A Historical Look at Mortgage Fraud

Lessons Learned and How to Prevent Future Risk

ARMCO
ACES RISK MANAGEMENT

"Spikes in mortgage fraud are precipitated by several distinct factors."

- Phil McCall, President of ARMCO

Factor: Rise in interest rates

When interest rates increase, the number of refinances decreases – reducing the number of overall mortgage transactions.

"Reductions in transaction volume can impact revenue and income, creating the 'need' for fraudulent transactions among the unscrupulous."

- Phil McCall, President of ARMCO

Factor: Increase in purchase transactions

Purchase transactions bring more "moving parts" and more interested parties.

"The more participants involved in each transaction, the greater the opportunity for quality oversights and fraud."

- Phil McCall, President of ARMCO

Factor: Loosening guidelines and regulations

With most mortgage businesses, fewer regulations lead to more lenient underwriting and eligibilty guidelines. This results in weaker quality checks - creating the opportunity for fraudulent activity to slip by undetected.

"We've seen it too many times to not know: looser regulations can be a slippery slope when it comes to lender QA and fraud mitigation."

- Phil McCall, President of ARMCO

MORTGAGE FRAUD IN THE 1980's

Savings & Loan Crisis

1,043 of 3,234 savings and loan associations in the US failed between 1986 and 1995

