



STATEMENT

OF

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**. “The Role of Mortgage Fraud in
the Financial Crisis and Its Impact on Miami, Florida.”**

BEFORE

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Mr. Chairman and distinguished Members of the Committee. I would like begin by thanking this Committee for the opportunity to represent the State of Florida and the Florida Department of Law Enforcement on the topic of investigating mortgage fraud. I am Special Agent Ellen Wilcox with the Florida Department of Law Enforcement. FDLE Special Agents investigate complex felony cases which target criminal organizations, whose illegal activities and/or associates cross jurisdictional boundaries, include multiple victims, represent a major social or economic impact to Florida, and/or address a significant public safety concern. FDLE's primary investigative efforts are divided into five focus areas: Violent Crime, Economic Crime, Major Drugs, Public Integrity and Domestic Security. Mortgage Fraud is a major component of the Economic Crime focus and is one of the top priorities for FDLE. The Department is committed to working complex, protracted high impact criminal investigations. Because of their complexity, cases are lengthy and labor intensive, resulting in Special Agents investing more hours in fewer cases over a longer period of time. Also, the elimination of Special Agent positions due to budget reductions has had an impact on the number of cases that are being investigated.

Mortgage fraud is not new; it has existed for many years; however, in 2003/2004, the mortgage industry exploded, particularly in the sub-prime arena, and mortgage fraud followed along. The extreme price increases in the real estate market have provided for easy concealment of criminal activities and other abuses as the perpetrators' schemes were concealed in, and absorbed by, the legitimate rise in real estate values and sales. Now that the real estate market has tanked, these frauds are more apparent and are being reported by the investment firms left holding the bad loans.

The State of Florida and the Florida Department of Law Enforcement have been addressing the mortgage fraud problem for many years. In 2005, FDLE Office of Statewide Intelligence issued a mortgage fraud assessment, warning that mortgage fraud was running rampant. This document and other research were used to support the need for a new mortgage fraud statute, which was passed by the Florida legislature in 2007. The Economic Crime Bureau for Miami-Dade Police Department was instrumental in getting this legislation passed. This Bureau also identified the need to train more investigators and obtained a grant to provide specialized training to law enforcement investigators throughout the state in 2008. In 2009, the Tampa US Attorney's office also coordinated a two day seminar for state and federal investigators and prosecutors. This was significant as there is very little training on financial crimes available for prosecutors. I am an adjunct instructor for the National White Collar Crime Center (NW3C) in their course, Financial Records Evaluation and Analysis. The course is applicable to the investigation of any financial crime, but the case study used during the course is a mortgage fraud investigation. FDLE has helped to sponsor this class throughout the state since 2000. Because mortgage fraud cases are complex, this type of specialized training is needed for successful investigations; however, most agencies training budgets have been cut back and can fund only mandatory law enforcement training. Fortunately, all of the training mentioned above was able to be provided free to the law enforcement community.

FDLE has dedicated at least two Special Agents per FDLE region/office with expertise in mortgage fraud to investigate mortgage fraud cases. There are currently 40 Special Agents with active mortgage fraud investigations (16% of total agents). Within my squad, 3 of the 6 Special Agents have open mortgage fraud investigations. Numerous FDLE cases are being worked jointly with Office of Financial Regulation, which is the agency under Florida's Chief Financial Officer that regulate and investigate mortgage brokers. This partnership brings another level of expertise to an investigation. FDLE is also participating in Federal Mortgage Fraud Task Forces through the state. I am part of the FBI Mortgage Fraud Task Force in Tampa. This has helped to promote a more cooperative atmosphere between all state, local and federal agencies to ensure that all

available resources were being focused on the mortgage fraud issue. Even with all these joint efforts, resources are still limited. Limited resources and the complicity of mortgage fraud cases result in only the most egregious of the offenses and offenders being targeted for investigation and prosecution.

I would like to cover some of the problem areas that investigators have encountered while investigating mortgage fraud:

1. Mortgage fraud investigations are complex and paper intense, causing most investigators and prosecutors to shy away from these types of cases. The typical mortgage fraud investigation takes one to two years to investigate. Most Sheriff's Offices or Police Departments can not dedicate that length of time to a single investigation. The length of these investigations makes them less attractive to both investigative agencies and prosecutors trying to justify their budgets based on investigative statistics. The FDLE case known as "Florida Beautiful" was opened in 2005; that is when FDLE was asked to assist in the investigation. The case had already been developed and worked by Tampa Police Department and Hillsborough County Consumer Protection for almost a year. During this five year investigation, ten investigators and two prosecutors contributed significant time to this task force. Over 250 subpoenas were served resulting in tens of thousands of documents, which were all reviewed and analyzed. The investigation resulted in 18 arrests. The defendants ranged from the processor in the mortgage brokerage business, to the construction foreman, to the mortgage broker, and up to a Vice President of a national sub-prime lender. Two defendants are still awaiting trial.

