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Nicholas McCann

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FEDERAL LAW ENFORCEMENT IN THE HOME MORTGAGE  
LENDING MARKET ENHANCED BY THE “FRAUD  
ENFORCEMENT AND RECOVERY ACT OF 2009”

*Nicholas McCann\**

*I. Introduction*

The rise of the subprime lending market in the early 2000’s allowed many Americans who may have otherwise been denied credit to realize the dream of homeownership.<sup>1</sup> However, with the benefits of the subprime lending market came more opportunities for improper and fraudulent lending practices. The subprime lending market was particularly susceptible to fraud due to innovative adjustable rate mortgages, a wider variety of pricing options, and new methods of selling these loan products to consumers. During the peak of the subprime mortgage market, half of all subprime mortgages were originated by private mortgage lending businesses that were not regulated by the federal government.<sup>2</sup> Mortgage fraud perpetrated by these unregulated private mortgage brokers may have contributed to the instability and loss in the residential lending market that contributed to the mortgage crisis.

In response to the sharp increase of reported fraud in the mortgage industry, on May 20, 2009, President Obama signed the bipartisan “Fraud Enforcement and Recovery Act of 2009” (“FERA”) into law.<sup>3</sup> FERA enhanced several federal statutes

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\* J.D. Candidate, May 2010, Loyola University Chicago School of Law.

<sup>1</sup> Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 FED. RES. BANK OF ST. LOUIS REV. 31, 31 (2006) (Potential borrowers in the subprime market may fail credit history requirements in the prime mortgage market, and therefore have greater access to credit in the subprime market).

<sup>2</sup> Greg Ip & Damian Paletta, *Lending Oversight: Regulators Scrutinized in Mortgage Meltdown –States, Federal Agencies Clashed on Subprimes As Market Ballooned*, WALL ST. J., Mar. 22, 2007, at A1 (Federal regulators had no enforcement authority over state-licensed, stand alone private mortgage lenders).

<sup>3</sup> Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123

pertaining to financial fraud, particularly those that are applicable to mortgage fraud prosecutions.<sup>4</sup> The clear purpose of the provisions of FERA applicable to mortgage fraud prosecutions was to substantially strengthen the federal government's ability to investigate and prosecute mortgage fraud.<sup>5</sup> Additionally, policy makers sought to provide more "accountability for the corporate and mortgage frauds that contributed to the recent economic collapse."<sup>6</sup> FERA enhances the federal government's ability to investigate and prosecute mortgage fraud in two ways: (1) FERA amended key federal statutes to include private mortgage lending businesses and mortgage brokers within the definition of a "financial institution," allowing the application of federal fraud statutes and enhanced punishment provisions to private mortgage brokers; and (2) FERA substantially increases resources to federal investigative and prosecutorial agencies to disrupt and prosecute mortgage fraud.<sup>7</sup>

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Stat. 1617 (2009) (codified as amended in scattered sections of 18 U.S.C.) ("[a]n Act to improve enforcement of mortgage fraud, securities and commodities fraud, financial institution fraud, and other frauds related to Federal assistance and relief programs, for the recovery of funds lost to these frauds, and for other purposes").

<sup>4</sup> FERA modified several important financial fraud statutes that will not be analyzed in this note, including the "False Claims Act" 31 U.S.C.A §§ 3729 - 3733 (2006) *amended by* Pub. L. No. 111-21, §4a-c, 123 Stat. 1621-25 (2009), and the federal Major Frauds against the United States statute 18 U.S.C. § 1031 (2006) *amended by* Pub. L. No. 111-21, §2d 123 Stat. 1618 (2009), which now includes the Troubled Asset Relief Program funds in order to protect Government assistance from fraud that was provided during the economic crisis.

<sup>5</sup> Press Release, Office of the Press Sec'y, The White House, Remarks by the President at the Signing of the Helping Families Save Their Homes Act and the Fraud Enforcement and Recovery Act (May 20, 2009) *available at* [http://www.whitehouse.gov/the\\_press\\_office/Remarks-by-the-President-at-Signing-of-the-Helping-Families-Save-Their-Homes-Act-and-the-Fraud-Enforcement-and-Recovery-Act/](http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-at-Signing-of-the-Helping-Families-Save-Their-Homes-Act-and-the-Fraud-Enforcement-and-Recovery-Act/) (President Obama stating that FERA "provides the resources necessary for [ . . . ] law enforcement and federal agencies, from the Department of Justice to the SEC to the Secret Service, to pursue these criminals, bring them to justice, and protect hardworking Americans affected most by these crimes").

<sup>6</sup> S. REP. NO. 111-10, at 2 (2009), *reprinted in* 2009 U.S.C.C.A.N. 430; *see also* 155 CONG. REC. S4531-01 (daily ed. Apr. 22, 2009) (statement of Sen. Kaufman) (" [ . . . ] this bill is a critical step to restoring investor confidence in the financial markets by assuring the public that criminal behavior by unscrupulous mortgage brokers and corrupt financiers will be prosecuted and punished").

<sup>7</sup> S. REP. NO. 111-10, at 3.

This note will discuss the purpose of FERA and predict whether its statutory enhancements and allocation resources for federal law enforcement will protect homeowners and the lending industry from mortgage fraud perpetrated by private mortgage brokers. Part II of this note will provide a context for federal law enforcement against mortgage fraud. First, a brief history of the rise and fall of the subprime mortgage market is necessary to discuss the extent to which mortgage fraud perpetrated by private mortgage lenders played a role in the mortgage crisis. Next, mortgage fraud will be defined, and an overview of its victims and case examples will be provided. Additionally, the landscape of federal statutory law prior to the enactment of FERA will be analyzed.

Part III this Note will discuss the Congressional intent behind enacting FERA and how FERA fits within, and changes, the landscape of federal law enforcement of mortgage fraud. Part IV will analyze and predict the effectiveness of FERA in future fraud enforcement, and address criticisms of FERA. Ultimately, FERA necessarily updates federal statutory law to address fraud in the modern real estate market. Additionally, FERA provides the resources necessary to ensure that those laws are enforced for the purpose of protecting home mortgage lenders, and ultimately consumers.

## *II. Home Mortgage Lending and Mortgage Fraud*

The subprime mortgage crisis arose from aggressive and risky lending practices, and in part because homeowners took on debt that they could not afford. The mortgage lending industry has been hit hard by billions of dollars in losses as risky subprime loans have increasingly gone into default, and analysts expect hundreds of thousands more loans could go bad over the next several years.<sup>8</sup> Opportunities for improper practices in mortgage lending were much more prevalent in the subprime market than in the prime market, because the subprime market offers a wider variety of loan products and strategies to craft pricing options and risk mitigation.<sup>9</sup> The relative contributions to lender failures that have been made by fraudulent activity, as opposed to risky and misjudged mortgage products, are not known and may never

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<sup>8</sup> Rick Brooks & Ruth Simon, *Subprime Debacle Trans Even Very Credit-Worthy*, WALL ST. J., Dec. 3, 2007, at A1.

<sup>9</sup> Joseph D. Adamson & Todd J. Zywicki, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 8 (2009).

be clear.<sup>10</sup> However, there has been a significant increase in suspected mortgage fraud and other mortgage-related criminal activity in the home lending market.<sup>11</sup>

### A. The Subprime Lending Market

Subprime loans are high interest loans that are offered to people who typically do not qualify for market rate mortgages. Potential borrowers, who are unable to meet the credit history requirements for standard or prime mortgages, have greater access to credit in the subprime market.<sup>12</sup> Traditionally the mortgage market set minimum lending standards based on a borrower's financial history. However, the subprime market introduced a substantial amount of risk based pricing with innovative loan products by varying the interest rates of a loan based upon the borrower's credit history and down payment.<sup>13</sup> Furthermore, upfront and continuing costs are higher for subprime loans, including application fees, appraisal fees, and other fees associated with originating a mortgage.<sup>14</sup> Low documentation and stated income and option adjustable rate mortgages offered to non-conforming borrowers were the key

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<sup>10</sup> Merle Sharick et al., *Tenth Periodic Mortgage Fraud Case Report to the Mortgage Brokers Association*, 10 MORTGAGE ASSET RES. INST. 8 (2008) available at <http://www.marisolutions.com/pdfs/mba/mortgage-fraud-report-10th.pdf> (last visited Feb. 20, 2010); Press Release, Fed. Bureau of Investigation, Letter to the Editor Regarding the Mortgage Crisis, available at <http://www.fbi.gov/pressrel/pressrel08/kaiserletter090208.htm> (last visited Feb. 20, 2010) (“[F]raud alone does not appear to be the straw that broke the mortgage camel’s back” because most of the mortgage crisis can be attributed to very aggressive lending practices and too little risk management in the mortgage industry).

<sup>11</sup> *Enforcement of Financial Consumer Protection Laws, Before the Comm. on Fin. Servs.*, 111th Cong. 2 (2009) (statement of Elizabeth A. Duke, Member, Bd. of Governors of the Fed. Reserve Sys.) available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/frb\\_-\\_duke.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/frb_-_duke.pdf) (last visited Feb. 20 2010) [hereinafter *Enforcement of Financial Consumer Protection Laws*].

<sup>12</sup> Chomsisengphet & Pennington-Cross, *supra* note 1, at 31.

<sup>13</sup> *Id.* at 55.

<sup>14</sup> *Id.* at 32 (federal deregulation of the mortgage industry opened the door to the development of the subprime lending market); see Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified at 12 U.S.C. 226 (2006)); Alternative Mortgage Transaction Parity Act of 1982, Garn-St Germain Depository Institutions Act of 1982, Pub L. No. 97-320, 96 Stat. 1469 (codified as amended at 12 U.S.C. § 3901-3806 (2006)).

culprits in the current state of the meltdown.<sup>15</sup>

Subprime loans were common in areas with large minority populations or low to moderate income populations. However, in the peak of the subprime boom, even borrowers with credit scores high enough to qualify for conventional loans with better terms were receiving subprime mortgages.<sup>16</sup> In 1994 fewer than 5 percent of mortgage originations were subprime, but by 2005 about 20 percent of new mortgage loans were subprime.<sup>17</sup>

Additionally, the growth of mortgage securitization was a major factor in the explosion of the subprime mortgage market. There have been more than \$2.5 trillion in subprime loans made since 2000, most of which were ultimately packaged into securities for sale to investors.<sup>18</sup> In 1995, subprime mortgages were securitized at a rate of 30%.<sup>19</sup> The percentage of subprime loans that were securitized rose from 50.4% in 2001 to 81.2% in 2005.<sup>20</sup> The advent of securitization of subprime loans allowed an increase in competition and a wider variety of mortgage products available for consumers as more mortgage brokers and mortgage finance companies entered the market and competed with traditional banks.<sup>21</sup> More private mortgage brokers were able to enter the market and compete with traditional banks by offering a wider variety of mortgage products available to consumers that were being packaged into securities at an ever increasing rate.

### B. Private Mortgage Brokers

The role of private mortgage brokers began to grow as subprime lending moved from traditional lending banks.<sup>22</sup>

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<sup>15</sup> Sharick, et. al., *supra* note 10, at 3.

<sup>16</sup> Brooks & Simon, *supra* note 8, at A1.

