officials to combat mortgage fraud. While law enforcement has all the legal tools it needs at its disposal, it requires more resources and a more efficient framework to use those tools effectively. This can be accomplished by:

- Providing more funding for mortgage fraud prevention and prosecution efforts
- Assuring that investigative and prosecutorial resources are committed to mortgage fraud prevention
- Placing responsibility for enforcement in a dedicated office within the Department of Justice
- Providing for intergovernmental cooperation in prosecuting mortgage fraud

As with federal law, state law already authorizes state law enforcement officials to prosecute mortgage fraud. Rather than creating new statutes, legislative efforts should concentrate on providing the focus and resources needed by state and local law enforcement officials to combat mortgage fraud. Moreover, state law already provides victims of mortgage fraud with means of redress. Just as new federal mortgage fraud legislation is unnecessary, the same is the case with respect to new state laws.

Ultimately, any solution to mortgage fraud should remain focused on true mortgage fraud. The differences between mortgage fraud and predatory lending make efforts to address both problems simultaneously ill-advised. Law and policy makers should take care to ensure that proposed solutions to each of these problems are not conflated or confusing.

3 "Private right of action" refers to the ability of individuals to seek civil damages when federal or state law has been violated.

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Introduction

Mortgage fraud is a large and growing blight on the mortgage industry. The Federal Bureau of Investigation (FBI) has reported that mortgage fraud cost the mortgage lending industry between $946 million and $4.2 billion in 2006 alone.[4] Additionally, the federal Financial Crimes Enforcement Network (FinCEN) has reported that the number of mortgage-related Suspicious Activity Reports (SARs) filed of 2006 rose 44 percent over the same period in 2005.[5] This follows a 29 percent increase from 2004 to 2005, and an almost 100 percent increase from 2003 to 2004.[6]

Mortgage fraud is receiving increased attention not only because of its prevalence, but because of the pervasive harm it causes. While mortgage lenders and investors are most proximately and frequently affected, losing billions of dollars annually as a result of mortgage fraud, the harm is not limited to the mortgage lending industry. "[B]ecause mortgage lending and the housing market have a significant overall effect on the nation's economy,"[7] the substantial harm caused to the mortgage lending industry impacts the national economy generally. Mortgage fraud often results in early payment defaults, a factor that likely is contributing to higher numbers of delinquencies and foreclosures and fueling the alarm over these statistics. Furthermore, because mortgage lenders and investors must recoup their losses in order to remain in business, the costs of mortgage fraud are passed on to consumers in the form of higher mortgage prices, decreased availability of mortgage credit and decreased loan values.

The increased interest in mortgage fraud prevention has taken a variety of forms. The FBI recently consolidated all mortgage fraud programs within the Financial Institution Fraud Unit, even when the targeted or victimized lender is not a federally chartered financial institution.[8] One state has enacted a statutory regime directed at preventing and punishing mortgage fraud,[9] and bills have been introduced in other states.[10] Legislation also has been introduced at the federal level.[11]

While increased focus on mortgage fraud is both necessary and appropriate, MBA recommends law and policy makers apply that focus in ways that are targeted at mortgage fraud and that do not duplicate (or possibly even limit) current statutes and mechanisms. MBA has prepared this white paper to assist law and policy makers in understanding existing laws that address mortgage fraud, as well as important issues and concerns implicated by additional measures intended to address mortgage fraud.

Additionally, MBA urges law and policy makers to keep in mind that mortgage lenders are the principal victims of mortgage fraud, along with, in many cases, communities and honest homeowners. Any steps taken to prevent or punish mortgage fraud must not expose mortgage lenders to additional (and possibly greater) risks of loss.

WHAT IS MORTGAGE FRAUD?

Mortgage fraud is a "material misstatement, misrepresentation, or omission relating to the property or potential mortgage relied on by an underwriter or lender to fund, purchase or insure a loan."[12] Stated differently, mortgage fraud is the intentional enticement of a financial entity to make, buy or insure a mortgage loan when it would not otherwise have done so, had it possessed correct information.

Mortgage fraud generally takes two forms: "fraud for profit" and "fraud for housing." Fraud for profit, also referred to as industry insider fraud, is fraud where the "motive is to revolve equity, falsely inflate the value of the property, or issue loans based on fictitious properties."[13] The FBI reports that,

4 Federal Bureau of Investigation, *Mortgage Fraud: New Partnership to Combat Problem,* available at *http://www.fbi.gov/page2/march07/mortgage030907.htm* (Mar. 9, 2007).

5 FinCEN, *The SAR Activity Review — By the Numbers,* Issue 8 (June 2007), available at *http://www.fincen.gov/sar_review_by_the_numbers_issue8.pdf.*

6 See Mortgage Asset Research Institute, *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association,* at 1 (Apr. 2006), available at *http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf.*

7 Federal Bureau of Investigations, *Financial Crimes Report to the Public,* at 20 (Mar. 2007), available at *http://www.fbi.gov/publications/financial/fcs_report2006/publicrpt06.pdf.*

8 *Id.*

9 Georgia Residential Mortgage Fraud Act, Ga. Code §§ 16-8-100, *et seq.*

10 *See,* e.g., Arizona S.B. 1221; Florida S.B. 240 & H.B. 349; Minnesota S.F. 797 & H.F. 851; Texas H.B. 716.

11 *See,* e.g., S.1222.

12 Federal Bureau of Investigation, *supra* note 7, at 20.

13 Federal Bureau of Investigation, *supra* note 7, at 20.

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based on existing investigations, 80 percent of all reported fraud losses arise from fraud for profit schemes that involve industry insiders.[14] Fraud for housing is fraud where a borrower perpetrates a fraud in order to acquire or maintain ownership of a house. "This type of fraud is typified by a borrower who makes misrepresentations regarding his income or employment history to qualify for a loan."[15]

Mortgage fraud is different from "predatory lending." Mortgage fraud is fraud that harms mortgage lenders or other members of the mortgage industry. While no accepted definition of "predatory lending" exists, the term generally is used to portray in a negative light practices that are likely to harm borrowers. Because mortgage fraud and predatory lending differ both in terms of the harmful activities and in terms of the parties harmed, steps taken to address mortgage fraud rarely, if ever, will be appropriate to address predatory lending (and vice versa). Indeed, the FBI has emphasized that "[t]he defrauding of mortgage lenders should not be compared to predatory lending practices which primarily affect borrowers."[16] MBA is committed to eradicating predatory lending and continues to support a balanced, strong, national anti-predatory lending standard that protects borrowers from unscrupulous actors without diminishing legitimate lending. MBA urges law and policy makers to recognize the important differences between mortgage fraud and predatory lending and to avoid conflating the two in actions intended to address either.

