

Fraud Focus – Borrower or Lender/Service



Does your Company focus on all or some of these “fraudsters”?

- Borrower – application issues, employer verification, cash available and collusion,
- Loan officer,
- Underwriter,
- Secondary market employees,
- Title company & employees,
- Investor or Insurer & employees,
- Senior Management/officer,
- Others?

Fraud Happens!



What happened in these Frauds and how was it carried out:

A. Lender creates two versions of the loan/note.

Two Notes are signed by the borrower - the Lender creates each note with different rates and sells the loan with the low rate to the secondary market. This fraud is typically executed with higher risk loans and Lender uses the spread to offset defaulted loan costs). No fraud based questions are asked of the borrower by the loan investor.

B. Duplicate loan sales to different investors or “double warehousing”.

Lender creates “duplicate notes” (eNotes are effective fraud prevention in most cases) and sends to the buyer of the loan and/or to the warehouse banks that finance the lender. The failure to detect occurs most often due to poor document controls and the lack of reconciliation (in place at the custodian, warehouse lender and the lender’s accounting staff) of what loans are sold or warehoused between the parties.

More Fraud Happens!



C. Company uses PI & TI and loan payoff funds for corporate needs, payroll, advances, etc.

The Lender has poor liquidity and it uses collected servicing funds (principal and interest, payoffs, tax and insurance escrows) for corporate needs, payroll, advances, etc. Poor reconciliation of the advances actually made by the Company, what the Servicing Advance receivable balance is per the financials and the amounts per the servicing system (what the balance of the investor/mortgagor trust accounts should be and the respective cash accounts).

D. Fraudulent financials and/or tax returns for borrowers that are business owners, fraudulent tax preparers, IRS transcripts.

Self-employed borrowers are very difficult to underwrite. Falsified financials and/or tax returns are the primary issue. Tax preparers will create fraudulent tax returns and the Lender fails to obtain IRS transcripts.

Even More Fraud Happens?



E. Off-balance sheet servicing cash accounts (non-banks)

Non-bank servicers will not show the balance of the trust servicing accounts in the financials. Controls over these off-balance sheet servicing cash accounts may not exist which allows servicing personnel to set up cash accounts to move funds into their personal accounts.

F. Support loan approval and/or Investor requirements

LO's or others make changes to the application and supporting documents to demonstrate basis for approval or investor purchase.

Every day a new type of Fraud Happens?



G. Lender/servicer financial statement fraud to meet net worth requirements, liquidity and other bank loan covenants, etc.

Given higher net worth, liquidity, debt to equity and other financial metrics to be approved by Federal agencies, warehouse banks, loan investors, etc. – the Company (senior management) commits fraud to ensure that the financial statements will meet the applicable requirement.

H. Loan modification schemes: Perpetrator offers to renegotiate the mortgage terms with the lender for an upfront fee.

I. Air loans and Property flipping: Sale occurs with a false/straw borrower, falsified appraisal and loan documentation with kickbacks to all parties involved.

J. Silent second: The property buyer borrows the down payment from the seller through the issuance of a non-disclosed second mortgage.

K. Hackers Stealing Your Down Payment

L. Foreclosure rescue schemes: Service company/lender misleads borrower that they can save their home by deed transfer to an investor.

Corporate Frauds



Hilltop has identified and mitigated frauds at the Corporate level:

- managers overstating sales to achieve higher bonuses,
- “padding” travel/business expense reimbursements,
- asset misappropriation (stolen IP/assets, retail inventory, technology software/hardware, etc.),
- sales or other financial measures overstated to increase earn-outs on acquisition agreements,
- understating/not disclosing major risks – regulatory, litigation, loss of contracts, etc.,
- securities fraud (including insider trading and/or market manipulation),
- insurance fraud (false claims made, shared claim with insurance adjustor),
- assisting borrowers covering up financial problems and inability to repay,
- establishing corporate bank accounts to use for personal gain (moving funds to such),
- creating transactions, documents, financial entries and more to “puff up the financials”,
- skimming higher sales price and having the company record a lower fraudulent price – this also allows the seller to “kick-back” funds to the buyer of the goods.
- unauthorized write-offs of receivables or customer refunds recorded but not paid,
- payroll fraud (payment made to ghost employees), and
- check tampering (forged maker, forged endorsement, altered payee and authorized maker schemes).

And the list keeps growing....

Fraud is Hard to Prevent & Detect!



Management of a company is responsible for designing and implementing controls to prevent/deter, detect and mitigate an identified fraud or financial crime. However, identifying fraud or financial crimes requires the following:

- Most senior management teams do not have fraud training or a significant amount of skepticism (most auditors have a “healthy dose” of skepticism but they don’t have all the information that senior management has)
 - **Result** – most frauds go undetected!
- Most auditors have a basic level of investigative skills (especially as data and the technology that produces such is growing more and more complex),
 - **Result** – too much reliance is put on the auditors to prevent, detect and mitigate!
- Most senior management and auditors do not have specific fraud training.
 - **Result** – prevention/detection is difficult when you don’t know where to look and don’t have significant prior fraud experience.

Hilltop has the resources, training, experience with hundreds of frauds to help your Company assess its fraud vulnerability, identify the likely exposure and help mitigate the fraud outcome.