<sup>17</sup> *Subprime Mortgages and Predatory Mortgage Lending: New Regulatory Guidance, Current Market Conditions and Effects on Regulated Financial Institutions Before the Subcomm. on Fin. Inst. and Consumer Credit, Comm. on Fin. Servs.*, 110th Cong. 3 (2007) (statement of Sandra F. Braunstein, Dir., Div. of Consumer and Cmty. Affairs, Bd. of Governors of the Fed. Reserve Sys.) available at <http://financialservices.house.gov/hearing110/htbraunstein032707.pdf> (last visited Feb. 20 2010) [hereinafter *Hearing on Subprime Mortgages*].

<sup>18</sup> Brooks & Simon, *supra* note 8, at A1.

<sup>19</sup> Chomsisengphet & Pennington-Cross, *supra* note 1, at 37.

<sup>20</sup> Adamson & Zywicki, *supra* note 9, at 8.

<sup>21</sup> *Hearing on Subprime Mortgages*, *supra* note 17.

<sup>22</sup> WILLIAM APGAR & RENE S. ESSENE, JOINT CTR. FOR HOUSING STUDIES, HARVARD UNIV., UNDERSTANDING MORTGAGE MARKET BEHAVIOR: CREATING GOOD MORTGAGE OPTIONS FOR ALL AMERICANS 2

Private mortgage brokers or independent finance companies, which are non-depository institutions not subject to federal regulation, began to be more involved in the lending market and contributed to the explosion of subprime mortgages.<sup>23</sup> By 2005 during the peak of the subprime mortgage market, 52% of subprime mortgages were originated by companies that were not regulated by the federal government.<sup>24</sup> Bundling and selling home loans in the secondary mortgage market provided private mortgage brokers with great incentive to make numerous loans with increased risk of default and foreclosure, because they received fees for things such as loan origination and loan application processing fees.<sup>25</sup> Innovative loan products including teaser-rate adjustable rate mortgages, low or zero-equity loans, and subprime loans allowed mortgage brokers in the mortgage industry to shift the risk of these loans to lenders and ultimately consumers.<sup>26</sup> Since they were often bundled and sold to investors, the poor quality of these loans could be concealed by the brokers who originated the loans.<sup>27</sup>

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(2007) available at [http://www.jchs.harvard.edu/publications/finance/mm07-1\\_mortgage\\_market\\_behavior.pdf](http://www.jchs.harvard.edu/publications/finance/mm07-1_mortgage_market_behavior.pdf) (last visited Feb. 20 2010) (The development of new mortgage products, such as innovative adjustable rate mortgages, and new approaches to sell these products contributed to private mortgage brokers acquiring a significant share of the residential lending market) [hereinafter UNDERSTANDING MORTGAGE MARKET BEHAVIOR].

<sup>23</sup> Cathy Lesser Mansfield, *The Road to Subprime "Hel" was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 526 (2000); see also FIN. CRIMES ENFORCEMENT NETWORK, MORTGAGE LOAN FRAUD: AN INDUSTRY ASSESSMENT BASED UPON SUSPICIOUS ACTIVITY REPORT ANALYSIS 6 (2006), available at [http://www.fincen.gov/news\\_room/rp/reports/pdf/MortgageLoanFraud.pdf](http://www.fincen.gov/news_room/rp/reports/pdf/MortgageLoanFraud.pdf) (last visited Feb. 20, 2010) [hereinafter FINCEN SUSPICIOUS ACTIVITY REPORT ANALYSIS] (Noting that in 2006, the National Association of Mortgage Brokers reports that as many as two thirds of all mortgage loans are now originated by mortgage brokers).

<sup>24</sup> Ip & Paletta, *supra* note 2 (stating that federal regulators had no enforcement authority over state-licensed, stand alone private mortgage lenders).

<sup>25</sup> UNDERSTANDING MORTGAGE MARKET BEHAVIOR, *supra* note 22, at 51.

<sup>26</sup> FED. BUREAU OF INVESTIGATION, FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007 (2007), [http://www.fbi.gov/publications/financial/fcs\\_report2007/financial\\_crime\\_2007.htm](http://www.fbi.gov/publications/financial/fcs_report2007/financial_crime_2007.htm) (last visited Feb. 20, 2010) [hereinafter FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007].

<sup>27</sup> Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*, 41 CONN. L. REV. 1257, 1268 (2009) (explaining that

Therefore, the shift in a substantial amount of loan originations to third-party mortgage brokers driven by the compensation structure of the lending market, created more opportunities for fraud. As a result, private mortgage brokers could take advantage of borrowers and investors alike by engaging in fraudulent lending practices by misrepresenting the terms of a loan to lenders, and ultimately passing the burden of a risky loan product onto consumers.<sup>28</sup>

### C. Mortgage Fraud

Mortgage fraud involves intentional misrepresentations to a lender for the purpose of obtaining a loan that would otherwise not have been made, if the lender had been given truthful information. Mortgage fraud is defined by the Federal Bureau of Investigation ("FBI") as "a material misstatement, misrepresentation, or omissions, relied upon by an underwriter or lender to fund, purchase, or insure a loan."<sup>29</sup> Mortgage loan fraud can be divided into two categories: (1) fraud for property, which entails "misrepresentations by the applicant for the purpose of purchasing property as a primary residence"; and (2) fraud for profit, which often involves multiple loans and schemes "perpetrated to gain illicit proceeds from property sales."<sup>30</sup> Fraud for profit will be the type of fraud analyzed in this note, as it is the main target of federal law enforcement efforts.

Also, it is important to distinguish mortgage fraud from "predatory lending" which forces borrowers to pay high origination fees, subprime or high interest rates, unreasonable servicing fees, and ultimately causes the borrower to default or

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securitization could lead the degrading of the quality of underwriting that the loan originators used in determining which borrowers to lend, and the terms upon which the loan will be made).

<sup>28</sup> *Id.* at 1268 (2009); *see also* UNDERSTANDING MORTGAGE MARKET BEHAVIOR, *supra* note 22, at 9 (explaining that private mortgage brokers may not always be acting in the borrower's best interest due to the premiums they would obtain by selling loans to wholesale lenders, and therefore have an incentive to place borrowers with particular loan products that may or may not reflect the borrowers best interests).

<sup>29</sup> FED. BUREAU OF INVESTIGATION, 2008 MORTGAGE FRAUD REPORT "YEAR IN REVIEW" (2008), [http://www.fbi.gov/Publications/fraud/mortgage\\_fraud08.htm](http://www.fbi.gov/Publications/fraud/mortgage_fraud08.htm) (last visited Feb. 20, 2010) [hereinafter FBI 2008 MORTGAGE FRAUD REPORT].

<sup>30</sup> *Id.*



undergo a foreclosure.<sup>31</sup> Predatory loans include an inevitable anticipated default and foreclosure on a home, and can give rise to fraudulent lending practices.<sup>32</sup> However, predatory lending will not be analyzed by this note.

The federal government focuses on investigating fraud for profit, which is more egregious than fraud for housing, and is sometimes referred to as “industry insider fraud.”<sup>33</sup> Industry insiders include: appraisers, accountants, attorneys, real estate brokers, mortgage underwriters and loan processors, settlement or title insurance employees, mortgage brokers, and loan originators.<sup>34</sup> Fraud perpetrated by industry insiders accounts for 80 percent of all reported fraud losses.<sup>35</sup> Fraud for profit occurs where the underlying motivator is cash, and typically involves collusion of industry insiders who slip away with the cash, leaving the buyer to deal with future mortgage risk.<sup>36</sup>

There were, and remain, several opportunities for fraud in the home mortgage market. The use of the internet to receive and process loan applications has increased, leading to streamlined low document, or even “no-document” loans, and created a condition vulnerable to fraud.<sup>37</sup> Additionally, industry insiders with vast knowledge of the origination process took advantage of the system to defraud lenders by falsifying borrower

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<sup>31</sup> FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007, *supra* note 26; *see also* Adamson & Zywicki, *supra* note 9, at 12 (While there is no precise definition for predatory lending, a predatory loan is generally one where there is no reasonable anticipated financial benefit to borrowers).

<sup>32</sup> Adamson & Zywicki, *supra* note 9, at 12.

<sup>33</sup> FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007, *supra* note 26; *see also* *The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn Before the S. Comm. on the Judiciary*, 111th Cong. (statement of John Pistole, Deputy Dir. Fed. Bureau of Investigation) [http://judiciary.senate.gov/hearings/testimony.cfm?id=3651&wit\\_id=7603](http://judiciary.senate.gov/hearings/testimony.cfm?id=3651&wit_id=7603) [hereinafter Statement of John Pistole, Deputy Dir. Fed. Bureau of Investigation] (“Industry insiders are of priority concern as they are, in many instances, the facilitators that permit the fraud to occur”).

<sup>34</sup> FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29.

<sup>35</sup> *Id.* at 14

<sup>36</sup> CHOICE POINT, MORTGAGE ASSET RESEARCH INST., CURBING MORTGAGE FRAUD: PROACTIVE STRATEGIES, WHITE PAPER 4 (2008) (on file with author) [hereinafter CURBING MORTGAGE FRAUD].

<sup>37</sup> James H. Freis Jr., Dir., Fin. Crimes Enforcement Network, Remarks at the Mortgage Bankers Association National Fraud Issues Conference (Mar. 16, 2009), *available at* [http://www.fincen.gov/news\\_room/speech/html/20090316.html](http://www.fincen.gov/news_room/speech/html/20090316.html) last visited Feb. 20, 2010) [hereinafter Remarks of James H. Freis].

documentation, or even creating false loan applications.<sup>38</sup> In many instances, fraud perpetrated by insiders was concealed by the sheer volume of loan originations, and the profitable sales on collateral.<sup>39</sup>

#### D. Victims of Mortgage Fraud in the Home Lending Market

While, mortgage fraud most proximately affects lenders and investors, victims of mortgage fraud extend throughout the home lending market. Victims of mortgage fraud can include borrowers, mortgage industry entities, and those living in neighborhoods affected by mortgage fraud.<sup>40</sup> When lenders are subject to fraudulent activity, the effects trickle down to consumers doing business with victimized institutions, or consumers seeking new loans. Therefore, consumers are finding themselves exposed to mortgage fraud, as complaints and problems are on the rise across the country.<sup>41</sup>

In addition to victimizing consumers and lenders, mortgage fraud has contributed to the overall uneasiness in the home mortgage market. Flaws in the lending system undercut investor confidence. Until investors are satisfied with the system, the market is likely to remain in a depressed state.<sup>42</sup> Due to the lack of investment in the residential mortgage market, there may be requirements of higher returns for mortgage backed securities.<sup>43</sup> Furthermore, the lack of investment may result in a limited amount of investment funds available for mortgage loans.

Financial institutions and other lenders are victims of mortgage fraud, because fraudulently obtained loans can cost lenders in the home mortgage market millions of dollars.<sup>44</sup> When

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<sup>38</sup> CURBING MORTGAGE FRAUD, *supra* note 36 at 4.

<sup>39</sup> *Id.*

<sup>40</sup> FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29.

<sup>41</sup> UNDERSTANDING MORTGAGE MARKET BEHAVIOR, *supra* note 22, at 2.

<sup>42</sup> Gretchen Morgenson, *Get Ready, Get Set, Point Fingers*, N.Y. TIMES, Dec. 13, 2008, at BU 1.