CURRENT FEDERAL LAWS ALREADY PROVIDE LAW ENFORCEMENT WITH AUTHORITY TO PROSECUTE ALL INSTANCES OF MORTGAGE FRAUD

One of the approaches for addressing mortgage fraud that continues to receive consideration is the enactment of new federal legislation. Indeed, in addressing issues of nationwide concern, a federal solution can be effective. In the case of mortgage fraud, however, current federal law already provides law enforcement with substantial authority to prosecute all instances of mortgage fraud. These federal statutes applicable to mortgage fraud are tried and tested, have been interpreted and clarified by courts over the course of many years and are tools familiar to federal prosecutors. MBA recommends that new federal legislation, if any, be crafted so as to fit comfortably within the established framework of laws addressing mortgage fraud.

Federal mail and wire fraud statutes apply to all instances of mortgage fraud.

Federal mail and wire fraud statutes are broadly fashioned and have been broadly interpreted. Indeed, the reach of these statutes is so broad that they apply to all instances of mortgage fraud.

The mail fraud statute[17] makes it illegal to devise or intend to devise any "scheme or artifice to defraud" anyone and to place in the mail (or a private carrier), cause to be deposited in the mail, take or receive from the mail, or knowingly cause to be delivered any material for the purpose of carrying out the scheme or artifice to defraud. A violation is punishable by fine or up to 20 years imprisonment. Additionally, if the violation affects a federally chartered or federally insured financial institution, a violation is punishable by up to a $1 million fine and up to 30 years imprisonment.

The wire fraud statute[18] similarly makes it illegal to devise or intend to devise any "scheme or artifice to defraud" anyone and to transmit or cause to transmit by wire, radio or television any materials for executing such scheme. Penalties for a violation of the wire fraud statute are the same as for a violation of the mail fraud statute.

The breadth of these statutes, both in terms of the statutory language and the interpretations by federal courts, make them applicable to any and all instances of mortgage fraud. An illustrative example is the case of *United States v. Hitchens,* in which the United States Court of Appeals for the Third Circuit upheld the conviction for mail and wire fraud of a real estate agent who participated in conveying false documentation to

14 *Id.*

15 *Id.*

16 See Federal Bureau of Investigations, *Financial Crimes Report, supra,* note 7, at 21.

17 18 U.S.C. § 1341

18 18 U.S.C. § 1343

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mortgage companies.[19] In *Hitchens,* the real estate agent argued that she could not be convicted of mail or wire fraud because the evidence at trial did not show that she personally used the mails or wires. The Third Circuit rejected her arguments, because judicial precedent interpreting the mail and wire fraud statutes has established that law enforcement need not show that the person committing the fraud herself placed documents in the mail. Rather, law enforcement need only show that a person commits an act with knowledge that use of the mails or wires would follow in the ordinary course of business.[20] Furthermore, evidence of business custom is sufficient to establish knowledge that the use of the mails or wires would follow.[21] The Third Circuit concluded that because the evidence showed (1) the routine practice of mortgage companies using mail or carrier services for various documents associated with the mortgage loan, and (2) the prevalence of wire transfers from mortgage lenders to transmit loan proceeds and wire transfers in mortgage transactions, the evidence supported the real estate agent's conviction.

Since law enforcement agencies can show that mortgage companies routinely use mail and carrier services for documents associated with mortgage loans and that wire transfers are prevalent in mortgage transactions, the mail and wire fraud statutes would be applicable in the case of mortgage fraud as in any case of mail or wire fraud.

Federal law regarding the transportation of stolen goods applies to many, if not all, instances of mortgage fraud.

The federal statute prohibiting the transfer of stolen goods applies to many, if not all, instances of mortgage fraud. It provides in relevant part:

> Whoever transports, transmits, or transfers in interstate or foreign commerce any goods, wares, merchandise, securities or money, of the value of $5,000 or more, knowing the same to have been stolen, converted or taken by fraud; or
>
> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transports or causes to be transported, or induces any person or persons to travel in, or to be transported in interstate or foreign commerce in the execution or concealment of a scheme or artifice to defraud that person or those persons of money or property having a value of $5,000 or more; …
>
> Shall be fined under this title or imprisoned not more than 10 years, or both.[22]

Judicial interpretations of this statute have given it a broad application. The Supreme Court has explained that the term "interstate commerce" is intended to be as broad as the Court has used that phrase in Commerce Clause decisions (which is very broad), and can reach activities that do not themselves cross a state's border.[23] Additionally, the federal courts have held that a wire transfer satisfies the "transport" requirement of the statute.[24] Since (1) wire transfers are prevalent in mortgage transactions, (2) wire transfers make use of an interstate system for transmitting money, and (3) wire transfers, in many cases, involve the transfer of funds between entities in different states, it is difficult to envision many cases of mortgage fraud, if any, that would not be subject to § 2314.[25]

Other federal statutes make illegal fraud on federally chartered or federally insured financial institutions.

In addition to the statutes discussed above, other federal statutes specifically make illegal defrauding the United States, any agency, and any so-called Section 20 financial institutions (defined generally as federally chartered or federally insured institutions but not state-licensed, non-depository lenders).[26] In particular,

19 *United States v. Hitchens,* 2002 WL 31898234 (3d Cir. Nov. 19, 2002).

20 *See, e.g., U.S. v. Bentz,* 21 F.3d 37, 40 (3d Cir. 1994).

21 *See, e.g., U.S. v. Hannigan,* 27 F.3d 890, 894 (3d Cir. 1994).

22 18 U.S.C. § 2314

23 *McElroy v. United States,* 455 U.S. 642, 653-54 (1982).

24 *See, e.g., United States v. Wright,* 791 F.2d 133 (10th Cir. 1986).

25 *See, e.g., United States v. Bond,* 231 F.3d 1075 (7th Cir. 1990) (upholding conviction under § 2314 for mortgage fraud).

26 18 U.S.C. § 20 defines "financial institution" as: "(1) an insured depository institution (as defined in section 3(c)(2) of the Federal

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- 18 U.S.C. § 1014 makes illegal the making of "any false statement or report, or willfully overvalue[ing] any land, property or security, for the purpose of influencing in any way the action of" the United States, federal agencies, and Section 20 financial institutions in connection with a mortgage loan. The punishment for a violation is a fine of not more than $1 million and/or imprisonment of not more than 30 years.[27]

- 18 U.S.C. §§ 1344 makes illegal the defrauding of a Section 20 financial institution. The punishment for a violation is a fine of not more than $1 million and/or imprisonment of not more than 30 years.[28]

- 18 U.S.C. §§ 1010 and 1012 make illegal any false statements for purposes of influencing the Department of Housing and Urban Development (HUD) or getting a HUD-insured loan. The punishment for a violation is a fine and/or imprisonment of not more than two years.[29]

These statutes apply to all mortgage fraud targeted at one of the named entities or types of entities. These statutes also apply to subsidiaries of entities covered by these entities in some circumstances, even if the subsidiary ordinarily would not be covered.[30] Section 1014 does not, however, reach all mortgage fraud targeted at state-licensed, non-depository mortgage lenders.