Many of the mortgages being investigated for fraud were stated income loans, commonly referred to as a "liar's loan". The borrower was allowed to state their place of employment and their income amount. The lender usually verified the place of employment, but accepted the income amount as long as it fell within very lenient range of typical salaries for that employment type. I work for a State agency, so I do not have access to federal tax returns. In order to prove that the income amount is false, I need to do a complete analysis on my target's financial status for that time period. This requires obtaining and analyzing records from all of the target's bank accounts. This process is time consuming and costly, as state law allows for reimbursement for the production of records in response to a subpoena.

2. No one at the state level is mandated to coordinate the response of the various agencies that regulate the mortgage and real estate industry. When a victim tries to file a criminal complaint, they generally go their local Police Department or Sheriff's Office. If the complaint involves mortgage fraud, most street officers really do not understand the complaint and, in the past, have told the victim that their complaint is either civil or regulatory. Most Police Departments and Sheriff's Offices now require that a report of the alleged crime be written, even if the complaint might ultimately be determined to be civil or regulatory. The victim may also try to file a complaint with a Florida regulatory agency. However, in Florida, there are at least four different regulatory agencies that govern parties to a mortgage transaction. Complaints to one agency were not necessarily shared with other agencies that could have investigated or might have received complaints about the same schemes. With the formation of task forces throughout the state, we are slowly overcoming the issue of sharing information.
3. If you ask a State prosecutor what the number one problem is the answer will be Statute of Limitations. Most mortgage fraud will not be reported until the mortgage goes bad,

but the “crime” occurred when the money was lent. If there was mortgage fraud in the granting of a mortgage loan in 2004, it can not longer be criminally charged. In Florida, the statute of limitations for obtaining a mortgage by false representations is only three years; for an organized scheme to defraud it is four years; and for grand theft, the statute of limitations is five years. In a conspiracy or racketeering charge, the mortgages prior to 2005 can be used as predicate acts, but not actually charged as substantive crimes. This has impact on the sentencing guidelines. There is a fraud exception to the statute of limitations, conditioned upon the date of discovery of the fraud, that can extend the time period for up to 3 years; However, most agencies, both investigative and prosecutorial, can not justify spending a year or more on an investigation that is relying solely on this exception. This is due to fact that pinpointing such a date is often speculative and difficult to prove, and if the exception is disallowed, or the agreed upon time moves, the case might be lost due to the events falling outside the statute of limitations.

4. In a criminal case, the State must have a witness from the original lender as the lender is the “victim”. This witness must identify the documents that were critical to their lending decision. The witness must then testify that “if he/she had known that these documents critical to the lending decision were fraudulent, he/she would not have loaned the money”. If the lender is out of business, how does the state find that witness? Defunct lenders that gave out substantial mortgage loans in Florida include Argent Mortgage; AmeriQuest; Long Beach Mortgage; Mortgageit; First NLC Financial Services; First National Bank of Arizona, Ownit Mortgage Solutions; American Brokers Conduit; First Franklin; Taylor, Bean, & Whitaker Mortgage Corp., etc.

We spend an exorbitant amount of time trying to find someone that worked for that now defunct lender. If I find a former underwriter or account manager, I then tell them that I need them for one or two days to testify on behalf of a company that they no longer work for. The “testifying” part usually scares away half of my prospects. Then I tell them that we will be paying actual expenses, plus a \$5.00 witness fee. A trial subpoena requires their current employer to release them to testify, but it does not require the employer to pay the employee for the time missed. That does not leave a lot of incentive for people to testify on behalf of the State.

5. In a criminal investigation, the first hurdle that we must overcome is obtaining the documentation of the mortgage transaction from both the lender and the title company. The lender’s file provides the information about the lending decision and the documentation provided by the borrower and/or broker to support this lending decision. The title file allows the investigator to “follow the money”. If the lender and/or title company is out of business, how can we find the records? Under Florida laws, the records retention period for a mortgage broker is only three years. For a lender, the records retention period is three years by state law and five years by federal law. For a title company, the records retention period is the longest at seven years. But if the company goes out of business, what does the owner do with the business’ records? Most destroy their records. What are the consequences? On the state level, the owner could be held responsible for failure to maintain records by revoking the individual’s license, fines, and other penalties. However, realistically nothing is done. In one of my investigation, I found that a Federal bankruptcy judge granted an order to a major lender to destroy their records because the lender could not afford to pay the storage fee. In another case, the lender was a bank taken over by FDIC so two different state subpoena were issued. In response to the first state subpoena, a FDIC senior attorney responded “that as a federal agency, the FDIC is not subject to a subpoena issued by a state court in

connection with proceedings in which the agency is not a party". For the second subpoena, the FDIC took over a year to respond and responded by stating that the loan file could not be located. In most cases, the lender file can be located by contacting the loan servicer. However, we are now facing a court challenge as to the use of this file from the loan servicer.