<sup>43</sup> *Mortgage Fraud and its Impact on Mortgage Lenders Before the H. Comm. on Housing and Comty. Opportunity*, 108th Cong. 4 (2004) (statement of Chris Swecker, Assistant Dir. Criminal Investigation Div., Fed. Bureau of Investigation) available at <http://financialserviceshousegov/media/pdf/100704cs.pdf> [hereinafter *Mortgage Fraud and its Impact on Mortgage Lenders*].

<sup>44</sup> *Mortgage Fraud and its Impact on Mortgage Lenders Before the H. Comm. on Housing and Comty. Opportunity*, 108th Cong. 1 (2004) (statement of Bob Ney, Chairman, Subcomm. On Housing, and Cmty. Opportunity) available at <http://financialservices>.

a fraud scheme is perpetrated against a mortgage lender, the lender and investors must recoup their losses.<sup>45</sup> The losses are then passed on to consumers in the form of increased interest rates, higher mortgage prices, decreased availability of mortgage credit, and decreased loan values.<sup>46</sup> Additionally, government insured loans that fall victim to fraud will at the end of the day be paid for by American taxpayers.<sup>47</sup>

Homeowners can be victimized more directly by mortgage fraud occurring in their community. The recent downturn in the housing market and the rise in foreclosures have exacerbated the instances of mortgage fraud. Consumer debt has grown due to a rise in interest rates, and adjustable-rate mortgage payment increases.<sup>48</sup> Consumer debt combined with an increase in home prices has led to an increase in foreclosure rescue scams. Therefore, mortgage fraud can rob homeowners of their homes, savings, and their security in their home equity.<sup>49</sup>

Mortgage fraud often results in early defaults on loans, which is likely contributing to higher numbers of delinquencies and foreclosures.<sup>50</sup> Property values in neighborhoods affected by mortgage fraud can experience a swing from being artificially inflated to depreciating in value as properties go into foreclosure due to fraudulently acquired loans.<sup>51</sup> Foreclosed properties can remain vacant for long periods of time and contribute to neighborhood instability and stigma.<sup>52</sup> Therefore, mortgage fraud has a trickle down effect on the residential lending market. Fraud perpetrated against lenders has broad effects on the residential real estate market by impacting investment and the availability

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house.gov/media/pdf/100704ne.pdf. [hereinafter *Mortgage Fraud and its Impact on Mortgage Lenders*]

<sup>45</sup> MORTGAGE BANKERS ASS'N, MORTGAGE FRAUD: STRENGTHENING FEDERAL AND STATE MORTGAGE FRAUD PREVENTION EFFORTS 5 (2007), [http://www.mortgagebankers.org/files/News/InternalResource/57274\\_Study.pdf](http://www.mortgagebankers.org/files/News/InternalResource/57274_Study.pdf) (last visited Feb. 20, 2010) [hereinafter MORTGAGE FRAUD].

<sup>46</sup> *Id.* at 5.

<sup>47</sup> *Mortgage Fraud and its Impact on Mortgage Lenders*, *supra* note 44, at 1.

<sup>48</sup> STEVE TRIPOLI & ELIZABETH RENAULT, NAT'L CONSUMER LAW CTR., DREAMS FORECLOSED: THE RAMPANT THEFT OF AMERICANS' HOMES THROUGH EQUITY-STRIPPING FORECLOSURE "RESCUE" SCAMS 7 (2005), available at <http://www.consumerlaw.org/news/ForeclosureReportFinal.pdf> (last visited Feb. 20, 2010).

<sup>49</sup> Remarks of James H. Freis, *supra* note 37.

<sup>50</sup> MORTGAGE FRAUD, *supra* note 45, at 5.

<sup>51</sup> FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29.

<sup>52</sup> UNDERSTANDING MORTGAGE MARKET BEHAVIOR, *supra* note 22, at 2.

of credit for consumers. Additionally, mortgage fraud can be committed directly on consumers through foreclosure rescue scams.

### E. Examples of Mortgage Fraud

The ultimate goals of the mortgage fraudsters may be different, and will determine what type of frauds are perpetrated. For instance in some cases the goal of the fraudster may be to realize only the net amount from his mortgage fraud scheme.<sup>53</sup> Or, on the other hand, a fraudster may at the time the fraud is committed have as their ultimate objective to realize the full value of the sales price of a loan they had originated, which involves selling the loan to another financial business.<sup>54</sup> Another factor which influences the type of fraud scheme perpetrated is the overall state of the economy and the residential lending market. When times are good and loan originations are up, there will likely be more fraud at the origination stage. However, there is a consensus among industry experts that there is a direct correlation between mortgage fraud and the distressed housing markets.<sup>55</sup> When the lending market is distressed, then foreclosure rescue scams and loan modification fraud will likely increase.

The following three cases provide examples of common fraudulent lending practices committed by private mortgage brokers in the residential real estate market, and demonstrate the harm such criminal conduct can have on lenders and homeowners alike. The examples also illustrate the types of fraud that can exist at different stages of the overall health of the housing market.

The first example involves false and material misrepresentations on loan applications; the most commonly reported type of fraud.<sup>56</sup> In *United States v. Septon*, the

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<sup>53</sup> See *United States v. Carter*, 412 F.3d 864 (8th Cir. 2005).

<sup>54</sup> See *United States v. Miller*, 588 F.3d 560, 567 (8th Cir. 2009).

<sup>55</sup> FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29; see also FIRST AMERICAN CORELOGIC, CORE MORTGAGE RISK MONITOR Q2, 3 (2007), available at [https://www.corelogic.com/documents/Core\\_Mortgage\\_Risk\\_Monitor\\_Q2\\_2007.pdf](https://www.corelogic.com/documents/Core_Mortgage_Risk_Monitor_Q2_2007.pdf) (last visited Feb. 20, 2010).

<sup>56</sup> Jennifer Butts et al., *Eleventh Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, 11 MORTGAGE ASSET RESEARCH INST. 5 (2009), available at [http://www.mbaa.org/files/Advocacy/2009/2009MARI\\_FraudCaseReport.pdf](http://www.mbaa.org/files/Advocacy/2009/2009MARI_FraudCaseReport.pdf) (last visited Feb. 20, 2010); FINCEN SUSPICIOUS ACTIVITY REPORT ANALYSIS, *supra* note 23, at 1.

defendant engaged in a mortgage fraud scheme that allowed a private mortgage broker to realize the profit of his illegal scheme himself.<sup>57</sup> Beginning in 2000 and continuing through 2004, a mortgage broker who ran his own mortgage lending business instructed his employees to submit fraudulent loan applications, provide homebuyers with “bridge-loans” for down payments allowing them to purchase their new homes, and to act as a sham employer for homebuyers and borrowers in order to falsify and substantiate their incomes.<sup>58</sup> Between sixty-five and eighty percent of the loans brokered were fraudulent.<sup>59</sup> The broker collected interest on the bridge-loans to homebuyers, and obtained commissions and fees for brokering these fraudulent loans which were ultimately approved by oblivious banks or mortgage lending companies.<sup>60</sup> Many of the home loans brokered went into default, and caused losses to the lenders in excess of \$2 million.<sup>61</sup>

In contrast, there are cases in which a private mortgage broker committed fraud, where the broker sought more than to simply profit directly off the fraudulently originated loans. The intended objective of such fraud schemes is to realize the full face value sales price of the amount of each loan that the broker originated, by obtaining its profit after being sold to a bank or lender. In *United States v. Miller* a private mortgage broker who owned and operated a financial services business acting as a correspondent lender had packaged and sold fraudulently acquired individual residential mortgage loans to lending institutions.<sup>62</sup> This case involved the largest mortgage broker in Arkansas, and implicated its top ten executives.<sup>63</sup> In *Miller*, the broker would receive commissions from the individual borrowers, as well as fees from the lenders who bought the individual loans from Miller.<sup>64</sup> The broker and his co-

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<sup>57</sup> *United States v. Septon*, 557 F.3d 934 (8th Cir. 2009) (The United States charged the broker with conspiring to commit mail and bank fraud, and bank fraud, and ultimately resulted in a guilty plea).

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 936.

<sup>61</sup> *Id.*

<sup>62</sup> *Miller*, 588 F.3d at 562 (The broker was convicted for conspiracy to commit wire fraud, and aiding and abetting wire fraud, and was sentenced to one year and a day of imprisonment).

<sup>63</sup> FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007, *supra* note 26.

<sup>64</sup> *Miller*, 588 F.3d at 562

conspirators at the business sent fraudulent loan documents to several lending institutions, which contained misrepresentations as to the appraisal worth of properties, the qualifications of borrowers, the state of titles, and fee and service charges.<sup>65</sup> As a result, the loans originated by this broker were much riskier than were represented to the banks and lenders, and induced them to purchase these risky loans.<sup>66</sup> Testimony from these banks and lenders at trial established that none of them would have bought the mortgages if there had been truthful and complete disclosure.<sup>67</sup> The total amount of the fraudulent loans was \$3,770,784, and while the broker reaped the profit, the risk of these loans was passed on to the lenders, and dealt with by the homeowners.<sup>68</sup>

The most recent form of mortgage fraud are “foreclosure rescue” scams, which typically consist of perpetrators soliciting distressed homeowners in foreclosure and inducing them to sign over title of the property or requiring upfront fees on the pretense of rescuing their home.<sup>69</sup> A particularly egregious case involved a foreclosure rescue scam combined with an “equity skimming” scam illustrating the impact that mortgage fraud can have on lenders, homeowners, and communities.<sup>70</sup> In 2008, two indictments were issued and alleged that the defendant’s financial services business “Creative Loans, L.L.C.” contacted homeowners near foreclosure, and would either assure homeowners they would be able to avoid foreclosure<sup>71</sup>, or enter a program that would allow them to refinance their home and repair damaged credit.<sup>72</sup> In this scam, the business would arrange for “straw buyers”<sup>73</sup> to replace financially distressed homeowners

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<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 562-63

<sup>67</sup> *Id.* at 563.

<sup>68</sup> *Id.* at 567.

<sup>69</sup> See FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29.

<sup>70</sup> See FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007, *supra* note 26 (equity skimming schemes involve the use of corporate shell companies, corporate identity theft, and the use or threat of bankruptcy or foreclosure to dupe homeowners or investors).

<sup>71</sup> Indictment at 2, United States v. Charles Head et al., No. 08-cr-116 (E.D. Cal. Feb. 2, 2008), *available at* <http://www.centralmediaserver.com/KNXV/news/20080324110751780.pdf> (last visited Feb. 20, 2010).

<sup>72</sup> Indictment at 2, United States v. Charles Head et al., No. 08-cr-116 (E.D. Cal. Mar. 13, 2008), *available at* <http://www.centralmediaserver.com/KNXV/news/20080324110710500.pdf> (last visited Feb. 20, 2010).