Many other federal statutes would apply to cases of mortgage fraud in various contexts.[31] These statutes include:

- 18 U.S.C. § 1348, which prohibits "defraud[ing] any person with any security of an issuer with a class of securities registered under section 12" of the Securities Exchange Act of 1934;

- 18 U.S.C. § 1001, which prohibits fraud "in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States;"

- 18 U.S.C. § 1028, which prohibits the presentation or use of a falsified identification document or other identifying information that appears to have been issued by the United States;

- 18 U.S.C. § 1342, which creates an additional offense for the use of a fictitious name or address in connection with mail fraud;

- 42 U.S.C. § 408(a)(7), which prohibits the use of false social security numbers;

- 18 U.S.C. § 1964, which provides for civil remedies for Racketeer Influenced and Corrupt Organizations (RICO) violations;

- 18 U.S.C. § 1503, which prohibits the obstruction of justice; and

- 18 U.S.C. §§ 1956-57, which prohibits money laundering.

Deposit Insurance Act); (2) a credit union with accounts insured by the National Credit Union Share Insurance Fund; (3) a Federal home loan bank or a member… of the Federal home loan bank system; (4) a System institution of the Farm Credit System, as defined in section 5.35(3) of the Farm Credit Act of 1971; (5) a small business investment company, as defined in section 103 of the Small Business Investment Act of 1958 (15 U.S.C. 662); (6) a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act; (7) a Federal Reserve bank or a member bank of the Federal Reserve System; (8) an organization operating under section 25 or section 25(a) of the Federal Reserve Act; or (9) a branch or agency of a foreign bank (as such terms are defined in paragraphs (1) and (3) of section 1(b) of the International Banking Act of 1978).

27 For an example of § 1014 being applied to mortgage fraud, *see United States v. Jack,* 2007 WL 329838 (11th Cir. Feb. 6, 2007).

28 For an example of § 1344 being applied to mortgage fraud, *see United States v. Small,* 2006 WL 3720253 (10th Cir. Dec. 19, 2006).

29 For an example of § 1010 or § 1012 being applied to mortgage fraud, *see United States v. Surujaballi,* 2006 WL 961098 (2d Cir. Apr. 11, 2006).

30 *See United States v. Walsh,* 75 F.3d 1, 9 (1st Cir. 1996) (holding that where the parent was specifically covered by one of the entity-specific statutes, and the parent determines which loan products should be offered by the subsidiary and the loan is immediately assigned to the parent, a fraud performed against the subsidiary is fraud against the parent — even where the subsidiary was not specifically covered by the statute).

31 For examples of many of these statutes applied to cases of mortgage fraud, *see SouthStar Funding, LLC v. Sprouse,* 2007 WL 812174 (W.D.N.C. Mar. 13, 2007) (18 U.S.C. § 1964); *United States v. Demetz,* 2007 WL 708975 (11th Cir. Mar. 8, 2007) (18 U.S.C. §§ 1956, 1957); *United States v. Soehnge,* 2007 WL 4213 (10th Cir. Jan. 2, 2007) (18 U.S.C. § 1342); *United States v. DeAngelis,* 2006 WL 3082674 (11th Cir. Oct. 31, 2006) (18 U.S.C. § 1001); *United States v. Havens,* 424 F.3d 535 (7th Cir. 2005) (42 U.S.C. § 408(a)(7)); *United States v. Igein,* 2002 WL 31429868 (3d Cir. 2002) (18 U.S.C. § 1028).

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Thus, in addition to the mail and wire fraud statutes and the law prohibiting transportation of stolen goods — which apply to all mortgage fraud — a large number of federal statutes also would apply to mortgage fraud in a variety of contexts.

New federal laws prohibiting mortgage fraud could have unforeseen consequences.

Enacting a new federal law — especially a federal law creating criminal penalties — carries with it the potential for unforeseen and unintended consequences. Unforeseen scenarios often arise to test the meaning of even the most carefully crafted statutes. The interpretation of a new statute may be influenced in unforeseen ways by other existing statutes (or vice versa). In the case of mortgage fraud, where well-established and well-understood federal law already provides law enforcement with the authority it needs to prosecute cases of mortgage fraud, MBA suggests that the risk of unintended consequences weighs heavily against enacting a new statute — particularly since federal law enforcement does not need additional authority to prosecute and punish mortgage fraud.

The meaning and reach of new statutes often is known only after they are applied and interpreted by the courts.

Mortgage fraud can be perpetrated in numerous ways — including ways that have not yet been discovered or considered. Unforeseen factual scenarios can challenge terms that the drafters considered clear. This is particularly true in the case of criminal statutes, where a violator is exposed to large fines and even imprisonment. In one illustrative example among many, the United States Supreme Court had to consider the meaning of the word "carries." While few would consider "carries" a potentially ambiguous term, a latent ambiguity was brought to light upon application of the statute.[32]

In contrast to any new statute, the existing laws prohibiting mortgage fraud have been on the books for many years — and, in some cases, decades. The meaning of these laws has been refined and their reach clarified through many applications and judicial interpretations. Consequently, prosecutors can bring charges under these tried and tested laws with greater confidence that the law applies to any given case — and with greater confidence that the application of that law will not lead to counterproductive appeals. It is probably for these reasons the Department of Justice has not asked for additional authority to combat mortgage fraud.

A new statute could have unwanted and/or unintended consequences.

Because of the inherent difficulty in knowing how a new statute will be interpreted or applied in every context, new statutes can have unwanted or unintended consequences. Terms may not be as broad or expansive as thought, and may result in unintended loopholes or gaps in coverage. For example, one pending mortgage fraud bill, S. 1222, would allow only a "mortgage professional" to be charged with the proposed federal crime of mortgage fraud. However, MBA's members are aware of many cases of individuals who have engaged in mortgage fraud — in particular, in the "fraud for housing" context — whether independently or in collusion with others, but who are not "mortgage professionals" as that term is defined in the bill. Even carefully crafted legislation is susceptible to such unintended gaps in coverage.

On the other hand, if terms, such as "mortgage fraud" are defined too broadly, they may encompass activities that are not "mortgage fraud" or fraudulent in any way. As a result, such activities may be subject to penalties that are not intended and are disproportionate to any harm caused. Penalties for mortgage fraud can be severe. For example, proposed S. 1222 would impose on cases of "mortgage fraud" a fine of up to $5 million and imprisonment of up to 35 years. While such criminal penalties may be appropriate in cases of true mortgage fraud, as that term is understood by law enforcement officials and the industry, such penalties may be inappropriate for other activities. For example, S. 1222 would define "mortgage fraud" to include obtaining money, including fees, under "false" pretenses — a term that is undefined in the bill. It is possible that a court could interpret this term

32 Federal law imposes a mandatory prison term for any person who, in connection with a drug trafficking offense, "carries" a firearm. One of the defendants in *Muscarello v. United States,* 524 U.S. 125 (1998), was driving a car containing illegal drugs. In the trunk, in a closed bag, was a gun. The defendant argued that he could not be considered to carry a firearm that was not within his reach and to which he did not have ready access. The Supreme Court, in a sharply divided decision, held that "carries" is not limited to carrying a firearm on one's person, but includes conveying it in a locked glove compartment or the trunk of a car.

