MORTGAGE FRAUD: IN BRIEF

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Public outcry caused by the mortgage crisis, the dramatic increase in foreclosures, and the downward spiraling market have cast much attention on the investigatory and prosecutorial efforts of the FBI, DOJ, and numerous other federal agencies.[1] In response, significant resources have been relocated to these efforts.[2] This piece presents a brief snapshot of the current investigatory climate in the area of mortgage fraud, as it relates to the market crisis, discusses the types of crimes under investigation and up for prosecution, and rejects the argument that prosecutors need a new criminal statute to fight this traditional type of criminal conduct.

Some Statistics

In a joint press release on June 19, 2008, the Department of Justice (DOJ) and the Federal Bureau of Investigation (FBI) announced that over the course of three and a half months Operation Malicious Mortgage (OMM) has yielded 144 mortgage fraud cases in which 406 defendants were charged.[3] These figures represent only a portion of the significant results achieved by "the joint collaborative efforts" of at least nine different federal agencies.[4] Over this short period, OMM had uncovered over $1 billion in losses from mortgage fraud schemes nationwide, according to its own reports.[5] While OMM has focused on three specific types of mortgage fraud schemes--lending fraud, foreclosure rescue schemes, and

[1] Eric Lichtblau, David Johnston, and Ron Nixon, *F.B.I. Struggles to Handle Financial Fraud Cases*, The New York Times (Oct. 19, 2008), *available at* http://www.nytimes.com/2008/10/19/washington/19fbi.html (last visited Oct. 20, 2008) ("The Federal Bureau of Investigation is struggling to find enough agents and resources to investigate criminal wrongdoing tied to the country's economic crisis, according to current and former bureau officials. . . . The pressure on the F.B.I. has recently increased with the disclosure of criminal investigations into some of the largest players in the financial collapse . . . ."); Noeleen G. Walder, *Criminal Prosecutions Predicted to Surge Over Financial Crisis*, New York Law Journal (Oct. 9, 2008), *available at* http://www.law.com/jsp/article.jsp?id=1202425138326 (last visited Oct. 20, 2008) ("With public anger reaching a boiling point over plunging stock prices and Wall Street "greed," white-collar defense attorneys are preparing for an inevitable surge in criminal prosecutions . . . . [The recently enacted] $700 billion bailout bill . . . provides that federal financial regulatory agencies must cooperate with the FBI and other law enforcement agencies 'investigating fraud, misrepresentation, and malfeasance with respect to development, advertising, and sale of financial products.'").

[2] Lichtblau, Johnson, and Nixon, *supra* note 1 ("Republicans and Democrats in Congress are pushing for a more aggressive response by the F.B.I. . . . [Some members have] called on Congress to triple the F.B.I.'s financing for financial crimes investigations); Walder, *supra* note 1 ("[U.S. Attorney] Campbell acknowledged that the mood of the country might affect decisions on resources devoted to such investigations . . . .")

[3] Federal Bureau of Investigation, *Press Release: More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage"* (June 19, 2008), *available at* http://www.fbi.gov/pressrel/pressrel08/mortgagefraud061908.htm (last viewed Oct. 20, 2008); Department of Justice, *Press Release: More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage"* (June 19, 2008), *available at* http://www.usdoj.gov/opa/pr/2008/June/08-odag-551.html (last viewed Oct. 20, 2008).

[4] *Id.*

[5] *Id.*

mortgage-related bankruptcy schemes--the President's Corporate Fraud Task Force has directed its resources to corporate sector mortgage fraud.[6]

The "Latest Mortgage Fraud Statistics" provided by the FBI on its Mortgage Fraud homepage[7] demonstrate both the motivation behind and the need for the nationwide crackdown.[8]

- Total estimated annual losses from mortgage fraud: $4 billion to $6 billion
- Total FBI Mortgage Fraud Task Forces/Working Groups (as of September 2008): 42
- Pending FBI Mortgage Fraud Investigations (as of August 2008): 1,569
- Cases opened in Fiscal Year 2007: 462 (as compared to 295 in Fiscal Year 2003)
- Successes in Fiscal Year 2008 (as of August 2008): 523 indictments/informations and 282 convictions
- States with Significant Mortgage Fraud problems in 2008: (1) Florida, (2) Nevada, (3) Michigan, (4) California, (5) Utah, (6) Georgia, (7) Virginia, (8) Illinois, (9) New York, and (10) Minnesota[9]