<sup>73</sup> Michael Barnhill & Brad R. Jacobson, *Drawing the Short Straw-Mortgage Fraud and Straw Buyers*, 21 UTAH BAR J. 9 (2008) (straw buyers are

on the titles of their homes, without the homeowner's knowledge.<sup>74</sup> This was an "equity skimming" operation, where once the title belonged to the "straw buyer", the business would take out a loan on the home and extract all the equity left in that home.<sup>75</sup>

The objective of this fraud scheme was to deceive homeowners to gain control of the property, and deceive lenders to provide loans on the property. The homeowners would continue to pay rent to the business, as the business profited on the loan taken out on the home.<sup>76</sup> Ultimately, the homeowners were left without their home when the loans were foreclosed on, the equity was stripped from their homes, and their credit ratings were damaged.<sup>77</sup> The scam allegedly netted approximately \$6.7 million from 47 homes, mostly in California, and another \$5.9 million from 68 homes across the United States.<sup>78</sup>

The preceding case examples demonstrate how mortgage fraud was perpetrated by private mortgage brokers in the home mortgage market during times of growth, and in times of distress for homeowners. The case examples also illustrate the need for criminal enforcement in this area of the home lending market, because the intentional misrepresentations and fraud perpetrated by these mortgage brokers had caused substantial loss to mortgage lenders and went as far to cause people to lose their homes.

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loan applicants who are used to obtain home loans on the straw buyers personal information and credit score to obtain a mortgage loan higher than the actual homeowner could, but the straw buyers do not intend to occupy the properties that they are buying).

<sup>74</sup> Press Release, Dep't of Justice, Federal Authorities Announce Significant Regional Federal Mortgage Fraud Investigations and Prosecutions Coinciding with Nationwide "Operation Malicious Mortgage" (June 19, 2008) available at <http://www.fbi.gov/pressrel/pressrel08/mortgagefraud061908.htm> [hereinafter Press Release, Regional Federal Mortgage Fraud Investigations and Prosecutions]; see also *The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn, Hearing Before the S. Comm. on the Judiciary*, 111th Cong. 4 (statement of Rita Glavin, Acting Assistant Att'y Gen., Criminal Div., United States Dep't of Justice) <http://judiciary.senate.gov/pdf/09-02-11GlavinTestimony.pdf> [hereinafter statement of Rita Glavin, Acting Assistant Att'y Gen., Criminal Div., United States Dep't of Justice].

<sup>75</sup> Press Release, Regional Federal Mortgage Fraud Investigations and Prosecutions, *supra* note 74.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

## F. Federal Criminal Law Statutory Framework

There is no single federal “mortgage fraud” statute that can be applied to the preceding examples of mortgage fraud. Rather, there is a framework of federal fraud statutes that are applicable to the schemes perpetrated in the mortgage industry. The most commonly applied federal criminal statutes to mortgage fraud prosecutions are: mail fraud<sup>79</sup>, wire fraud<sup>80</sup>, and bank fraud.<sup>81</sup> Additionally, mortgage fraud can be prosecuted under Section 1014, which proscribes false statements on loan applications.<sup>82</sup>

However, prior to the enactment of FERA, the extent to which the provisions of this statutory framework applied to private mortgage brokers, if at all, was determined by whether the fraud implicated a “financial institution” as defined by Title 18 of the United States Code.<sup>83</sup> Prior to the enactment of FERA, Section 20 defined a “financial institution,” as a federally insured depository institution.<sup>84</sup> Each of the preceding statutes will be analyzed to show how they are applicable to mortgage fraud prosecutions. Additionally, this brief analysis will provide the foundation necessary to demonstrate the impact that the statutory enhancements under FERA will have on federal mortgage fraud prosecutions.

### i. Mail, Wire, and Bank Fraud

The federal mail, wire, and bank fraud statutes were always applicable to private mortgage brokers, but under limited circumstances. The three statutes are similar in the nature of the offenses that they proscribe, and in the elements of the offense that the government must prove in order to obtain a conviction for mortgage fraud.

All three fraud statutes, mail, wire, and bank, include a

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<sup>79</sup> 18 U.S.C. § 1341 (2006).

<sup>80</sup> *Id.* at § 1343.

<sup>81</sup> *Id.* at § 1344.

<sup>82</sup> *Id.* at § 1014.

<sup>83</sup> 18 U.S.C. § 20(1) (2006).

<sup>84</sup> *See* United States v. Mavashev, No. 08-CR-902 2009 WL 4746301, at \*4 (E.D.N.Y. Dec. 7, 2009) (the court could not apply the amended definition of a “financial institution” under FERA due to the constraints of the Ex Post Facto Clause, and therefore, in a mortgage fraud prosecution, the most relevant definition for a financial institution is a “[federally] insured depository institution”).



fraudulent “scheme or artifice to defraud” as an element of the offense. However, Congress has not specifically defined those terms, and the federal courts are left to craft a definition of fraud, an ever evolving form of criminal conduct. Courts have liberally construed a “scheme or artifice to defraud” as “any plan, pattern or course of action [ . . . ] intended to deceive others to obtain something of value.”<sup>85</sup> Additionally, each fraud statute requires the government to prove the defendant had a specific intent to defraud.<sup>86</sup> Furthermore, the United States Supreme Court has held that materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes.<sup>87</sup>

The elements of mail and wire fraud are almost identical, and therefore will be analyzed together. The first element of mail and wire fraud is participation in a “scheme or artifice to defraud.”<sup>88</sup> Mail fraud requires the use of the mails and to “deposit” or “cause” mail “to be deposited” to the post office or a private interstate carrier.<sup>89</sup> Wire fraud requires the use of interstate wire facilities and that the accused “transmits or causes to be transmitted [ . . . ] any writings, signs, signals, pictures, or sounds.”<sup>90</sup> Additionally, the use of the mail or interstate wire communications must be in furtherance of the fraudulent scheme.<sup>91</sup> Mortgage companies routinely use mail and carrier services for documents associated with mortgages, and wire transfers are common in mortgage transactions.<sup>92</sup> Therefore, the

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<sup>85</sup> See *United States v. Colon-Munoz*, 192 F.3d 210, 221 (1st Cir. 1999); see also Carolyn A. DeLone, *Financial Institutions Fraud*, 46 AM. CRIM. L. REV. 621, 640 (2009).

<sup>86</sup> *United States v. Harmon*, No. 03-10537, 2004 WL 1763909, at \*1 (9th Cir. Aug. 5, 2004).

<sup>87</sup> *United States v. Neder*, 527 U.S. 1, 25 (1999); see also *United States v. Wells*, 519 U.S. 482, 489 (1997) (the United States Supreme Court understands the term “materiality” to mean “having a natural tendency to influence or being capable of influencing the decision making body to which the false information was addressed”).

<sup>88</sup> 18 U.S.C. §§ 1341, 1343.

<sup>89</sup> 18 U.S.C. § 1341; see *United States v. Hitchens*, No. 02-1554, 2002 WL 31898234, at \*2 (3rd Cir. Nov. 19, 2002) (“It is sufficient to show that ‘where one does an act with knowledge that the use of the mails will follow in the ordinary course of business or where such use can reasonably be foreseen, even though not actually intended, then he ‘causes’ the mails to be used’”).

<sup>90</sup> 18 U.S.C. § 1343.

<sup>91</sup> *United States v. McGeehan*, 584 F.3d 560, 565 (3rd Cir. 2009).

<sup>92</sup> MORTGAGE FRAUD, *supra* note 45, at 7; see also *United States v. Berry*, No. 08-60011, 2009 WL 1096327, \*2 (5th Cir. Apr. 23, 2009) (sustaining the conviction for mail fraud where the defendant fraudulently inflated the

mail and wire fraud statutes can potentially apply where fraud is prevalent in mortgage transaction.

Prior to FERA, the federal offenses of mail fraud and wire fraud could be applied in most instances of mortgage fraud, including that perpetrated by private mortgage brokers. Prior to FERA, a private mortgage broker convicted of either the mail fraud statute or the wire fraud statute could face a fine under title 18 and a maximum of twenty years imprisonment.<sup>93</sup> However, the penalties for crimes affecting a “financial institution” as defined by Section 20 carries an increased penalty under the mail and wire fraud statutes. If convicted for mail or wire fraud against a “financial institution”, there is a possible fine of \$1,000,000 or a thirty year prison sentence or both.<sup>94</sup>

The mail and wire fraud statutes served as the model for the federal bank fraud statute. The bank fraud statute prohibits any “scheme or artifice to defraud” a financial institution or to obtain any property from a financial institution “by false or fraudulent pretenses.”<sup>95</sup> However, the federal bank fraud statute was enacted to allow protection of federally created, controlled, or insured financial institutions.<sup>96</sup> The bank fraud statute requires proof that the victim of the fraud is a federally insured institution.<sup>97</sup> A financial institution is considered a victim of bank fraud if it is an actual or intended victim.<sup>98</sup> Courts generally find that banks are victims of fraud if the bank had “custody and

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values of homes by modifying square footage for the purpose of obtaining inflated loans, and caused the mail to be used and acted with knowledge the use of the mails will follow in the ordinary course of business in real estate transactions); *Hitchens*, 2002 WL 31898234, at \*2 (to obtain a conviction for mail fraud, it is sufficient to show that the defendant acted with knowledge that the use of the mail would follow in the ordinary course of business, or where such use of the mails could reasonably be foreseen).

<sup>93</sup> 18 U.S.C. §§ 1341, 1343.

<sup>94</sup> *Id.* at §§1341, 1343.

<sup>95</sup> *Id.* at §1344 (“[w]hoever knowingly executes or attempts to execute a scheme or artifice to (1) defraud a financial institution”).

<sup>96</sup> PAUL E. COGGINS, *LENDER LIABILITY LAW AND LITIGATION* § 11.07 (2009).

<sup>97</sup> *See United States v. Ragosta*, 970 F.2d 1085, 1089 (2nd Cir. 1992) (the defendant must engage in conduct designed to deceive a federally chartered or insured financial institution).

<sup>98</sup> *United States v. Moran*, 312 F.3d 480, 489 (1st Cir. 2002) (held that a bank does not have to be the immediate victim of the defendant’s fraud in order to obtain a conviction); *see also United States v. Riggs*, 490 F.3d 208, 231 (2nd Cir. 2007) (the defendant must have intent to expose the financial institution to an “actual or potential loss”).

control” of the funds in question, which in turn exposed the bank to risk of loss or civil liability.<sup>99</sup>

To obtain a conviction under the bank fraud statute, the government had to prove that the financial institution that was victimized fell within the definition of “financial institution” under Section 20, because the bank fraud statute does not define the term “financial institution” itself. Therefore, because private mortgage brokers and lending companies were not within the previous definition of a “financial institution” under Section 20, the bank fraud statute was inapplicable to private mortgage brokers unless they victimized a specific group of financial entities. Like violations for mail and wire fraud offenses against a financial institution, the penalty for violating the bank fraud statute is a fine of not more than \$1,000,000, or imprisonment for up to thirty years, or both.<sup>100</sup>

While the mail, wire, and bank fraud statutes were always applicable to private mortgage brokers under the old statutory framework, private mortgage brokers and federally insured financial institutions were not protected or penalized to the same effect under federal criminal law.

## ii. False Statements in Mortgage Applications Statute

Unlike the mail, wire, and bank fraud statutes, the federal prohibition regarding false statements to financial institutions under Section 1014 of Title 18 was not applicable to private mortgage brokers prior to the passage of FERA. Section 1014 prohibits knowingly making “any false statement or report, or willfully overvalues any land, property or security, for the purpose of influencing” a loan or credit application “for the purpose of influencing” a lender.<sup>101</sup>

Prior to FERA, Section 1014 only included federal depository institutions or government institutions among the types of financial entities that the statute could be invoked to protect or to prosecute for falsifying home loan applications.

