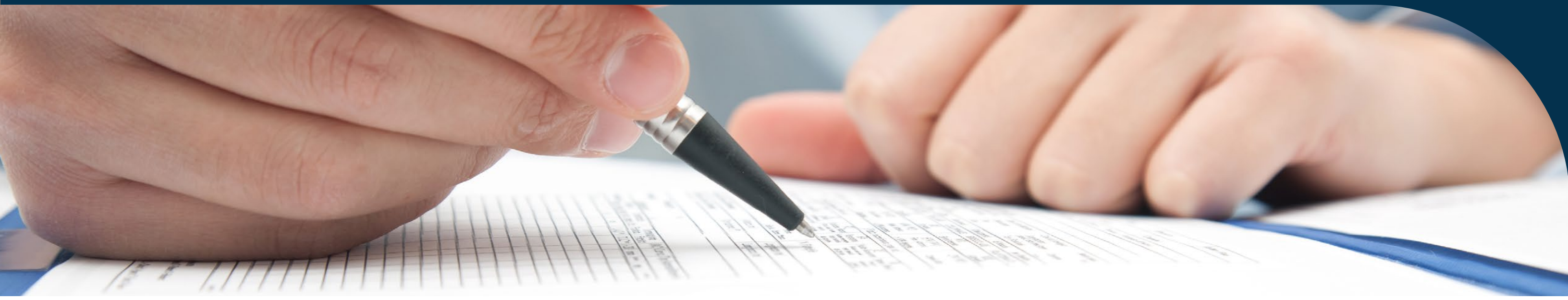

Reviewing your fraud controls in QC

Fraud is a frequent topic of discussion with lenders. That's not surprising, given the rapid shiftft in the market in 2022, which included staff reductions and significant drops in origination volumes relative to prior years. Two of the three elements in the Fraud Triangle, Opportunity and Pressure, are uniquely positioned to impact the industry in this environment. Large changes in staffing create opportunity as people might exploit turnover or changes in control environments during times of transition. Additionally, reduced volume creates new financial pressures for industry participants. Given this backdrop, it's a critical time for lenders to sharpen their focus relative to fraud.

Fannie Mae provides publicly available data on fraud trends at our Mortgage Fraud Prevention webpage. Our datashow that misrepresentation on non-third-party loans is more frequent than misrepresentation on third-party loans. Lenders should ensure they have an equal control environment for their own production and third-party production. Top drivers include:

- Income and employment (62% in 2020–2021)
- Liabilities (increased from 23% in 2020 to 33% in 2022)
- Occupancy (increased from 10% in 2020 to 18% currently)

Specific examples recently reviewed by Fannie Mae have included creation of false child support orders alongside false divorce decrees, which were designed to show borrower income; falsified lease agreements to show rental income; and modified bank statements with an ending balance that did not align with the beginning balance and the transactions.

Misrepresentation of outstanding financial obligations continues to increase. The Federal Reserve Bank of New York reported increases in mortgage debt, student loans, auto liabilities, and home equity line of credit (HELOC) balances in Q1 2023 relative to Q1 2022. The number of outstanding credit card accounts increased from 500 million in Q1 2020 to 600 million in Q1 2023. With the increased number of accounts in circulation, borrowers have more opportunities to not include (intentionally or not) key financial obligations as part of their loan application.

Lenders have a responsibility to respond to the increase in fraud and misrepresentation. Among the tools in their toolbox:

- Use a critical eye and heightened sense of awareness during this time period.
- Create a rules engine that pulls loans with certain characteristics/red flags.
- Establish a tipline within your organization.
- Confirm quality control (QC), operations, and sales team members receive regular fraud training.

Our data show that retail and third-party organizations are notably impacted and may be at higher risk for fraud.

- Obtain a fully executed IRS Form 4506-C on all borrowers whose applications require 1040s, and order transcripts to verify Schedule C and Schedule E business activities.
- Perform reverifications in prefunding QC.
- Confirm appraisal management companies' controls.
- Run all borrowers employed by family through LexisNexis.
- Utilize webinars from the **Association of Certified Fraud Examiners** to see the latest types of fraud.
- Collaborate with servicing teams to determine if any similar patterns of fraud exist; for example, if origination is finding numerous instances of fraud in a certain county, is servicing seeing anything similar?

Given the unique financial pressures and opportunities that exist in the current market, lenders should continue to remain diligent and continually look out for ways to improve their fraud detection and prevention controls.

General Fraud Detection and Prevention Tips

- Establish a zero-tolerance fraud policy.
- Understand and know the practices of the businesses in your third-party originations (TPO) channel.
- Establish, and encourage the use of, a hotline/inbox for employees to report suspected fraud.
- Utilize at least one fraud detection tool on all loans in your pipeline.

Common red flags

- Paystubs do not show common deductions and withholdings.
- Pay increases or job titles do not make sense.
- Gifts are not able to be verified by the donor(s).
- Paystub earnings are rounded dollar amounts.
- New job on January 1 with a significant pay increase.
- Paystubs that do not have dollar signs and/or have fonts that don't match.
- Paystubs with different formatting.
- Deposits and withdrawals don't add up to the ending balance.
- Rental income from a departure residence despite the intention to sell the property.
- Rental income based on falsified lease agreements.
- An employer's phone number cannot be confirmed online.
- Uncommon child support or alimony payment amounts.

Resources

***Selling Guide* A3-4-03 Preventing, Detecting, and Reporting Mortgage Fraud**

Mortgage Fraud Prevention

Association of Certified Fraud Examiners

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