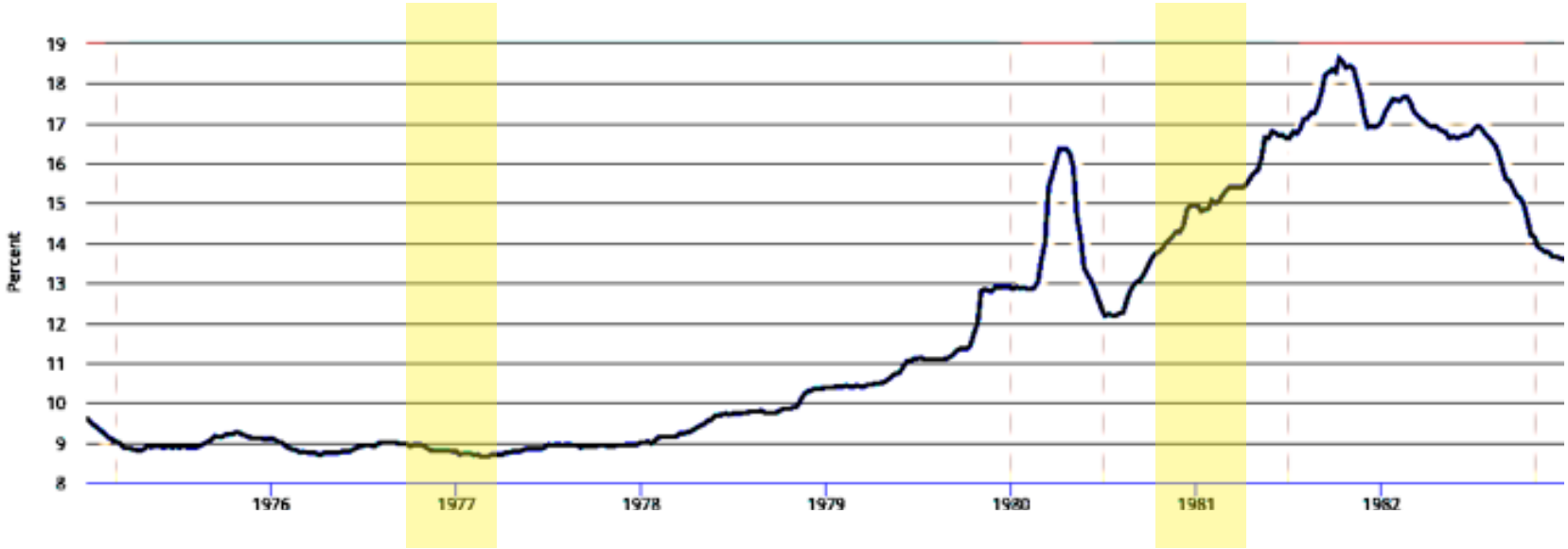
OVER 32% Failure Rate

MORTGAGE FRAUD IN THE 1980's

Interest Rates Increased in the Years Prior to the S & L Crisis

Interest Rate Average Comparison

1977: 8.85% 1981: 16.63%

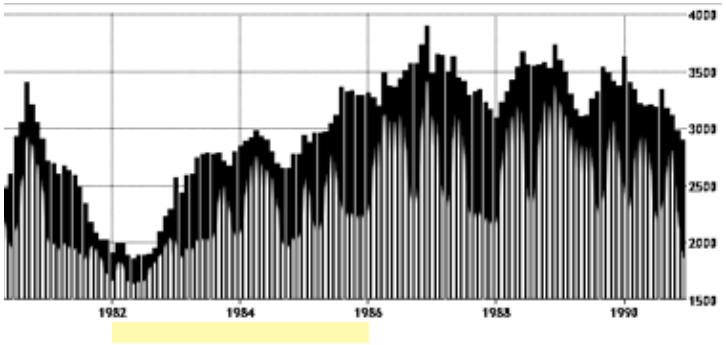


Freddie Mac 30 year fixed rate 1975-1982

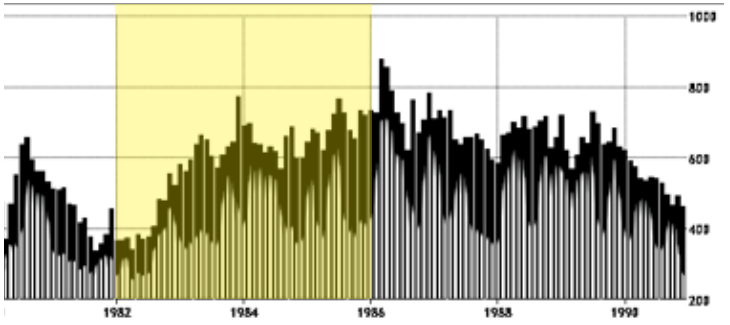
MORTGAGE FRAUD IN THE 1980's

Purchase Transactions Increased in the Years Prior to the S & L Crisis

Both new and existing home sales increased dramatically between 1982 and 1986 – the start of the S&L crisis.



Existing Home Sales 1980-1990



New Home Sales 1980-1990

MORTGAGE FRAUD IN THE 1980's

Regulations Loosened in the Years Prior to the Chain of S & L Failures

1980

The **Depository Institutions Deregulation and Monetary Control Act** removes many restrictions on thrifts and credit unions.

1982

The **Garn-St. Germain Depository Institutions Act** gives thrifts greater latitude to invest in real estate loans.

1986

The **Tax Reform Act** fundamentally alters the banking landscape and engenders conditions that contributed to the banking crisis.

MORTGAGE FRAUD IN THE 2000's

Subprime Mortgage Crisis

The U.S. housing market bubble burst, triggering a global economic recession.

MORTGAGE FRAUD IN THE 2000's

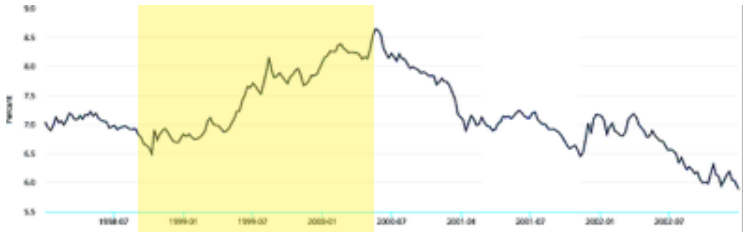
Interest Rates Increased in the Years Prior to the Mortgage Meltdown