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to a broad range of activities that are not fraudulent. Such activities might include a lender's recommending a loan to a borrower — a process that involves a lender's subjective judgment — that, after the fact, the borrower decides may not have been in his or her best interest. Even if such judgment calls could be questioned in retrospect, they are not fraudulent. Many lender actions that are not fraudulent are governed by laws and regulations that impose substantial civil penalties for violations. These penalties, as a general matter, are proportionate to the harm caused. If terms are defined too broadly, some actions may be subject to penalties that are disproportionate to any harm caused and far more severe than ever intended.

The interaction of a new law with existing law may produce unwanted consequences. Since the mail and wire fraud statutes and entity-specific statutes already apply to any case of mortgage fraud, the enactment of a new federal mortgage fraud law could be interpreted as an indication from Congress that the reach of the existing statutes may not be as broad as previously believed. As a result, it is possible to imagine a situation in which coverage of the existing statutes could be restricted by judicial interpretations, thereby restricting law enforcement's ability to enforce those laws against perpetrators of mortgage fraud. While MBA believes a court should not adopt such a view, it is not possible to predict with any certainty how courts will view the interaction of a new mortgage fraud law with existing law.

Repackaging existing laws into a single mortgage fraud statute could have similar unwanted and unforeseen consequences.

In addition to calls for new federal legislation, some have suggested repackaging existing federal law into a single mortgage fraud statute. While the motives for such a reorganization may be commendable, it is difficult to see any benefit such a reorganization would add to the fight against mortgage fraud. Law enforcement officials are sophisticated, educated in the law in this area and familiar with location of the current statutes that apply to mortgage fraud. Rearranging the existing statutes would not improve law enforcement officials' ability to understand or apply these laws.

While such a repackaging would not enhance the ability of law enforcement officials to combat mortgage fraud, it could have unwanted and unforeseen consequences similar to those discussed above. For example, court decisions interpreting laws applicable to mortgage fraud reference those laws by the law's title and section number within the United States Code. Changing the title and/or section numbers of these laws may separate the laws from the established body of precedent and confuse judges — who, although generally well versed in the law, are less familiar with these laws than are law enforcement officials. Questions may arise as to whether existing precedent applies to a repackaged law that would be a new Congressional enactment.

The risk of unwanted and unforeseen consequences, combined with the lack of any meaningful benefit from a repackaging of mortgage fraud laws, weighs heavily against such a course.

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A FEDERAL PRIVATE RIGHT OF ACTION FOR MORTGAGE FRAUD IS UNNECESSARY AND WOULD BE HARMFUL TO THE MORTGAGE INDUSTRY

Another approach that has been considered by some is the creation of a private right of action for mortgage fraud. The creation of a private right of action for mortgage fraud would harm members of the mortgage industry — the very ones mortgage fraud laws should protect.

Participants in the mortgage transaction process already have access to private rights of action under state law.

A private right of action for mortgage fraud is unnecessary because victims of mortgage fraud already have private rights of action under state law. Every state has laws providing for private rights of action for fraud. Any person or entity wishing to bring a civil action for mortgage fraud can do so under these statutes. For example, Georgia law has at least three statutory provisions that provide remedies to victims of fraud. Section 51-6-1 of the Georgia Code provides that "Fraud, accompanied by damage to the party defrauded, always gives a right of action to the injured party." Sections 23-2-51 *et seq.* also provide private equitable rights of action for fraud. Section 13-5-5 provides that "[f]raud renders contracts voidable at the election of the injured party."

Additionally, injured parties can bring civil claims against persons committing fraud under the federal Racketeer Influenced and Corrupt Organizations (RICO) Act. Engaging in a pattern of "racketeering activity" — which includes violations of the federal mail and wire fraud statutes[33] — is a criminal offense.[34] In addition to the criminal penalties, any person "injured in his person or property" by reason of a RICO violation may bring a civil action. In a civil action, a litigant may recover treble damages, as well as attorney fees.

State laws creating private rights of action for unfair and deceptive acts and practices (UDAP) would also apply to mortgage fraud. Not only do these laws provide a means for bringing a private civil action in the case of mortgage fraud, but they also frequently provide for treble damages, punitive damages and attorneys fees.[35] For example, North Carolina's UDAP statute creates a private cause of action for "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce."[36] The commission of any such act that injures a person or a business may be punished by treble damages and attorneys fees.[37]

The lone state law specifically addressing mortgage fraud suggests that the states recognize that private rights of action for mortgage fraud already exist. Georgia's Residential Mortgage Fraud Act[38] creates the criminal offense of residential mortgage fraud, but does not create a private right of action for mortgage fraud. Indeed, as discussed above, Georgia law — like the laws of other states — already provides for a private right of action for fraud, including mortgage fraud.[39] Most other state bills addressing mortgage fraud are patterned after Georgia's[40] and similarly do not provide for a private right of action — suggesting that other states recognize that an additional private right of action for mortgage fraud is not necessary.

Any federal law broad enough to reach all instances of mortgage fraud must be tempered by prosecutorial discretion.

The very breadth necessary to make a mortgage fraud statute effective in the hands of law enforcement would make it harmful to the mortgage industry in the hands of private litigants. To encompass all instances of mortgage fraud — including those not yet discovered or considered — a statute addressing mortgage fraud necessarily must be broad. In the hands of responsible law enforcement exercising appropriate discretion, a broadly phrased statute can be a valuable tool. And, in those

33 18 U.S.C. § 1961(1)(B).

34 18 U.S.C. § 1962.

35 18 U.S.C. § 1964(c).

36 N.C.G.S. § 75-1.1(a).

37 *Id.* §§ 75-16, 75-16.1.

38 Ga. Code §§ 16-8-100 *et seq.*

39 *Id.* § 16-8-102.

40 *See, e.g.,* Arizona S.B. 1221; Florida S.B. 240 & H.B. 349; Minnesota S.F. 797 & H.F. 851; Texas H.B. 716.

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cases when law enforcement abuses its discretion, defendants may resort to the courts and to the political process.

Such a broadly phrased statute only makes sense when its application is tempered by prosecutorial experience and discretion. Law enforcement personnel generally can be trusted to weigh numerous factors in deciding whether to prosecute an offense, such as the effect on public welfare, the relative seriousness of the offense, the precedential value of any judicial ruling, etc. In short, as public servants, law enforcement officials generally can be relied upon to bring only those actions that benefit the public.