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<sup>99</sup> *United States v. Gallant*, 537 F.3d 1202, 1225-26 (10th Cir. 2008); *United States v. Colton*, 231 F.3d 890, 908 (4th Cir. 2000).

<sup>100</sup> 18 U.S.C. §1344.

<sup>101</sup> 18 U.S.C. § 1014 (2006). However, there is a circuit split on what transactions Section 1014 applies to. The Fifth Circuit applies Section 1014 only to statements made to obtain loans or other extensions of credit. *See United States v. Devoll*, 39 F.3d 575, 589-80 (5th Cir. 1994); However, other federal circuits have applied the statute to transactions other than loans. *See United States v. Krilich*, 159 F.3d 1020, 1027-1030 (7th Cir. 1998).

Section 1014 applied only to federal agencies, banks, and credit associations.<sup>102</sup> Therefore, Section 1014 was inapplicable to private mortgage brokers, even if they were handling federally-regulation or federally-insured mortgages.<sup>103</sup>

In contrast to the mail, wire, and bank fraud statutes, materiality of falsehood is not an element of the offense under Section 1014.<sup>104</sup> However, the penalties under Section 1014 are similar to the enhanced penalties under the mail, wire, and bank fraud statutes. Because Section 1014 applied to financial institutions, the penalty was a fine of not more than \$1,000,000 and a maximum thirty year sentence.<sup>105</sup>

Section 1014 prohibits a significant offense, because it pertains to false statements and appraisals in loan applications. However, federal prosecutors were unable to apply Section 1014 to the conduct of private mortgage brokers despite numerous reports of false statements on loan applications through the home lending market.

### III. The Fraud Enforcement and Recovery Act of 2009

The legislative intent behind FERA's enhancements to combat mortgage fraud is clear: to reinvigorate the federal government's ability to investigate and prosecute the financial frauds that "so severely undermined our financial markets and hurt so many hard working people in these difficult economic times".<sup>106</sup> The Senate report makes a strong assertion that with new resources and enhanced criminal statutes, "it will be easier to ensure that all of those responsible for these financial crimes are held accountable."<sup>107</sup> However, the Senate acknowledged that the "full scope of the fraud that helped trigger the economic crisis is still unknown."<sup>108</sup> Nonetheless, the legislation specifically points to relaxed lending standards, increased securitization of mortgages, and the prevalence of private mortgage brokers in the

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<sup>102</sup> Statement of Rita Glavin, Acting Assistant Att'y Gen., Criminal Div., United States Dep't of Justice, *supra* note 74, at 10).

<sup>103</sup> *Id.*

<sup>104</sup> *Wells*, 519 U.S. at 498.

<sup>105</sup> 18 U.S.C. § 1014.

<sup>106</sup> S. REP. NO. 111-10, at 3; *see also* 155 CONG. REC. H5260-01 (daily ed., May 6, 2009) (statement of Rep. Scott) ("The Fraud Enforcement and Recovery Act of 2009 is crafted to combat financial fraud that contributed to causing and worsening our nation's current economic crisis").

<sup>107</sup> S. REP. NO. 111-10, at 2.

<sup>108</sup> *Id.*

real estate market as factors that “created an environment that invited fraud.”<sup>109</sup> Therefore, FERA is meant to enhance federal law enforcement to prevent the reoccurrence of such an environment by enhance federal statutory law and providing the manpower to enforce it.<sup>110</sup>

### A. The Purpose of FERA

FERA had a two part approach to reinvigorating federal law enforcement against mortgage fraud. First, FERA makes enhances the criminal statutory framework that is applicable to mortgage fraud prosecutions, to “strengthen prosecutors’ ability to combat [the] growing wave of fraud.”<sup>111</sup> The Senate Report indicated that private mortgage brokers and lending businesses “came to dominate the home housing market, and these companies were not subject to the kind of banking oversight and internal regulations that had traditionally helped prevent fraud.”<sup>112</sup> Additionally, the Senate Report indicates that the growth of securitization contributed to the increased participation of private mortgage brokers in the home lending market.<sup>113</sup> As a result, there were “even more fraud and victimizing investors nationwide.”<sup>114</sup>

The Senate report highlights the significance of the amendment to Title 18 Section 20, which allows the full force of federal fraud laws to be extended to mortgage lending businesses that are not directly regulated or insured by the federal government.<sup>115</sup> The stated goal of enhancing the statutory framework is to apply the federal fraud laws to private mortgage businesses, “just as they apply to federally insured and regulated banks.”<sup>116</sup>

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<sup>109</sup> *Id.*

<sup>110</sup> FERA also established the Financial Crisis Inquiry Commission (“Commission”) to “examine the causes, domestic and global of the current economic crisis in the United States”. Pub. L. No. 111-21 § 5. The Commission began meeting on September 17, 2009 and will continue to examine the financial crisis through December 15, 2010.

<sup>111</sup> S. REP. NO. 111-10, at 3.

<sup>112</sup> *Id.* (indicating that private mortgage businesses were “responsible for nearly half of the residential mortgage market before the economic collapse”).

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 3; *see also* Statement of Rita Glavin, Acting Assistant Att’y Gen., Criminal Div., United States Dep’t of Justice, *supra* note 73, at 10 (suggesting

Second, FERA authorized hundreds of millions of dollars to be contributed over fiscal years 2010 and 2011 to boost the ranks of federal investigators and prosecutors.<sup>117</sup> The allocation of these resources to federal investigative and prosecutorial agencies will be discussed in detail in Part IV. The overall effect of this shift in resources dedicated to combating mortgage is to provide the ability of the federal government to more effectively investigate and prosecute mortgage fraud as the fraud schemes change with the residential real estate market.

### B. Statutory Amendments and Enhancements under FERA

The most notable statutory amendment applicable to mortgage fraud prosecutions is to Title 18 Section 20, which defines “financial institution.” FERA has expanded Section 20 to include a “mortgage lending business” and mortgage brokers within the definition of a “financial institution” for the purposes of applying federal fraud laws.<sup>118</sup> The United States Code defines a mortgage lending business is defined as “an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce.”<sup>119</sup> Section 20 now includes a “mortgage lending business” or “any person or entity that makes in whole or in part a federally regulated loan”<sup>120</sup>, subject to the same federal fraud laws and penalties as federally insured and national banks.<sup>121</sup> The Amendment to Section 20 is critical to the application of federal fraud statutes to private mortgage brokers in mortgage fraud cases.

Additionally, FERA enhances federal fraud laws that were previously applicable to private mortgage brokers, including the mail, wire, and bank fraud statutes. However, the

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that Mortgage brokers and lending businesses should be held accountable just as traditional financial institutions are); *see also* 155 CONG. REC. S2315-01 (daily ed., Feb. 13 2009) (statement of Sen. Kaufman) (“[ . . . ]the Justice Department’s Criminal Division, the FBI, and the Special Inspector General are deadly serious about finding and prosecuting financial fraud”).

<sup>117</sup> S. REP. NO. 111-10, at 3.

<sup>118</sup> 18 U.S.C. § 20 (2006) *amended by* Pub. L. No. 111-21, §2a, 123 Stat. 1617 (2009).

<sup>119</sup> 18 U.S.C. § 27 (2006).

<sup>120</sup> *See* 12 U.S.C. § 2602 (1996) (defines the term “federally related mortgage loan”).

<sup>121</sup> 18 U.S.C. § 20.

penalties are enhanced by FERA's amendments to existing statutory law. FERA's amendment to Section 20 fulfills Congress' desire to hold private mortgage brokers and businesses accountable for fraud, given the prevalence of these actors in the subprime mortgage market, and their impact on the federally insured and federally regulated institutions.<sup>122</sup> The penalties for crimes affecting a "financial institution" as defined by Section 20 carries an increased penalty under the mail, wire, and bank fraud statutes. Under the mail, wire, and bank fraud statutes, the penalty increases to a maximum of \$1,000,000, and a maximum prison sentence of thirty years.<sup>123</sup> Furthermore, the United States Sentencing Guidelines provide for increases in sentence range for frauds that have a major effect on a financial institution.<sup>124</sup> Therefore, FERA was meant to provide harsher punishments for mortgage fraud perpetrated among private mortgage brokers and lending businesses.

Furthermore, expanding the definition of a "financial institution" not only increases punishment, but provides more fraud protection to a wider range of financial businesses in the mortgage market. Prior to FERA, a popular defense among mortgage fraud defendants was to claim that the government could not prove the defendant had defrauded a "financial institution" under Section 20 in order to obtain a conviction for bank fraud.<sup>125</sup> The Section 20 amendment eliminates this legal defense to a charge of bank fraud, because now the definition of a "financial institution" is not simply limited to federally insured institutions.<sup>126</sup>

Additionally, the FERA enhancements now criminalize

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<sup>122</sup> See S. REP. NO. 111-10, at 2-3; see also 155 CONG. REC. S4531-01 (daily ed. Apr. 22, 2009) (statement of Sen. Leahy) ("As long as people carrying out these frauds and these scams think they will never get caught, will never get prosecuted, the laws aren't tough enough, they are in an unregulated industry, nobody is going to go after them"); 155 CONG. REC. S4531-01 (daily ed. Apr. 22, 2009) (statement of Sen. Spector) (suggesting jail sentences are important in the way to deal with this kind of crime").

<sup>123</sup> See 18 U.S.C. §§ 1341; See also 18 U.S.C. §§ 1343, 1344.

<sup>124</sup> U.S. SENTENCING GUIDELINE MANUAL § 2B1.1(b)(14)(B) (requires a four level increase in the offense level for frauds that had a major effect on a financial institution).

<sup>125</sup> See *Mavashev*, 2009 WL 4746301, at \*1 (defendant asserted this defense after allegedly had submitted loan applications containing materially false information in order to purchase multiple properties to a wholly-owned subsidiary of a federally insured bank).

<sup>126</sup> See Statement of Rita Glavin, Acting Assistant Att'y Gen., Criminal Div., United States Dep't of Justice, *supra* note 74, at 10.

false statements to private mortgage businesses in loan applications. FERA ensures that private mortgage brokers are held fully accountable under Section 1014. The Senate Report indicated that this is a “particularly important offense” to apply to private mortgage brokers, because it “specifically relates to false appraisal fraud, which has been a particularly problematic type of mortgage fraud.”<sup>127</sup> The FERA amendment to Section 1014 now includes the term “mortgage lending business” among the financial institutions that this crime applies to.<sup>128</sup>

Prior to FERA, federal prosecutors could not charge a private mortgage lending business for making a “false statement or report, or willfully [overvalue] any land, property, or security.”<sup>129</sup> This is an important enhancement, given the widespread reports of misrepresentations on home loan applications. Private mortgage brokers can now be prosecuted to the fullest extent of federal law. Furthermore, penalties for violating Section 1014 are identical to that of violations of the mail, wire, and bank fraud statutes: a fine of no more than \$1,000,000, or imprisoned not more than thirty years, or both.<sup>130</sup>

The enhancement to Section 20 also includes one final, but important, tool for prosecutors in combating mortgage fraud. The statute of limitations for filing charges against defendants affecting financial institutions is longer than that which applies to other fraud victims. For all federal offenses “not capital”, the statute of limitations is five years.<sup>131</sup> Mortgage fraud investigations and prosecutions of private mortgage brokers used to fall under this five year window in which charges must be filed. However, for “financial institution” offenses, which private mortgage brokers now fall under, the ten year statute of limitations applies.<sup>132</sup>

The extension of the statute of limitations will relieve a substantial obstacle to federal authorities, because one of the inherent complexities of mortgage fraud cases is the length of time it takes to investigate and ultimately bring offenders to

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<sup>127</sup> S. REP. NO. 111-10, at 6.