Interest rates dipped in the late 1990s then spiked in 2000

October 1998: 6.49%

Freddie Mac 30 year fixed rate 1995-2002

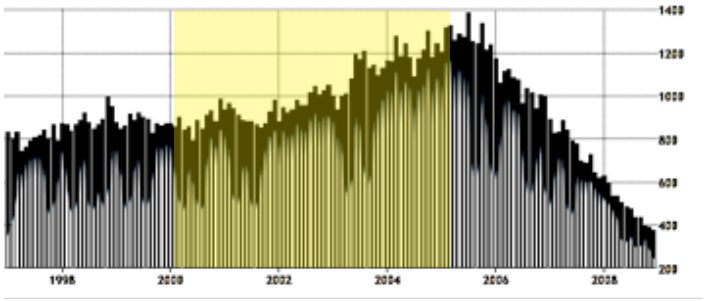
May 2000: 8.62%



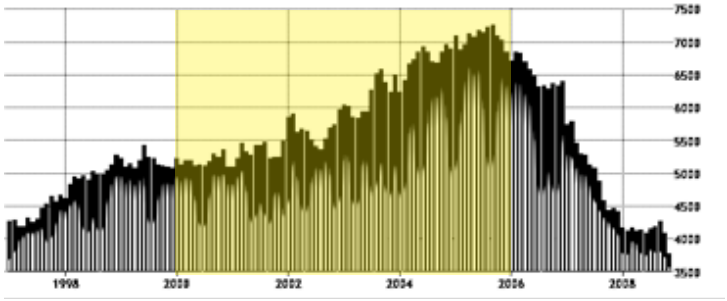
Freddie Mac 30 year fixed rate 1998-2002

MORTGAGE FRAUD IN THE 2000's

Purchase Transactions Reached a Fever Pitch in the Years Leading to the Mortgage Crisis



New Home Sales 1997-2008



Existing Home Sales 1997-2008

According to the U.S. Census Bureau, homeownership in the U.S. peaked at an all-time high of 69.2%.

According to FinCEN (Financial Crimes Enforcement Network, a division of the U.S. Treasury Department), "Between 1997 and 2005, the number of SARs [Suspicious Activity Reports] pertaining to mortgage loan fraud increased 1,411 percent."

MORTGAGE FRAUD IN THE 2000's

The mortgage and financial markets underwent major loosening of regulations and guidelines.

1998

Brooksley Borns, head of **Commodity Futures Trading Commission (CFTC)** recommends investigating over-the-counter derivatives like credit default swaps, but is shut down.

1999

Fannie Mae eases credit requirements. **Gramm-Leach-Bliley Act repeals Glass-Steagall Act**, deregulating banking, insurance, securities and financial services industry.

2000

Commodity Futures Modernization Act of 2000 declares credit default swaps to be unregulated, banning the SEC, Fed, CTFC, state insurance companies and others from meaningful oversight.

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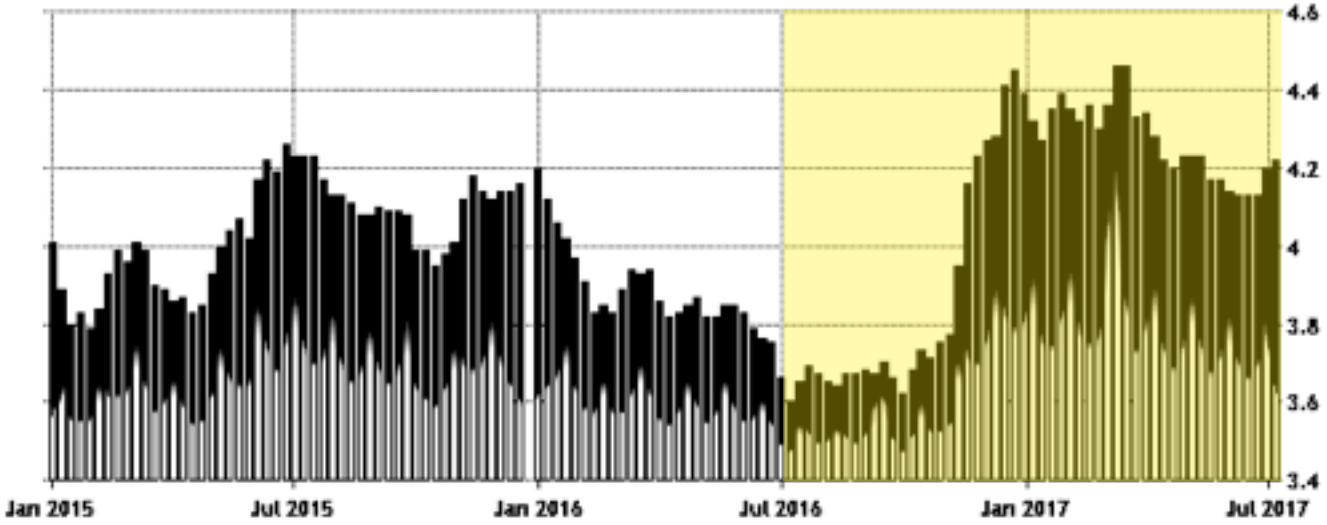
Fraud factor evaluation for 2017...