The interests of law enforcement personnel are vastly different from the interests of private litigants. While law enforcement generally can be trusted to exercise its discretion to prosecute only cases where it believes some material harm has been done or where important public policy is served, private litigants do not and will not feel so constrained. The self-interest of private litigants alone could motivate private enforcement actions — even if adverse to the public welfare.

In an analogous context, periodically there are calls for a private right of action under a federal UDAP law, notwithstanding the existence of a federal UDAP law in Section 5 of the Federal Trade Commission Act (FTC Act). Congress considered and rejected creation of a private right of action when the FTC Act was enacted[41] and again two decades later when Congress amended the FTC Act.[42] Decades later, a private litigant requested that the United States Court of Appeals for the District of Columbia create a private right of action where Congress had not. The D.C. Circuit rejected this request, explaining that the expansive scope of the private right of action in Section 5 of the FTC Act makes sense only when subject to the FTC's experience and prosecutorial discretion. In language equally applicable here, the court explained:

> Inherent in the exercise of this discretion is the interplay of numerous factors: the relative seriousness of the departure from accepted trade practices, its probable effect on the public welfare, the disruption to settled commercial relationships that enforcement proceedings would entail, whether action is to be taken against a single party or on an industry-wide basis, the form such action should take, the most appropriate remedy, the precedential value of the rule of law sought to be established, and host of other considerations. Above all, there is need to weigh each action against the Commission's broad range policy goals and to determine its place in the overall enforcement program of the FTC.[43]

The court went on to explain that private litigants could not and would not exercise such discretion:

> Private litigants are not subject to the same constraints. They may institute piecemeal lawsuits, reflecting disparate concerns and not a coordinated enforcement program. The consequence would burden not only the defendants selected but also the judicial system. It was to avoid such possibilities of lack of coherence that Congress focused on the FTC as an exclusive enforcement authority.[44]

Indeed, scholars have recognized what industry has long known:

> [T]he incentives for private attorneys bear no resemblance to what motivates classic governmental law enforcement personnel. A government enforcer is charged with promoting the public good and typically is paid the same modest salary regardless of (1) which alleged wrongdoers he or she chooses to pursue, and (2) the size of any settlement or verdict he or she obtains. Private class action attorneys, in contrast, have a very direct interest in the outcome of class action litigation, since they normally keep a hefty portion of the proceeds.[45]

41 *See, e.g.,* S. Rep. No. 597, 63d Cong., 2d Sess., at 8-13 (1914); H.R. Rep. No. 1142, 63d Cong., 2d Sess., at 18-19 (1914) (Conference Report).

42 *See, e.g.,* H.R. Rep. No. 1613, 75th Cong., 1st Sess., at 3 (1937); 83 Cong. Rec. 392-406 (1938).

43 *Holloway v. Bristol-Myers Corp.,* 485 F.2d 986, 997 (D.C. Cir. 1973).

44 *Id.* at 997-98.

45 John H. Beisner et al., *Class Action "Cops": Public Servants or Private Entrepreneurs?,* 57 STAN. L. REV. 1441 (2005).

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Just as a private right of action under Section 5 of the FTC Act would be harmful to business, so too would a private right of action under a mortgage fraud law be harmful to mortgage lenders, the very entities mortgage fraud laws should aim to protect.

Putting aside the possibility of lawsuits that might directly and negatively impact lenders, there is the possibility that legal tools designed to protect lenders could be restricted in their usefulness by precedents established in a private litigation context. Federal prosecutors have indicated that they take great care to protect the statutes at their disposal and shape positively the development of precedent interpreting those statutes. For this reason, federal prosecutors are reluctant to put the enforcement of criminal statutes into private hands because of the possibility that abuse of discretion by private litigants will lead to damaging precedent — and the restriction in the power of prosecutors themselves.

A private right of action could spawn vexatious[46] and frivolous litigation and would prove costly to the industry.

Since state laws already provide private litigants with an abundance of private rights of action to address mortgage fraud, the main impact of a federal private right of action would be the creation of new possibilities for nationwide class actions against mortgage lenders. As discussed above, if the meaning of "mortgage fraud" is expanded, there is a high risk that it would apply to activities that are not truly mortgage fraud, as that term is understood by law enforcement officials and industry, and even to practices that are not fraudulent in any way. Private litigants could — and likely would — use such a statute as a proxy for other claims (whether or not the other claims have merit) because such claims may be easier to bring — and, as a nationwide class, more threatening to lenders — than claims arising from any actual injury.

The use of federal statutes to bring class actions as proxies for other types of claims is sadly commonplace. Perhaps the most infamous example is the *Rodash* case.[47] The consumer in *Rodash* brought a class action under the Truth in Lending Act (TILA) arguing that a courier fee and mortgage tax should have been included in the finance charge. Even if these small fees had been included in the finance charge, the difference in the amount of finance charge disclosed would have been negligible. This claim was brought instead of one based on the real grievance underlying the suit no doubt because the TILA claim was easier to plead and could be converted into a class action. When the plaintiff in *Rodash* prevailed, the case spawned a host of similar class action lawsuits over technical and immaterial disclosure violations.[48] This flow of class action law suits was only abated by Congress enacting a temporary class action moratorium[49] and amending TILA (known as the *Rodash* amendments) to address *Rodash.*

Similarly, a federal private right of action for "mortgage fraud" (as redefined to include non-fraudulent lender conduct), particularly if it carried large penalties, easily could become a proxy for other claims, whether the other claims have merit or not. As a result, mortgage lenders — the primary victims of mortgage fraud — would become defendants in private litigation under statutes ostensibly intended to prevent mortgage fraud.

The potential harm to mortgage lenders is exacerbated because, since the claims likely would be heavily fact based, any private right of action likely will not be capable of resolution by dispositive motion. A motion to dismiss generally is granted only if the moving party can show there is no genuine issue of material fact[50] — a standard difficult to satisfy in cases that are heavily fact dependent. A motion for summary judgment generally is granted only if the moving party can show that it is entitled to judgment as a matter of law,[51] which in fact-dependent cases often requires extensive fact discovery. As a result, lenders and other industry-related parties will not be able to resolve frivolous claims quickly and cheaply. Thus, lenders and others will be faced with a Hobson's choice of trying a nationwide class action or settling. Because of the increased size and risk, nationwide class actions — even

46 In the legal sense, "vexatious litigation" refers to litigation instituted without sufficient grounds and serving only to cause annoyance to the defendant.

47 *Rodash v. AIB Mortgage Co.,* 16 F.3d 1142 (11th Cir. 1994).

48 *See, e.g.,* H.R. Rep. 104-193, at 52 (1995).