6. If the information on the loan application is false, how does an investigator prove who put down that false information? For most loans, the information on the loan application is input into a computer program, printed and then faxed to the lender. For some lenders, an application can be completed online. So who provided the false information - the mortgage broker, the borrower, a lender representative? One defendant has put forth the defense that that information and the documents passed through so many hands, the state can never prove who actually put in the false information and supplied the false supporting documentation. Without originals, a handwriting analysis cannot even be done on the signatures.
7. In Florida, most closings are handled by title companies. The typical borrower views the title company as "trustworthy" authority and believes that the title company is watching out for their best interest. However, title companies are an independent third party and do not represent any of the parties of the transaction. According to a title agent, the title company should be more aligned with the interest of the lender as they have to certify that they have followed the lenders' closing instructions. In reality, title companies are loyal to their clients; usually the mortgage brokers or realtors, as their future business rely on repeat business from these brokers.

A typical closing occurs at a title company and the licensed title agent goes over the documents as the buyer/borrower signing each document. The title agent will usually point out the terms of the note and explain the basic purpose of each document. However, a title company is allowed to use a mobile notary to handle closings that can not occur in the title office. I interviewed an individual that had a very lucrative mobile notary business during the housing boom. This individual stated that a mobile notary's job is to make sure the buyer/borrower signs all of the closing documents and that the person signing matches a valid form of identification. This mobile notary specifically stated that he DOES NOT go over any of the documents being signed; he just points out where the document must be signed. In almost every investigation where the borrower/"investor" claimed that they just signed the documents, a mobile notary was used. In the Florida Beautiful case, the mortgage broker paid to have his employees become notaries so that they could handle the closings and control what the borrower saw and signed.

8. The last problem is probably the biggest obstacle to a criminal case – proving INTENT. We have numerous cases where "investors" were brought into a scheme to make money from flipping houses. These "investors" were told that their name and credit would just be used to buy houses. After the houses were "fixed" up, the houses would be re-sold and they would participate in the profit. Some were even paid part of the "profit" upfront for the use of their credit. Now that the market has crashed, these investors are left with these houses in their names and the mortgages in foreclosure. The "investors" are now claiming that they are victims. The "investor" is shown the loan documents filled with false information. The investor responds that they did not provide that information to the lender; it was done by a third party. At the closing, the "investor" did sign the closing documents, but did not read what they were signing. The closing person just pointed to

spot on each document where they should sign. This scenario happened regularly during the housing boom.

Now in 2010, what do we do with that “investor”? If the State charges the “investor” with submitting false loan documents, his first defense is that he gave the correct information to the mortgage broker and the broker changed the information and submitted it to the lender. A prominent defense attorney just presented his potential defense to the State by saying that there is a distinct difference between false documents and fraudulent documents. Fraudulent documents imply intent. His client may have signed documents with false information, but did not have any intent to defraud the lender. Therefore, with no intent, his client has not committed a crime. It doesn’t matter that the borrower signed a loan application right under an attestation that the information is true and correct, because no one reads that part and no one at the closing explained the documents before they were signed.

If the State charges the mortgage broker with submitting false documents on behalf of the borrower, the first defense raised will be that the borrower provided the false information and that the broker just passed it onto the lender. Therefore, the broker had no intent to defraud the lender. Besides, the borrower signed the final loan application at the closing which had all of the false information on it. For an application that failed to list other real estate owned and their corresponding liabilities, another defense has been presented the loan application is completed by an online software program that self populates the various fields, particularly liabilities, with information directly from a credit report. Therefore, if other mortgage debt was not listed, it was just an “error” caused by the credit reporting agency.

What if the “investor” was a waitress that actually made \$1,200 per month, but the loan application stated that she made \$9,000 per month and she managed to buy four (4) houses totaling \$900,000 within seven (7) months? This waitress claimed that she had no “intent” to defraud any lenders because she was just doing what her broker boyfriend suggested and she did not read anything that she signed because she doesn’t read English. Should the waitress be charged with a crime? The prosecutor declined to prosecute the waitress, but is planning to charge the broker boyfriend.