<u>The Activity Under Investigation</u>

In its Financial Crimes Report for the Fiscal Year 2007, the FBI explains that each mortgage fraud scheme contains some type of 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.[10] According to this report, while the FBI investigates both fraud for housing, which represents illegal actions perpetrated solely by the borrower, and fraud for profit, which is sometimes referred to as "Industry Insider Fraud," its primary focus is on the later.[11] Some of the current trends in this area include equity skimming, property flipping, and mortgage related identity theft.[12] In the area of mortgage-backed securities, the FBI is focusing on material misrepresentations, overvaluation, and insider trading.[13] The largest area of mortgage fraud activity seems to be on the local level and may be characterized as "White Collar Street Crime," in that it essentially consists of traditional white collar crimes – mail fraud and wire fraud – on an individual and personal level.[14]

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[6] *Id.*

[7] Federal Bureau of Investigation, *Just the Facts: The Latest Mortgage Fraud Statistics*, *available at* http://www.fbi.gov/hq/mortgage_fraud.htm (last viewed Oct. 20, 2008).

[8] According to a recent New York Times article, "[i]n addition to the investigations into Fannie Mae and Freddie Mac, the F.B.I. is carrying out investigations of American International Group and Lehman Brothers, and it has opened more than 1,500 other mortgage-related investigations." Lichtblau, Johnson, and Nixon, *supra* note 1.

[9] Federal Bureau of Investigation, *supra* note 7.

[10] Federal Bureau of Investigation, *Financial Crimes Report To The Public Fiscal Year 2007*, Mortgage Fraud Section (Oct. 1, 2006 – Sept. 30, 2007), *available at* http://www.fbi.gov/publications/financial/fcs_report2007/financial_crime_2007.htm#Mortgage (last viewed Oct. 20, 2008).

[11] *Id.* at Mortgage Fraud, I. General Overview.

[12] *Id.*

[13] Evan Perez, *Familiar Abuses Seen in Latest Finance Crisis*, The Wall Street Journal (Oct. 2, 2008), *available at* http://online.wsj.com/article/SB122307667720003963.html (last visited Oct. 20, 2008) ("Campbell, U.S. Attorney for New York's Eastern District, said . . . that his office has come across instances of material misrepresentation, insider trading and valuation discrepancies.").

[14] "[E]ven if authorities snare a few 'big fish,' state and local prosecutors are likely to pursue hundreds of retail-level fraud cases against individual brokers, real-estate agents and buyers. Just last week, three people pleaded guilty in the Southern District of New York to a multimillion dollar subprime mortgage scheme, bringing to 11 the number of defendants convicted so far in the case." Walder, *supra* note 1.

Indicting the Criminal Conduct

Senator Obama has sponsored the STOP Fraud Act, S. 1222, which seeks to address many aspects of this crisis with several non-criminal provisions. For example, the legislation would provide state and federal agencies with additional funds to combat mortgage fraud, improve monitoring and enforcement, and create mortgage fraud task forces. It also would widen reporting requirements, authorize and fund mortgage fraud counseling, and create borrowers' rights in foreclosure proceedings. However, Section 2 of the STOP Fraud Act moves outside the area of protection, regulation, and funding – arguably all necessary for combating this market crisis – and into the realm of new criminal law. Specifically, it seeks to amend Chapter 63 of Title 18 of the United States Code by adding a new criminal statute, 18 U.S.C. § 1350, that creates, defines, and penalizes "Mortgage fraud."[15]

Creating a new crime of "mortgage fraud" is unnecessary and redundant. This is because material misrepresentations and omissions, overvaluation, and insider trading already fit under the well established crimes of mail, wire, bank, and securities fraud, as codified in 18 U.S.C. §§ 1341 *et seq*. The Federal Criminal Code also contains numerous criminal provisions for prosecuting fraud and false statements (Title 18, Chapter 47) and obstruction (Title 18, Chapter 73) – statutes that cover the type of criminal activity that often occurs as part of, or in the attempt to cover-up, mortgage fraud. Furthermore, the FBI recently acknowledged the applicability of these same provisions, along with a few others, to the activity and conduct that is encompassed under the proposed crime of "mortgage fraud." The FBI statement specifically identifies nine "applicable Federal criminal statutes which may be charged in connection with mortgage fraud."[16]