49 Pub. L. 104-12 (codified at 15 U.S.C. § 1640(i)).

50 Fed. R. Civ. P. Rule 12(b)(6).

51 Fed. R. Civ. P. Rule 56.

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where claims are weak or frivolous — create tremendous pressure on lenders to settle (even for large sums) to avoid a potential verdict that, although unlikely, might threaten the lender's very existence. Indeed, the Supreme Court has noted that "[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense."[52]

SUGGESTIONS FOR FEDERAL LEGISLATIVE ACTION THAT WOULD ASSIST IN PREVENTING AND PROSECUTING MORTGAGE FRAUD

Federal law can enhance the prevention of mortgage fraud by increasing resources available to law enforcement and facilitating the coordination of federal and state law enforcement.

While existing federal statutes already give law enforcement the authority to prosecute all instances of mortgage fraud, there are steps federal law and policy makers can take to enhance the prevention and aid the prosecution of mortgage fraud. Since law enforcement already is authorized to prosecute all cases of mortgage fraud, the Mortgage Bankers Association (MBA) recommends that any federal legislative action focus on increasing the resources available to law enforcement and facilitating the coordination of federal and state law enforcement. MBA recommends the following:

- Federal law could create and fund a federal Office of Mortgage Fraud Enforcement with prosecutors and investigators with experience with mortgage fraud and the mortgage lending industry. This Office would have the experience necessary to effectively target mortgage fraud and would periodically report to Congress regarding its efforts and progress. By developing a centralized body of expertise, federal capabilities and a continual focus will be assured. It could be argued that the lack of such a focus until recently has let mortgage fraud become a path to profit for fraudsters. Mortgage fraud has the same or greater potential to inflict financial harm as a bank robbery, but the more hidden nature of the crime makes its perpetration easier, its detection harder, and its prosecution more difficult and apparently less appealing to some law enforcement personnel. A growing awareness of the harm done by mortgage fraud to lenders, consumers and alike, and potentially to the national financial markets has raised awareness of the impact of this type of crime. However, institutionally recognizing the seriousness of this problem by creating an Office of Mortgage Fraud Enforcement within the Department of Justice would be a logical next step in protecting against this widespread and growing abuse.

- Federal law could provide for the creation and funding of Intergovernmental Mortgage Fraud Task Forces, enhancing communication between the proposed new Office of Mortgage Fraud Enforcement at DOJ and State Attorneys General and prosecutors for purposes of coordinating the detection and prosecution of mortgage fraud.

- As part of this intergovernmental initiative, federal law could create an intergovernmental data sharing mechanism through which DOJ and the states could share information regarding mortgage fraud activities and investigations. Provision could be made for mortgage lenders to access certain parts of this database to assist in preventing instances of mortgage fraud. Mortgage lenders and other participants in the mortgage process could contribute data to such a database. The database would help to prevent serial offenders from moving from one community to another using the same fraudulent scheme to bilk lenders.

52 *Coopers & Lyrand v. Livesay,* 437 U.S. 463, 476 (1978); *see also Newton v. Merrill Lynch,* 259 F.3d 154, 164 (3d Cir. 2001) (noting that "class certification places inordinate or hydraulic pressure on defendants to settle"); *In re Rhone-Poulenc Rorer, Inc.,* 51 F.3d 1293, 1299 (7th Cir. 1995) (noting that class certification may require defendants to "stake their companies on [the] outcome of a single jury trial"); *see also* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions,* 43 STAN. L. REV. 497, 499 (1991) ("[A] significant and identifiable class of settlements is in reality neither voluntary nor accurate. These settlements are not voluntary in that trial is not regarded by the parties as a practically available alternative for resolving the dispute, and they are not accurate in that the strength of the case on the merits has little or nothing to do with determining the amount of the settlement.").

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To the extent a mortgage-specific addition to federal law is determined to be in order, a better course than enacting a new law would be to expand the applicability of an existing law. MBA suggests one or more of the following would be appropriate:

- 18 U.S.C. §§ 1014 and 1344 currently apply to fraud affecting Section 20 financial institutions, but not fraud affecting state-licensed mortgage lenders. If these provisions were expanded to cover transactions involving any "federally related" mortgage loan[53] (as that term is defined in RESPA and Regulation X), it would apply to all mortgage transactions.

- The mail and wire fraud statutes currently apply to all mortgage fraud, but apply increased fines and imprisonment only when a Section 20 financial institution is involved. If these provisions were expanded to cover transactions involving any "federally related" mortgage loan (as that term is defined in RESPA and Regulation X), the increased penalties would apply to all mortgage transactions.

By expanding an existing statute to apply to loans defined using the well-established and defined term "federally related" mortgage loan, these suggestions would have the effect of expanding the tools available to federal prosecutors, and would recognize the economic reality that with the rise of the secondary mortgage market, the number of loans originated through mortgage lenders that are not insured depositories has increased greatly.

Some provisions of S. 1222 could be effective in preventing mortgage fraud.

Several of the provisions of Senator Barack Obama's (D-IL) "Stopping Mortgage Transactions which Operate to Promote Fraud, Risk, Abuse, and Underdevelopment Act," or the "STOP FRAUD Act" (S. 1222), show that federal law can play an important role in making law enforcement more effective in combating mortgage fraud. The MBA commends Senator Obama for recognizing that a key to combating mortgage fraud is increasing funding to law enforcement and creating mechanisms for law enforcement cooperation.

In particular, the following concepts contained in S. 1222 likely will be beneficial in enhancing the ability of law enforcement officials to combat mortgage fraud:

- *Mandatory Reporting Requirements.* Section 3 of the bill would expand the obligation to report regarding certain transactions to many other types of entities involved in residential mortgage transactions, including government sponsored enterprises (GSEs), appraisers, mortgage brokers, real estate brokers, title companies and others. While the specific requirements of this bill raise concerns beyond the scope of this discussion, the concept of increasing the information available to law enforcement officials generally is a good one.

- *Communication Between Industry and Law Enforcement.* Section 4 of the bill would require the Secretary of the Treasury to establish a system whereby the mortgage industry can receive updates from federal law enforcement regarding suspicious activity trends and mortgage fraud-related convictions. Such communications would be very beneficial in assisting the mortgage industry in policing itself and preventing mortgage fraud before it occurs.

- *Database of Debarred or Censured Mortgage Professionals.* Section 5 of the bill would require the creation of a database containing the status of mortgage professionals regulated by any federal or state agency. The provision would allow the database to be accessed by authorized institutions, as well as consumers. In general, providing such information would be helpful in assisting the mortgage industry prevent mortgage fraud before it occurs, as well as in assisting consumers avoid unethical mortgage professionals.

53 *See* Real Estate Settlement Procedures Act (P.L. 93-533) and Regulation X.