<sup>128</sup> 18 U.S.C. § 1014.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> 18 U.S.C. § 3282 (2006) (“no person shall be prosecuted, tried, or punished for any offense, not capital, unless the indictment is found or the information is instituted within five years next after such offense shall have been committed”).

<sup>132</sup> 18 U.S.C. § 3293 (2006).



justice. Therefore, FERA provides the federal government twice as much time to investigate and prosecute, signaling Congress's seriousness about addressing and deterring mortgage fraud. These statutory enhancements indicate Congress' seriousness about addressing and deterring mortgage fraud in the home lending market.

#### *IV. Federal Fraud Enforcement after FERA*

The statutory enhancements that FERA provides to federal criminal law were necessary in order to level the playing field, and allow federal criminal statutes to be applicable to all home mortgage lenders.<sup>133</sup> A loan from a large national bank on Wall Street can have just as much impact on a consumer's life as a loan originated by a private broker on Main Street. A fraud perpetrated by a private mortgage broker should be subject to the full extent of the federal fraud laws just as federally insured lending institutions were prior to the enactment of FERA.

However, enhancing federal criminal law in response to the recent credit crisis is a potential source of criticism for FERA. In light of the pressures from the public, and their constituencies, a main motivation for Congress to pass FERA was to restore faith in the federal government's ability to combat criminal activity in the residential real estate market. The public's "zeal for Wall Street pelts is high."<sup>134</sup>

During Senate floor debates, it was noted that constituents "feel no one is paying a price for [the financial crisis] – except hard-working people out around America."<sup>135</sup> Additionally, Senator's constituents have even questioned, "who is going to be held accountable?"<sup>136</sup> The primary sponsor of FERA, Senator Patrick Leahy stated in reference to the perpetrators of mortgage fraud: "I want to not only get the people who did it, but I want to deter others from doing it in the future."<sup>137</sup> Therefore, the desire

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<sup>133</sup> These statutory amendments remove potential defenses from mortgage fraud prosecutions, such as claiming that the victim that was defrauded was not a financial institution as previously defined by 18 U.S.C. § 20. See *Mavashev*, 2009 WL 4746301, at \*1.

<sup>134</sup> David Segal, *Financial Fraud Rises as Target For Prosecutors*, N.Y. TIMES, Mar. 12, 2009, at A1.

<sup>135</sup> 155 CONG. REC. S4531-01 23 (daily ed. Apr. 22, 2009) (statement of Sen. Kaufman).

<sup>136</sup> 155 CONG. REC. S4531-01 21 (daily ed. Apr. 22, 2009) (statement of Sen. Spector).

<sup>137</sup> 155 CONG. REC. S4531-01 (daily ed. Apr. 22, 2009) (statement of Sen.

amongst the public and members of Congress for accountability and deterrence for the recent collapse is reflected in Congress' concerns while debating the passage of FERA.<sup>138</sup>

Commentators have noted that legislators often turn to the criminal law in order to respond to crisis in the economy, and to political pressure to formulate a response.<sup>139</sup> It should not be concluded too quickly that the provisions of FERA enhancing federal criminal law were passed simply as a political response to the concerns of the public and investors. Nonetheless, FERA is subject to criticisms, particularly whether the tough talk of Congress has any real legal teeth.

There are three main criticisms that can be directed at FERA. First, the Ex Post Facto Clause of the United States Constitution will limit the application of the enhanced statutory framework to private mortgage brokers who may have committed fraud during the peak of the housing boom. As a result, only the future deterrent goals of Congress can be carried out. Second, the subprime lending industry has come to a virtual standstill. The source of several opportunities for mortgage fraud may no longer exist in the home lending market. Therefore, the enhanced criminalization of mortgage broker coming at such a late stage in the mortgage crisis may not fulfill the desired effect of FERA. And third, FERA amends already applicable statutes, and the federal government was effective in enforcing those laws before, therefore the actual deterrent effect of further criminalizing mortgage broker conduct for the purpose of protecting lenders and consumers is called into question.

Despite these criticisms, the overall effect of the statutory enhancements and resources that FERA provides to federal law enforcement will be to more effectively police the home mortgage market. As a result of the federal government's commitment to

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Leahy).

<sup>138</sup> See 155 CONG. REC. S4531-01 25 (daily ed. Apr. 22, 2009) (statement of Sen. Kaufman) (Senator Kaufman noted during floor debates on the passage of FERA, that revamping federal law enforcement in the residential mortgage industry is not a "witch hunt", but that "we need the FBI agents and the prosecutors to make sure we get the right people and that they are prosecuted to the full extent of the law").

<sup>139</sup> See Geraldine Szott Moohr, *The Balance Among Corporate Criminal Liability, Private Civil Suits, and Regulatory Enforcement*, 46 AM. CRIM. L. REV. 1459, 1464 (2009); Abbe David Lowell & Kathryn C. Arnold, *Corporate Crime after 2000: A New Law Enforcement Challenge or Déjà vu?*, 40 AM. CRIM. L. REV. 219, 221 (2003) (discussing Congress' response to the corporate frauds of the early 2000's).

preventing fraud, mortgage lending, investment in the lending market, and the ability of consumers to obtain housing, will be more secure.

#### A. Ex Post Facto Clause Limitations

The full effect of the statutory enhancements under FERA cannot be applied to mortgage brokers who committed fraud during the housing boom because of the Ex Post Facto Clause of the United States Constitution.<sup>140</sup> The Ex Post Facto Clause prohibits imposition of statutes that criminalize or increase penalties for criminal conduct that preceded the legislature's enactment of the statute.<sup>141</sup> Applying a statutory revision which increases the punishment of a crime, after the offense was committed is a violation of the ex post facto clause.<sup>142</sup> The statutory enhancements that FERA provides are inapplicable to mortgage fraud committed before enacting FERA into law. Therefore, private mortgage brokers who have committed mail, wire, or bank fraud that has affected a "financial institution" will not be subject to the increased fines or penalties that FERA provides.

Additionally, the extension of the ten year statute of limitations for financial institutions crimes, which FERA now applies to mortgage brokers, may not apply to frauds which were committed prior to the enactment of FERA. It is well established that extending the statute of limitations for prosecuting crimes which have not yet expired is not a violation of the ex post facto clause.<sup>143</sup> All United States Federal Circuit Courts have addressed this issue, and have uniformly held the extending a limitations period before the prosecution is barred does not violate the ex post facto clause.<sup>144</sup>

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<sup>140</sup> U.S. CONST. art. I, § 9 cl. 3 ("No bill of attainder or ex post facto law shall be passed").

<sup>141</sup> See *Calder v. Bull*, 3 U.S. 386, 390 (1798) (the ex post facto clause protects the accused's liberty by preventing the government from enacting criminal statutes with "manifestly unjust and oppressive" retro active effects on the accused).

<sup>142</sup> See *Miller v. Florida*, 482 U.S. 423, 432-33 (1987).

<sup>143</sup> See *Stogner v. California*, 539 U.S. 607, 617 (2003).

<sup>144</sup> *United States v. Grimes*, 142 F.3d 1342, 1351 (11th Cir. 1998); *United States v. Brechtel*, 997 F.2d 1108, 1113 (5th Cir.1993); *Cf. Stogner*, 539 U.S. at 617-21 (explaining that a statute may not be passed which revives an already expired statute of limitations, because it is the kind of the retroactive harm that violates the ex post facto clause).

However, the only basis for applying the ten year statute of limitations to private mortgage brokers before the five years has run is the amended definition of “financial institution” which did not previously include mortgage lending businesses and mortgage brokers. Therefore, FERA will not allow the federal government to prosecute mortgage brokers who may have committed fraud that contributed to the mortgage crisis. Nonetheless, the statutory enhancements under FERA extend the length of federal investigations, and provide federal prosecutors the ability to charge mortgage fraud defendant’s with a greater variety of offenses than before.

### B. Enhancing Criminal Enforcement of Mortgage Brokers

The passage of FERA was far from over “criminalizing” the federal fraud statutes applicable in mortgage fraud cases.<sup>145</sup> The statutory enhancements that FERA applies to the federal criminal law statutory framework are meant to level the playing field among actors in the residential mortgage industry. FERA was required in order to update federal criminal fraud statutes to reflect the realities of the home mortgage lending market. The market had undergone significant change in recent years, most notably the emergence of private mortgage brokers in the system of mortgage originations.<sup>146</sup>

One of Congress’ driving concerns for passing FERA was the increased reporting of mortgage fraud.<sup>147</sup> The reports of mortgage fraud in the residential real estate market also justify the targeting of private mortgage brokers in mortgage fraud investigations. However, the amount of mortgage fraud in the market, or its perpetrators, cannot precisely be determined. There is no central information collecting point for mortgage fraud. The closest thing to providing mortgage fraud reporting to federal law enforcement in the residential real estate market is utilizing Suspicious Activity Reports (“SARs”). Federally insured banking institutions and their affiliates are required to report suspected criminal financial activity by filing SARs.<sup>148</sup> A federally regulated

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<sup>145</sup> Cf. Moohr, *supra* note 139, at 1464 (noting that the provisions of FERA prohibit conduct that was already covered by other statutes).

<sup>146</sup> UNDERSTANDING MORTGAGE MARKET BEHAVIOR, *supra* note 22, at 8.

<sup>147</sup> *Enforcement of Financial Consumer Protection Laws*, *supra* note 11, at 2.

<sup>148</sup> DeLone, *supra* note 85, at 638 (the Department of the Treasury, the Office of Thrift Supervision, the Office of the Currency, the Federal Reserve,

institution subject to the SAR reporting requirement is required to submit a report to the Financial Crimes Enforcement Network (“FinCEN”), which then may detect “a known or suspected violation of federal law”, and distribute the SARs to federal law enforcement agencies.<sup>149</sup>

The SARs filed by federally insured depository institutions pertaining to mortgage fraud increased by 1,411% between 1997 and 2005.<sup>150</sup> In 2003, SARs reporting of mortgage loan fraud increased by 77% over 2002, and continued to increase.<sup>151</sup> Overall, SARs alleging mortgage fraud have increased nearly tenfold, and SAR mortgage fraud filings from financial institutions has increased 36 percent to total 63, 713 reports during 2008.<sup>152</sup>

The increase in reporting is partially attributable to the increased investigation on behalf of the mortgage industry.<sup>153</sup> The growing awareness of mortgage fraud is confirmed by the year to year increase in the number of SARs reported.<sup>154</sup> Furthermore, from 1997 to 2005, commercial banks and thrifts acquired almost 150 independent mortgage lending businesses, therefore making those institutions subject to mandatory submissions of SARs.<sup>155</sup>

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and the Federal Deposit Insurance Corporation created the Suspicious Activity Report to assist with the detection of illegal activities in the financial industry).