FACTOR: Rise in Interest Rates

Mid-2016 to Mid-2017:

Interest rates have gone up from a low 3.42% to over 4.0%

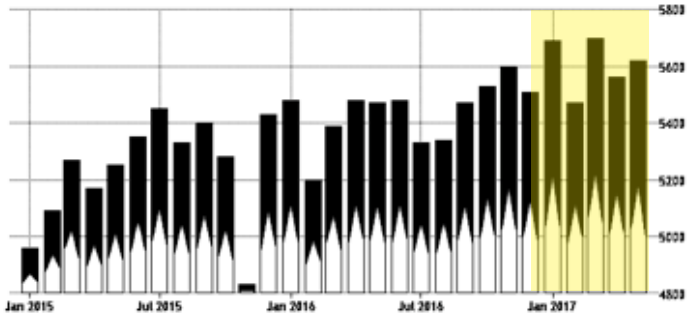


Freddie Mac 30 year fixed rate 2015-present

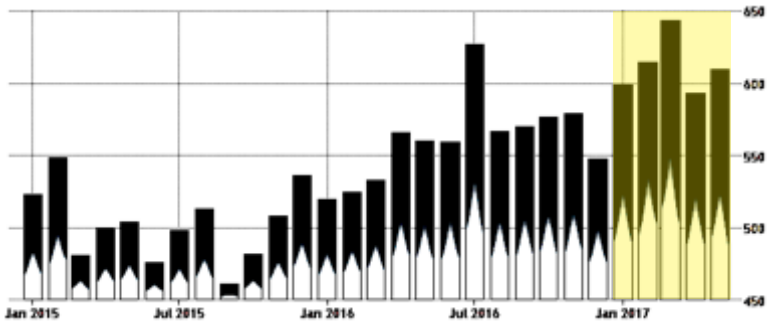
Current Outlook

FACTOR: Increase in Purchase Transactions

Both new and existing home sales are reaching higher levels in 2017 than in the past two years.



Existing home sales 2015 - present



New home sales 2015 - present

Current Outlook

FACTOR: Loosening Regulations

January 2017: President Trump vows to do "a big number" on Dodd-Frank.

However, regulations have not yet loosened.
The future of the CFPB remains in question.

The Implications of Fraud and Low Quality Loans

	S & L Crisis (1980's)	Mortgage Crisis (2000's)
Failed Institutions	1,043	465
GAO* Estimated Cost	$160 Billion	$22 Trillion

* U.S. Government Accountability Office

Lessons Learned from Past Fraud Cycles

"While fraud cycles may be out of lenders' control, fraud itself can be prevented.

We have at our disposal the most **advanced mortgage QC solutions** that we've ever had in the history of our industry.

If lenders can learn from the past and leverage the tools they have at present, they can protect themselves from the devastating repercussions of fraud in the future."

Phil McCall
President of ARMCO

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