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- *Increasing Funding for Appraiser Monitoring and Enforcement.* Section 7 of the bill would provide grants to state agencies with authority over appraisers to improve the monitoring and enforcement of appraisers. States with higher incidents of mortgage fraud, as determined by the FBI's and industry's statistics, would receive priority in the allocation of these funds. Because many mortgage fraud schemes include an appraisal component, such increased monitoring and enforcement would be very helpful in preventing mortgage fraud.

- *Additional Funding to Law Enforcement.* Sections 8 and 9 of the bill would increase the funding to federal, state and local law enforcement agencies. The bill would authorize grants to state and local law enforcement agencies to establish and/or improve mortgage fraud task forces and to improve the communication of such task forces with other federal, state and local law enforcement agencies. The bill also would provide additional funding to the Department of Justice to increase mortgage fraud investigation efforts. These infusions of funds into law enforcement agencies will be very beneficial in aiding the agencies' efforts in investigating and preventing mortgage fraud.

MBA believes the principles underlying the provisions discussed above are the appropriate principles for any new federal mortgage fraud legislation and that legislation based on these principles can add value to the current body of law addressing mortgage fraud.

Any new federal legislation should target mortgage fraud, not so-called predatory lending.

While the provisions of S. 1222 discussed above can be expected to enhance federal efforts to prevent mortgage fraud, the bill also has some problematic provisions. In addition to the potential loopholes discussed earlier, the bill inappropriately conflates mortgage fraud with predatory lending. Indeed, several of the provisions have little, if anything, to do with mortgage fraud as that term is understood by law enforcement officials and the mortgage industry. For example, S. 1222 would:

- Impose heightened foreclosure requirements on subprime loans containing a variety of terms;

- Create assignee liability in vague and undefined cases of "deceptive practices" — a term that, in context, appears to mean something different than "fraud"; and

- Require the provision of housing counseling services to borrowers regarding "any other activities or practices that… are likely to increase the risk of foreclosure by such individuals" without providing any guidance as to what such "other activities or practices" may be.[54]

Whether one believes such provisions have merit as a matter of public policy, they are not directly related to mortgage fraud. Instead, these provisions clearly are intended to address concerns related to "predatory" lending.

Mortgage fraud and predatory lending differ in many important respects in terms of the actions, methods and targets involved. As discussed above, mortgage fraud, as the term is understood by federal law enforcement officials and the mortgage industry, is the intentional enticement of a financial entity to make, buy or insure a mortgage loan when it would not otherwise have done so, had it possessed correct information. In contrast, predatory lending is an undefined term that generally describes negative practices that are harmful to consumers. Clear definitional boundaries around the term predatory lending have yet to be drawn. Because the actions and targets of mortgage fraud and predatory lending differ, actions taken to remedy one rarely, if ever, will remedy the other. Conflating the two creates the danger that solutions appropriate only to one will be applied to both. While there are actions federal law makers can take to address each, the numerous and essential differences between them make their conflation, as well as their simultaneous treatment, inappropriate.

54 S. 1222, §§ 6, 10.

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If federal law makers choose to enact new mortgage fraud legislation, MBA urges them to recognize that there are important differences between mortgage fraud and so-called predatory lending. MBA urges that law makers not attempt to address both mortgage fraud and predatory lending with the same statutory framework.

SUGGESTIONS FOR STATE LEGISLATIVE ACTION THAT WOULD ASSIST IN PREVENTING AND PROSECUTING MORTGAGE FRAUD

As with federal law, state law contains provisions allowing law enforcement to prosecute cases of mortgage fraud. Established state criminal laws, such as "theft by deception" and similar laws, authorize law enforcement to prosecute mortgage fraud.[55] Many state civil statutes, such as state UDAP statutes, also authorize state authorities to bring actions against perpetrators of mortgage fraud.[56] Additionally, state regulatory agencies have authority over and can take action against many participants in mortgage transactions, including mortgage lenders, mortgage brokers, appraisers and real estate agents.

Any additional state legislation, if desired, should reference or be closely patterned on well-established federal law.

As discussed above, new legislation carries with it the risk of unwanted or unintended consequences. In contrast, as explained above, numerous provisions of federal law authorize the prosecution of mortgage fraud. While state law enforcement and state regulators may not have authority to enforce federal law, if state law makers decide to enact new state laws to address mortgage fraud, MBA urges state legislatures to pattern any new law upon the existing federal precedent or to incorporate the language of federal law into a state statute.

State law already authorizes state law enforcement to punish many, if not all, instances of mortgage fraud.

Model Statutes

While several federal laws apply to mortgage fraud, two statutes in particular — 18 U.S.C. §§ 1014 and 1344, which prohibit defrauding Section 20 financial institutions — are particularly well-suited to serve as a pattern for a state mortgage fraud statute. Basing any new state legislation on these two statutes has several significant benefits.

- These two laws are broad enough to allow law enforcement officials to prosecute all instances of mortgage fraud, yet appropriately tailored so as not to extend beyond mortgage fraud. Thus, they address true mortgage fraud without attempting to reach the very different issues arising from "predatory" lending.
- These statutes also are tried and tested and can be modified as appropriate for state law without losing the benefit of the precedent interpreting them.
- The federal statutes already exist. Differences between state and federal law (and between the laws of different states) will make mortgage fraud statutory regimes less coherent and will hinder the ability of federal and state law enforcement officials working together to fight mortgage fraud. On the other hand, if any new state law mirrors federal law, mortgage fraud prevention regimes will be more coherent and intergovernmental cooperation will be facilitated.

If state law makers wish to enact state mortgage fraud legislation in addition to the laws already in place, MBA strongly urges that state legislatures consider the following model statutes:

Definitions.

"Financial Institution" means any entity that originates, funds or purchases loans to individuals secured by residential real estate. "Financial Institutions" include, without limitation,

55 *See, e.g.,* Ala. Code § 13A-8-2; Alaska Stat. § 11.46.180.

56 *See, e.g.,* Ala. Code § 8-19-10; Alaska Stat. § 21.36.150.

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[INSERT STATE CHARTERED AND STATE LICENSED FINANCIAL INSTITUTIONS]

Loan and Credit Applications. [Based on § 1014] Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, for the purpose of influencing in any way the action of a financial institution, officer, or employee thereof, upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution of security therefor, in connection with a loan to an individual secured by residential real estate, shall be fined not more than $1 million or imprisoned not more than 30 years, or both.

Lender fraud. [Based on § 1344] Whoever knowingly executes, or attempts to execute, a scheme or artifice —

(1) to defraud a financial institution; or

(2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises; shall be fined not more than $1million or imprisoned not more than 30 years, or both.

Additionally, comments to any such legislation should indicate that the statutes are patterned on 1014 and 1344, and that precedent interpreting those sections also should apply to the state law. By thus patterning state law on existing federal law, state prosecutors can benefit from the long history of interpretation and application of federal law it incorporates.