<sup>149</sup> 12 C.F.R. § 208.62 (2008); The SAR reporting requirement applies to (1) federal banks under OCC supervision, 12 C.F.R. §21.11 (2008); (2) FDIC-insured state banks, 12 C.F.R. § 208.62 (2008); (3) banks generally, 12 C.F.R. § 353.3 (2008); and (4) FDIC-insured savings associations, 12 C.F.R. § 563.180 (2008).

<sup>150</sup> See Remarks of James H. Freis, *supra* note 37; see also FINCEN SUSPICIOUS ACTIVITY REPORT ANALYSIS, *supra* note 23, at 1. The figures represented in the SAR analysis conducted by FinCEN do not provide the complete picture of the potential fraud that existed in the mortgage industry. SAR reporting does not include the private lending industry, because they are not subject to the federal reporting requirements.

<sup>151</sup> FIN. CRIMES ENFORCEMENT NETWORK, FILING TRENDS IN MORTGAGE LOAN FRAUD: A REVIEW OF SUSPICIOUS ACTIVITY REPORTS FILED JULY 1, 2007 THROUGH JUNE 30, 2008 5 (2008), available at [http://www.fincen.gov/news\\_room/nr/pdf/20090225a.pdf](http://www.fincen.gov/news_room/nr/pdf/20090225a.pdf) (last visited Feb. 20, 2010) [hereinafter FILING TRENDS IN MORTGAGE LOAN FRAUD].

<sup>152</sup> See FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29; see also S. REP. NO. 111-10, at 2.

<sup>153</sup> See Jennifer Butts et al., *supra* note 56, 8.

<sup>154</sup> FINCEN SUSPICIOUS ACTIVITY REPORT ANALYSIS, *supra* note 23, at 4. However, companies often report fraud cases years after the loans are originated, and therefore some of the SARs reported in 2004 and 2005 may have dealt with loans originated from 2000-2003.

<sup>155</sup> Merle Sharick et al., *Eight Periodic Mortgage Fraud Case Report to*

While, the drastic increase in reporting can also be attributed to the increase in activity in the mortgage industry, that same increase in mortgage loan origination activity provided an increase in the opportunities for mortgage fraud to occur within the residential real estate market.

FinCEN conducted a study of the SAR's filed by depository institutions between 1996 and 2006 that contained suspicious reports of mortgage fraud.<sup>156</sup> Of the 82, 851 SARs that reported suspected mortgage fraud during that time span, FinCEN chose a random sample of 1,054 SAR's to study.<sup>157</sup> Within that sample the number of reports of private mortgage brokers suspected of fraud in the first quarter of 2006 was equal to the total number of reports filed in 2004.<sup>158</sup> In addition to mortgage brokers originating as many as half to two-thirds of mortgage loans by 2006, FinCEN statistical reports indicate that the suspected fraud among private mortgage brokers had also experienced a significant increase during this period.<sup>159</sup>

Additionally, the FinCEN study showed that reports of material misrepresentations and false statements were the most reported suspicious activity in conjunction with mortgage fraud.<sup>160</sup> While FinCEN statistical reports may be the most comprehensive analysis of mortgage fraud in the lending market, there are additional studies being conducted by the lending industry that support FinCEN's conclusions. The Mortgage Asset Research Institute ("MARI") utilizes the Mortgage Bankers Association endorsed Mortgage Industry Data Exchange ("MIDEX") subscriber database which contains information submitted by over 400 mortgage lenders, agencies, and insurers.<sup>161</sup>

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*Mortgage Bankers Association*, 8 MORTGAGE ASSET RESEARCH INST. 2 (2006), available at <http://www.marisolutions.com/pdfs/mba/MBA8thCaseRpt.pdf> (last visited Feb. 20, 2010).

<sup>156</sup> FINCEN SUSPICIOUS ACTIVITY REPORT ANALYSIS, *supra* note 23, at 1.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* at 6.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 8. (of the 1,054 sample SARs, 65.78% revealed reports of material misrepresentation and false statements on loan applications, including: altered bank statements, altered or fraudulent earnings documentation, fraudulent letters of credit, fabricated letters of gift, misrepresentation of employment, altered credit scores, invalid social security numbers, failure to disclose borrower debts or assets, and mortgage brokers using the identities of prior customers to obtain loans).

<sup>161</sup> See Jennifer Butts et al., *supra* note 56, at 7 (The fraud experiences of

Like the FinCEN analysis, MARI reports that misrepresentation on loan applications ranks highest among fraud types for 2007, 2006, 2005, and 2004.<sup>162</sup>

While the legislative history behind FERA reveals Congress in effect assuming that the sharp increase in SAR reporting is indicative of the prevalence of fraud committed by private mortgage brokers, the statistics that are reported do support and justify the passage of FERA and the expansion of federal fraud statutes to apply to in more instances of mortgage fraud perpetrated by private mortgage brokers. The amount SARs suspecting mortgage broker fraud supports Congress' concern of these actors in the mortgage market. Additionally, the fact that false statements and misrepresentations ranks the highest amongst the types of fraud among SARs and the MIDEX index supports the expanded applicability of Section 1014, the statute that prohibits false statements and appraisals in loan applications.<sup>163</sup>

Under FERA, Section 1014 applies to both federally insured depository institutions and to private mortgage brokers. This is a significant statutory amendment, because private mortgage brokers had captured at least half of the mortgage market at the peak of the housing boom. Additionally, the statutory enhancements to the mail, wire, and bank fraud statutes increase the ability to charge mortgage fraud defendants in a wider variety of mortgage fraud cases.

However, there has been a "virtual halt" in nonconforming, subprime lending.<sup>164</sup> The subprime mortgage market is dormant, and non-conforming lending activity is modest at best.<sup>165</sup> Additionally, hundreds of lenders whose businesses were dependent on the secondary mortgage market through mortgage backed securities, and ideal contenders for fraud for profit schemes, have closed their doors and declared bankruptcy since 2007.<sup>166</sup> These developments raise questions as to whether the statutory enhancements under FERA will provide

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independent mortgage businesses are represented, among others in the MIDEX database).

<sup>162</sup> *Id.* at 5 (noting that the prevalence of misrepresentations and false statements on loan applications is "hardly surprising, given that the application form is comprehensive in collecting borrower personal identity, employment, asset and liability information").

<sup>163</sup> *See* 18 U.S.C. § 1014.

<sup>164</sup> *See* Jennifer Butts et al., *supra* note 56, at 2.

<sup>165</sup> *See* Merle Sharick et al., *supra* note 10, at 8.

<sup>166</sup> *Id.*

meaningful criminal enforcement if the residential lending industry if the intended targets of the legislation may no longer be in business.

### C. Effective Deterrence under FERA

While the federal government cannot hold fraudsters who contributed to the mortgage crisis accountable under FERA, the enhancements to the federal criminal law statutory framework and increased funding to federal law enforcement will allow federal authorities to disrupt and prosecute current and future frauds in the home lending market. However, like the underlying policy of accountability, the desired deterrent effect of FERA is susceptible to criticism. Policy makers exhibited a desire to deter future frauds in the residential real estate market by passing FERA. However, like talk of accountability and stiff criminal penalties, politicians often use the language of deterrence to justify increases in criminal penalties.<sup>167</sup>

Criminal penalties are the least used method of consumer protection today.<sup>168</sup> While criminal law is not often implemented, it can be an affective means of enhancing consumer protection.<sup>169</sup> The goal of such consumer protection legislation is to prosecute, punish, deter, and to prevent intentional, deviant, and normatively unacceptable conduct.<sup>170</sup> Unlike individual consumers, the state has a special independent interest in ensuring that criminal conduct is met with negative sanctions.<sup>171</sup> However, the decision to rely on criminal law enforcement in the area of consumer protection requires that a cost benefit analysis be conducted.<sup>172</sup> If criminal sanction is not a sufficient deterrent,

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<sup>167</sup> Miriam H. Baer, *Linkage and the Deterrence of Corporate Fraud*, 94 VA. L. REV. 1295, 1330 (2008).

<sup>168</sup> DEE PRIDGEN, RICHARD M. ALDERMAN, CONSUMER PROTECTION AND THE LAW §7.22 (2009); Christopher Steelman, *Mortgages and Misdemeanors: Criminal Enforcement of State Mortgage Lending License Requirements and Homeowner Protection*, 45 AM. CRIM. L. REV. 1439, 1454 (2008) (a survey of state criminal laws enforced against mortgage lending revealed that "criminal sanction is often the least utilized method of enforcement").

<sup>169</sup> Peter Cartwright, *Product Safety and Consumer Protection*, 58 MOD. L. REV. 222, 231 (1995).

<sup>170</sup> Eric H. Steele, *Fraud, Dispute, and the Consumer: Responding to Consumer Complaints*, 123 U. PA. L. REV. 1107, 1108 (1975).

<sup>171</sup> *Id.* at 1110.

<sup>172</sup> Steelman, *supra* note 168, at 1450-51.



then the costs of implementing it may outweigh the additional consumer protection that it provides.<sup>173</sup>

Some provisions of FERA do in fact prohibit conduct that has already been criminalized by federal law, such as the mail, wire, and bank fraud statutes. Furthermore, FERA amends laws that were previously applicable to private mortgage brokers, the actors that Congress was most concerned with in passing FERA. Additionally, the federal government was able to engage in successful investigations and prosecutions before FERA was enacted.<sup>174</sup> Through 2007, 1,204 mortgage fraud cases resulted in 321 indictments, and 260 convictions of mortgage fraud defendants.<sup>175</sup> The ability of the federal government to investigate and prosecute mortgage fraud without expanded charging abilities and enhanced penalties might suggest that FERA was an unnecessary piece of legislation, therefore supporting the criticism that FERA was a political response to the mortgage crisis.

However, the federal investigations and prosecutorial efforts to date only reflect a tiny percentage of reported mortgage fraud within the residential lending industry. There have been relatively few major federal mortgage fraud prosecutions to date.<sup>176</sup> But the lack of federal prosecutions is not an indicator

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<sup>173</sup> See *Id.* at 1450 (“the social benefits associated with prohibiting certain undesirable conduct of residential mortgage lenders [ . . . ] would likely be outweighed by the costs associated with the use of criminal sanction if the threat of the criminal sanction were not sufficient to deter the conduct”).

<sup>174</sup> The federal government engages in a collaborative enforcement approach among enforcement agencies when addressing mortgage fraud. However, the FBI is the main investigative enforcement agency addressing mortgage fraud. Enforcement efforts often take the form of “enforcement sweeps” or “task forces”, the most recent being “Operation Malicious Mortgage”. See Press Release, Regional Federal Mortgage Fraud Investigations and Prosecutions, *supra* note 74; see also John D. Arterberry, *Mortgage and Securitization Fraud: The Department of Justice Enforcement Program*, 1688 PRAC. L. INST. 405, 407 (2008) (Operation “Malicious Mortgage” involved the Department of Justice, the FBI, the U.S. Postal Inspection Service, the Internal Revenue Service-Criminal Investigation Division, U.S. Immigration and Customs Enforcement, and the U.S. Secret Service. The DOJ also focuses on fraud that may have impacted mortgage securitization, and works closely with the Securities and Exchange Commission to identify and prosecute fraud associate with securitization).