What if the “investor” is a law student that actually made \$3,755 for the entire year, but the loan application stated that she made \$6,750 per month. The law student purchased only one property for \$290,000. The law student claimed that she had no “intent” to defraud the lender because she was just doing what her broker brother suggested and she did not read anything that she signed. The law student never made any of the mortgage payments, even after graduating. Her broker brother paid the mortgage payments for approximately six (6) months before defaulting. The loan application stated that this would be a primary residence for the law student; however, a renter was already in the home at the time of the purchase. The renter stayed in the home and paid rent to the law student for approximately 15 months, until the renter was served with the foreclosure notice. Should the law student be charged with a crime?

What if the “investor” worked for a major lender making \$50,000 per year, but the loan applications stated that she made \$105,000 or \$180,000 per year? This “investor” purchased eleven (11) properties in six (6) months totaling \$3.6 million. The “investor” claimed that she had no “intent” to defraud the lender because she was just doing what her broker husband suggested and she did not read anything that she signed. The

“investor” also claimed that the income was actually correct for both her and her husband, and the lender told her that “household” income could be used, even though she was the sole applicant. Should this investor be charged with a crime?

Mortgage fraud is not stopping or going away. It used to mean something to own real estate – to buy your first home. It was a valued asset, a status symbol, an investment in the future. Now, thanks to infomercials, it is just a way to get rich quick.

With the current bailouts, mortgage modifications, and mortgage forgiveness programs, these “investors” and/or fraudsters are just taking advantage of the system and these new programs. The fraudsters are stalling foreclosures with bankruptcy or proposed short sales. The fraudsters are finding new “investors” for short sale purchases so that the foreclosure does not continue to affect their credit.

For example, Citimortgage, Wachovia and other lenders got caught up in a condominium conversion scam by a developer, basically a builder bailout scheme. The condominium units were primarily sold to investors for around \$300,000, with lenders giving mortgages for 90% of the value. Within a year, most of the loans went into default. The lenders were then solicited by the same investors to authorize short sales and some of these short sales have occurred. Public records show that one condominium sold as a short sale for \$32,500 and then, without the knowledge of the lender, was re-sold the same day for \$48,000. A short sale is usually based on representations from a realtor to the lender that this is the best price available in the current market. Obviously in this case, someone didn’t inform Citimortgage of the best price available.

I was asked what changes are needed legally and regulatory to prevent mortgage fraud. I would love to say hire more investigators and prosecutors and training them to handle complex financial crime cases. But in these hard budget times, that’s not at all realistic. Instead, I would like to make the following suggestions that might help:

1. Require lenders to do more due diligence before they fund the loan. You might consider some type of form with itemized listing of “due diligence” the lender has accomplished and acknowledges under oath. There would need to be criminal and/or civil sanctions for failure to complete, violations, or perjury on the form. At the beginning of the loan process, the borrower signs an authorization that allows the broker and/or lender to pull financial information.
2. Require lenders’ due diligence to include the IRS form 4506-T. At the closing, lenders have the borrower sign an IRS form 4506-T, which authorizes the lender to obtain a transcript of the borrower’s tax return. In the past, most lenders never sent this form to the IRS. Increased due diligence could include a requirement that the IRS form 4506-T be signed at the beginning of the loan process and if a loan is approved based on a “stated” income, the IRS form 4506-T must be submitted to the IRS prior to funding the loan.
3. It may not be practical to require that every closing be done by a licensed title agent, but there should be some requirement that a document review be completed at the time of signing closing documents. This could include licensing and training of mobile notary publics.
4. Require that a final loan application be signed at closing and that the closer be required to have the borrower review the loan application for accuracy prior to signing the

acknowledgment.

5. Require that the lender apply a “suitability test” to the loan – is the loan appropriate for that type of borrower and can the borrower handle any future changes to the terms of the loan. A suitability test is currently being used in the securities industry.
6. There is currently a three day rescission period for a re-financing mortgage loan. The three days allows the lender to do quality control on the loan documents to assure that the underwriting is still sufficient before funding the loan. However, most lenders did little to no quality control review until well after the loan was funded. This quality control review should be mandatory for all lenders and a similar rescission period may be appropriate for mortgage loans on new purchases.
7. A standardized records retention requirement and definitive standards for non-compliance. If the record were required to be maintained electronically, the problem with storage facilities would be eliminated. The records retention should require the lender to maintain the documentation that supported their lending decision. If the loan is sold, this documentation needs to be included in the loan package sent to the investor and/or loan servicer.

Thank you for this tremendous opportunity and I look forward to your questions.