Georgia's Mortgage Fraud Law

MBA notes that one state — Georgia — has enacted a mortgage fraud statute and that bills patterned on that statute have been introduced in other states. While Georgia's statute may contain some beneficial provisions for law enforcement, it is less beneficial than a state law closely patterned on federal law. Federal law, especially sections 1014 and 1344, have been applied numerous times, resulting in a body of judicial precedent applying and interpreting the statute and giving law enforcement a comfort level with the statute.

In contrast, there are no reported judicial decisions applying or interpreting the Georgia act. In fact, two recent cases of mortgage fraud involving Georgia mortgages were each prosecuted under federal law, rather than Georgia law. One, involving Phillip Hill, has attracted a great deal of attention nationally because a former professional athlete was among the victims.[57] In the other, the so-called "poster child" of mortgage fraud pled guilty to several violations of federal law.[58] While both cases involved significant numbers of Georgia properties, neither case was prosecuted under the Georgia act.

Because there is no judicial precedent regarding the Georgia act, there is greater uncertainty regarding the meaning and scope of its provisions. For example, the term "mortgage lending process" is untested and could be interpreted in such a way that it may not apply to all cases of mortgage fraud.

Finally, for the same reasons discussed above, a private right of action under a state mortgage fraud law could be harmful to mortgage lenders. Private litigants already have the right to bring private actions addressing mortgage fraud under state fraud and UDAP laws. Because a new private right of action could harm mortgage lenders and is unnecessary, MBA urges state law and policy makers to reject any calls for such provisions.

Any new state legislation should target mortgage fraud, not so-called predatory lending.

Whether a state opts to pattern any mortgage fraud law on existing federal law, as MBA recommends, or to follow another pattern, states should recognize that there are important differences between mortgage fraud and activities by mortgage industry participants that are characterized as predatory. As

57 *See, e.g.,* R. Robin McDonald, *Athletes Caught Up In Mortgage Fraud Case,* FULTON COUNTY DAILY REP., Jan. 23, 2007, at 1; R. Robin McDonald, Phil Hill, 18 *Others Charged With Fraud,* FULTON COUNTY DAILY REP. June 9, 2005, at 3.

58 *See, e.g.,* Bill Torpy, *Mortgage Fraud "Poster Child" Pleads Guilty,* ATL. J.-CONST., Apr. 10, 2007.

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discussed above, the actions and targets of mortgage fraud and predatory lending differ — and actions taken to remedy one rarely, if ever, will remedy the other. MBA urges that states not attempt to address both mortgage fraud and predatory lending with the same piece of legislation.

Generally, laws or bills addressing mortgage fraud and/or predatory lending can fall into three categories:

1. *Laws that target mortgage fraud without confusing the term with predatory lending.* This category addresses true cases of mortgage fraud without attempting to address actions that allegedly harm consumers.[59] MBA urges that state law and policy makers, if they decide that the state's mortgage lenders need additional protection, draft any proposal so that it addresses mortgage fraud and only mortgage fraud.

2. *Laws that purport to address mortgage fraud but that also seek to address predatory lending.* Laws that address true mortgage fraud, but that address other practices that allegedly harm consumers, would fall into this category.[60] An example of such legislation on the federal level is S. 1222. As discussed above, due to the differences between mortgage fraud and predatory lending, one remedy is highly unlikely to address both appropriately. Laws providing for a private right of action for mortgage fraud may fall within this category.

3. *Laws that use the term "mortgage fraud" but are aimed largely, if not exclusively, at predatory lending.* MBA suggests that laws aimed at predatory lending should be so described.[61] The term "mortgage fraud" should not be used as a red herring in proposing or enacting predatory lending legislation.

MBA recommends that any new State legislation be evaluated based upon its effectiveness in actually preventing mortgage fraud.

As discussed above, current state law already gives state law enforcement officials all the authority they need to prosecute mortgage fraud. Nevertheless, if state legislatures decide to enact additional legislation targeted at mortgage fraud, MBA urges state legislatures to craft any such legislation consistent with the following principles:

- *Any State Mortgage Fraud Law Should Enhance the Resources Available to Law Enforcement Officials to Combat Mortgage Fraud.* While state laws already authorize law enforcement officials to combat mortgage fraud, MBA believes the most beneficial thing new legislation could do is increase the funding and resources available to law enforcement to combat mortgage fraud. As recommended above in the context of federal legislation, state law enforcement could be more effective at prosecuting mortgage fraud if the state created a dedicated funding stream, a dedicated state law enforcement office focused directly on mortgage fraud and provided for cooperation with federal officials and officials from other states. MBA recommends the following:

    + State law could increase the funding available for mortgage fraud prosecution. One example of a method for increasing funding for mortgage fraud is the Washington Mortgage Lending Fraud Prosecution Account, which created a small surcharge imposed on the recording of a deed of trust.[62] Fines collected in connection with such enforcement could be used to offset the costs of enforcement.

59 *See, e.g.,* Arizona S.B. 1221; New York S.B. 2746; Utah H.B. 25.

60 *See, e.g.,* Colorado H.B. 1323.

61 *See, e.g.,* Michigan H.B. 6436; Ohio S.B. 185.

62 R.C.W.A. § 43.320.140.

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+ State law could increase the funding allocated to state regulators with authority to regulate and examine lenders, brokers, real estate agents, appraisers, etc. to assist them in detecting and punishing mortgage fraud.

- *Any State Mortgage Fraud Law Should Target Mortgage Fraud.* As discussed above, there are important differences between mortgage fraud and predatory lending. Given these differences, measures that address one often are inappropriate for the other. Legislation intended to address mortgage fraud should not also attempt to address predatory lending. If a state legislature determines that predatory lending legislation is necessary and appropriate, it should address this issue under separate statutory provisions that focus on the predatory lending practices the legislature believes need to be addressed. Any attempt to deal in the same statutory framework with two distinct behaviors — mortgage fraud, as historically defined ,and so called predatory lending — could jeopardize the effective prevention of both.

- *Any State Mortgage Fraud Law Should Be Consistent With Current Federal Law. Mortgage fraud is a problem nationwide.* Mortgage fraud schemes often are not confined within the borders of any one state. The ability of law enforcement officials from the federal government and various states to work together would be enhanced if the officials were operating under similar statutory regimes. To facilitate intergovernmental cooperation in combating mortgage fraud, any new laws should mirror existing law — in particular, the existing federal law.

Conclusion

Mortgage fraud remains a growing problem, affecting both those who make loans and those who receive loans. As this paper demonstrates, the necessary legal framework, both statute and case law, exists to prosecute those who knowingly and willingly seek to defraud lenders. What is currently missing, however, are the necessary resources to investigate and prosecute mortgage fraud. MBA strongly supports efforts to provide those resources and stands ready to work in cooperation with legislators and regulators in all levels of government to eliminate this problem that hurts lenders, honest borrowers and entire communities.

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