<sup>175</sup> FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEAR 2007, *supra* note 26.

<sup>176</sup> Andrew J. Ceresney, Gordon Eng & Sean R. Nuttall, *Regulatory Investigations and the Credit Crisis: The Search for Villains*, 46 AM. CRIM. L. REV. 225, 235 (2009); see also Eric Lichtblau, David Johnston, & Ron Nixon, *F.B.I. Struggling to Handle Wave of Finance Cases*, N.Y. TIMES., Oct. 19,

that mortgage fraud may not be as prevalent as reported. Rather, the relatively low number of major federal prosecutions is indicative that federal law enforcement did not have the resources available to effectively address this continuing problem in the residential real estate market.

The lack of law enforcement against mortgage fraud can be in-part contributed to the shift in federal resources to counterterrorism efforts after 9-11. The FBI shifted more than 1,800 agents to terrorism and intelligence duties, which resulted in a severe loss in staffing for investigations into white-collar crimes such as mortgage fraud.<sup>177</sup> Prior to the enactment of FERA, the FBI's resources were reportedly so depleted that they were unable to address suspected mortgage fraud cases that involved possible frauds of millions of dollars in losses to financial institutions.<sup>178</sup>

Despite the relatively few successes of the FBI and DOJ in investigating and prosecuting mortgage fraud prior to the enactment of FERA, the costs of mortgage fraud continued to increase and federal resources remained overwhelmed. In 2006 alone, after the mortgage lending boom had subsided, the FBI reported that mortgage fraud cost the mortgage lending industry between \$946 million and \$4.2 billion.<sup>179</sup> In 2008 it was estimated that the dollar losses due to mortgage fraud could reach \$2.5 billion, and that comparable losses were expected in following years.<sup>180</sup> Now the annual losses from mortgage fraud are estimated to be in the range of \$4 billion and \$6 billion.<sup>181</sup>

Additionally, the FBI's mortgage fraud caseload has tripled in the past three years.<sup>182</sup> The FBI reported in 2008 that

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2008, at A1 (Federal prosecutions for frauds perpetrated against financial institutions dropped 48 percent from 2000 to 2007).

<sup>177</sup> Lichtblau, Johnston, & Nixon, *supra* note 177.

<sup>178</sup> *Id.*; see also Statement of John Pistole, Deputy Dir. Fed. Bureau of Investigation, *supra* note 33, at 4 ("the increasing mortgage, corporate fraud, and financial institution failure case inventory, is straining the FBI's limited White Collar Crime resources").

<sup>179</sup> Fed. Bureau of Investigation, *Mortgage Fraud: New Partnership to Combat Problem*, <http://www.fbi.gov/page2/march07/mortgage030907.htm> (last visited Feb. 20, 2010).

<sup>180</sup> National Mortgage News, Daily Briefing, Weekend Edition: News Recap, *Mortgage losses Forecast at \$2.5 Billion*, Mar 2008, available at <http://www.mortgage-technology.com/premium/archive/?ts=1206633604> (last visited Feb. 20, 2010).

<sup>181</sup> Fed. Bureau of Investigation, [http://www.fbi.gov/hq/mortgage\\_fraud.htm](http://www.fbi.gov/hq/mortgage_fraud.htm) (last visited Feb. 20 2010).

<sup>182</sup> Kenneth R. Harney, *Half a Billion Dollars Says U.S. Is Getting Serious*

the 63 percent of all open fraud investigations, totaling 1,035 cases, involved dollar losses totaling more than \$1 million.<sup>183</sup> As of November 2009, the FBI was working on more than 2,800 mortgage fraud investigations, 1,842 of which involved over \$1 million in losses.<sup>184</sup> The exploding case load in FBI investigations indicates the presence of fraud throughout the home lending market. Additionally, this increase in investigations demonstrates the need for increased federal resources for the investigation and prosecution of mortgage fraud cases.

Resources and manpower are an issue in mortgage fraud prosecutions due to the inherent complexities of the mortgage industry and the schemes that fraudsters perpetrate. These inherent complexities of mortgage fraud cases are exacerbated by strained federal law enforcement resource and manpower shortages.<sup>185</sup> Obstacles to prosecution include the time and resources necessary to investigate and uncover wrongdoing, as well as the difficulty in apportioning blame, and proving intent to defraud.<sup>186</sup>

While enhancing the federal criminal law statutory framework, FERA also reinvigorates federal law enforcement of mortgage fraud by authorizing hundreds of millions of dollars to federal investigators and prosecutors. FERA provides \$140 million dollars to the FBI to nearly double the size of its mortgage and financial fraud program.<sup>187</sup> Additionally, FERA provides \$470 million to the DOJ for hiring new personnel, and provides additional funds to other federal agencies that investigate mortgage fraud.<sup>188</sup> The shift in focus to investigating and

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*About Busting Fraud*, WASH. POST, May 30, 2009, at Fin. E01 (the exploding case load in investigations of the FBI is indicative of the increase in the mortgage fraud through out the home lending market).

<sup>183</sup> FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29.

<sup>184</sup> *Testimony to the Financial Crisis Inquiry Commission*, 2 (Jan. 14, 2010) (statement of Lanny A. Breuer, Assistant Attorney Gen., Criminal Div., United States Dep't. of Justice) <http://www.fcic.gov/hearings/pdfs/2010-0114-Breuer.pdf>.

<sup>185</sup> Ceresney et al., *supra* note 176, at 235.

<sup>186</sup> *Id.*

<sup>187</sup> S. REP. NO. 111-10, at 3.

<sup>188</sup> *Id.* (FERA also authorizes \$50 million a year for U.S. Attorney's Offices to staff fraud task forces in the hardest hit parts of the nation, \$40 million for the Criminal, Civil, and Tax Divisions at the Justice Department, and \$160 million for investigators and analysts at the U.S. Postal Inspection Service, the U.S. Secret Service, and the Office of the Inspector General for the Department of Housing and Urban Development to combat fraud in Federal housing assistance programs).

prosecuting mortgage fraud is vital to combat the growing wave of fraud that Congress considered in enacting FERA.<sup>189</sup>

In addition to criminal prosecutions, Congress' investment in enforcement is predicted to not only root out fraudulent activity in the home lending market, but also lead to increased restitution payments to victims of mortgage fraud.<sup>190</sup> Federal statutory law provides for restitution recovery for fraud convictions.<sup>191</sup> It is estimated that the government recovers more than \$20 for every dollar spent on criminal fraud litigation.<sup>192</sup> The dollar losses caused by mortgage fraud in the residential lending market are substantial, and FERA is a necessary response to this continuing criminal activity.<sup>193</sup>

Furthermore, reinvigorated criminal enforcement under FERA is an effort to restore the public's faith in the federal government's ability to police the home lending market. Under FERA federal investigators and prosecutors will be combating a crime which eroded confidence in the home lending market and its institutions which were relied upon by investors, and depended upon by consumers to meet their housing needs. While FERA will not have the effect of holding those who may have contributed to the mortgage crisis accountable, this new legislation will ensure that federal law enforcement possesses the tools necessary to respond to future frauds against lenders and consumers.

Mortgage fraud schemes evolve with the changing economic conditions in the home lending market. This phenomenon is demonstrated by the increase in foreclosure rescue

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<sup>189</sup> 155 CONG. REC. S 4531-01 (daily ed. Apr. 22, 2009) (statement of Sen. Kaufman) (“[FERA] helps ensure that sophisticated criminals cannot cover their tracks and escape liability. Unless we get some agents working on these cases soon, the trails may go cold”).

<sup>190</sup> 155 CONG. REC. S4774-02 (daily ed. Apr. 28, 2009) (statement of Sen. Durbin).

<sup>191</sup> 18 U.S.C. § 366A (2006) (a court is mandated to require a defendant to pay restitution to a victim when the defendant is convicted of an offense “in which an identifiable victim or victims has suffered [ . . . ] pecuniary loss”); *see* United States v. Innarelli, 524 F.3d 286, 292-94 (1st Cir. 2008) (the Mandatory Victims Restitution Act compels a sentencing court to order a defendant to pay restitution to victims).

<sup>192</sup> 155 CONG. REC. S4774-02 (daily ed. Apr. 28, 2009) (Statement of Sen. Leahy).

<sup>193</sup> Statement of John Pistole, Deputy Dir. Fed. Bureau of Investigation, *supra* note 33 (“Mortgage and related corporate fraud were not the sole sources of the current financial crisis; however, it would be irresponsible to neglect mortgage fraud’s impact on the U.S. housing and financial markets”).

scams as consumer debt and risk of foreclosure increases in the currently depressed housing market. Foreclosure rescue schemes have increased substantially, with more than 2.3 million properties foreclosed upon in 2008.<sup>194</sup> The ability of the federal government to respond to these developments in the lending market is critical to not only enforcing the law and protecting consumers, but also restoring confidence in the market as a whole.

FERA broadens the range of conduct that is subject to criminal prosecution, results in less constrained prosecutions with a ten year statute of limitations, and increases penalties for more actors in the home lending market. Increasing criminal sentences for mortgage fraud has the effect of putting the industry professional intending to profit from fraud on fair notice that such conduct will not longer be tolerated.<sup>195</sup>

However, it is a difficult question to address whether such sanctions do actually prevent mortgage fraud in the home mortgage lending market. The government and the industry are uncertain of the prevalence of fraud in lending practices, because there is no central reporting system for mortgage fraud. Therefore, it is not possible to measure the deterrent effect of criminal sanctions against trends in reported mortgage fraud.

Nonetheless, the costs of implementing FERA in the residential real estate market are well outweighed by the reassurances that enhanced law enforcement could provide to investors, lenders, and consumers. The potential deterrent effect that a broader federal criminal statutory framework and the manpower necessary to aggressively enforce those laws, is sufficient to respond to the spike in reported mortgage fraud, and to future threats in the home lending market.

### *V. Conclusion*

FERA now provides the federal government, mortgage lenders, and consumers, what was needed five years ago at the

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<sup>194</sup> FBI 2008 MORTGAGE FRAUD REPORT, *supra* note 29; See also Jennifer Butts et al., *supra* note 56, at 8 (identifying foreclosure prevention schemes as an emerging scenario the mortgage lending industry should be concerned about); FINCEN SUSPICIOUS ACTIVITY REPORT ANALYSIS, *supra* note 23, at 18 (the current trend of rising interest rates and slowing housing equity growth could result in debt elimination fraud).

<sup>195</sup> See Donald P. Rothschild & Bruce C. Throne, *Criminal Consumer Fraud: A Victim-Oriented Analysis*, 74 MICH. L. REV. 661, 691 (1975).

peak of the subprime mortgage boom. The enhanced enforcement capabilities of the federal government will now be more effective at disrupting fraudulent lending practices, and prosecuting offenders. Criminal prosecutions alone are not the answer to eliminating fraud in the home mortgage lending market. However, no solution is possible without the aggressive enforcement of federal criminal laws against mortgage fraud. Such an effort on behalf of policy makers and federal law enforcement authorities will protect both home mortgage lenders and consumers seeking to refinance their existing mortgages, or to fulfill the American dream of homeownership.