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[15] The proposed language of 18 U.S.C. §1350 is as follows:

(a) In General. – It shall be unlawful for any mortgage professional to knowingly execute, or attempt to execute, a scheme or artifice –

(1) to defraud any natural person, financial institution, or purchaser of consumer credit or an interest in consumer credit (as such term is defined in subsections (e) and (h) under section 103 of the Truth in Lending Act (15 U.S.C. 1602(e) and (h))), which credit is, is to be, or is portrayed to being secured by an interest – (A) in real property; or (B) in personal property used or expected to be used as the principal dwelling (as such term is defined under section 103(v) of the Truth in Lending Act (15 U.S.C. 1602 (v))) of the natural person to whom such consumer credit is offered or extended; or

(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property, including without limitation in the form of fees or charges, from a natural person in connection with an extension of consumer credit which is, is to be, or is portrayed as being secured by an interest – (A) in real property; or (B) in personal property used or expected to be used as the principal dwelling of such natural person;

(b) Penalties –

(1) Criminal Penalties. – Any mortgage professional who violates subsection (a) shall be fined not more than $5,000,000, or imprisoned not more than 35 years, or both.

(2) Civil Penalties. – Any mortgage professional who violates subsection (a) shall be liable to an amount equal to the sum of all finance charges and fees paid or payable by the natural person, financial institution, or purchaser who was defrauded unless the mortgage professional demonstrates that such violation is not material.

[16] The list includes the following statutes: (1) 18 U.S.C. § 1001 – Statements or entries generally, (2) 18 U.S.C. § 1010 – HUD and Federal Housing Administration Transactions, (3) 18 U.S.C. § 1014 – Loan and credit applications generally, (4) 18 U.S.C. § 1028 – Fraud and related activity in connection with identification documents, (5) 18 U.S.C. § 1341 – Frauds and swindles by Mail, (6) 18 U.S.C. § 1342 – Fictitious name or address, (7) 18 U.S.C. § 1343 – Fraud by wire, (8) 18 U.S.C. § 1344 – Bank Fraud, and (9) 42 U.S.C. § 408(a) – False Social Security Number. Federal Bureau of Investigation, *Press Release: FBI Issues Mortgage Fraud Notice In Conjunction With Mortgage Bankers Association* (Mar. 8, 2007), *available at* http://www.fbi.gov/pressrel/pressrel07/mortgagefraud030807.htm and http://www.fbi.gov/pressrel/pressrel07/mortgagefraudwarning.pdf (last viewed Oct. 20, 2008).

According to a Press Release from Senator Obama, the STOP Fraud Act "will provide the first federal definition of mortgage fraud and authorize stiff criminal penalties against fraudsters."[17] Both Senators Obama and Durbin explicitly cite the need for "strict" and "stiff penalties to deter fraud and protect consumers."[18] Considering, however, that the proposed definition crime of "mortgage fraud" is much narrower than the definitions of mail and wire fraud, but the proposed penalties are significantly greater -- a $1 million fine and 20 year sentence for mail and wire fraud versus a $5 million fine and 35 year sentence for mortgage fraud – the desire for harsher and lengthier penalties may be the actual motivation behind this new federal crime. *See* 18 U.S.C. §§ 1341, 1343. This amounts to creating a crime of "aggravated" fraud in the mortgage area, and provides for sentences that are comparable to the most violent crimes on the books. Congress should not rush to re-criminalize behavior that is already criminalized as an easy answer to a difficult problem.

<u>Conclusion: No New Legislation</u>

The fact that prosecutors have been making significant strides in the battle against mortgage fraud, as evidenced by the success of programs like Operation Malicious Mortgage, seriously undercuts any argument for a new federal mortgage fraud crime. The admission by the FBI and prosecutors alike, that they have the statutory power to pursue the criminal activity potentially behind the market crisis, further dilutes any argument for additional criminal legislation. While the numbers clearly demonstrate that this crisis is significant and that the response must be dramatic, the fact remains that both state and federal investigators and prosecutors are sufficiently armed with the tools necessary to tackle the job.

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[17] Barack Obama, U.S. Senator for Illinois, *Press Release: Obama, Durbin Introduce Bill to Fight Mortgage Fraud and Abuse* (April 25, 2007), *available at* http://obama.senate.gov/press/070425-obama_durbin_in/ (last visited Oct. 23, 2008).

[18] *Id.*