

**AMERICAN  
LAND TITLE  
ASSOCIATION**



**TESTIMONY OF FRANK PELLEGRINI  
ON BEHALF OF  
THE AMERICAN LAND TITLE ASSOCIATION**

**“Strengthening Oversight and  
Preventing Fraud in FHA and other  
HUD Programs”**

**BEFORE THE  
HOUSE FINANCIAL SERVICES  
SUBCOMMITTEE ON OVERSIGHT AND  
INVESTIGATIONS**

**THURSDAY JUNE 18, 2009**

**10:00 AM**

## **Introduction**

My name is Frank Pellegrini, and I am President of Prairie Title in Oak Park, Illinois, with offices in Chicago, Schaumburg, Deerfield, Oakbrook Terrace, Palos Hills, Lisle and O'Hare. I have been a practicing lawyer since 1976 and founded Prairie Title in 1983 along with my wife, Mary. I served as President of the Illinois Land Title Association in 2004 and 2005 and on the Board of Directors of the Illinois Mortgage Bankers Association. I am a title agent, and a member of the Board of Governors of the American Land Title Association, which I am here today to represent. ALTA is the national association for the land title industry, representing nearly 3,000 member companies, with more than 100,000 employees, including title insurers, title insurance agents, abstracters and attorneys. Our members operate in every state and county throughout the country.

On behalf of ALTA, I appreciate the opportunity to appear before you today to discuss mortgage fraud and the title industry's role in: (1) facilitating the real estate purchase and refinance process (2) conducting closings in real estate transactions; and (3) protecting borrowers and lenders by preventing fraud. Finally, I will offer thoughts on additional steps that can be taken to combat mortgage fraud. The title industry protects consumers and lenders from fraud every day, and we provide consumers with the certainty that when they walk away from the closing table they own their real estate and that it cannot be taken from them because the property has been properly and legally conveyed.

## **Mortgage Fraud**

Mortgage fraud is a significant threat to our economy, to the stability of the nation's housing markets and to the peace of mind of millions of American homeowners. Mortgage fraud is one of the fastest growing white collar crimes in the United States. There are two types of mortgage fraud: fraud for property and fraud for profit.

Fraud for property, also known as fraud for housing, accounts for 20 percent of mortgage-related fraud and typically involves the borrower as the perpetrator on a single loan. The borrower may make a few misrepresentations, usually regarding their income, personal debt, and/or property value, or conceals the source of a down payment. The borrower wants the property and intends to repay the loan, and is sometimes coached by their realtor or broker in order to qualify for the loan.

Fraud for profit accounts for about 80% of mortgage-related fraud and involves defrauding one or more of the parties to the transaction and taking cash out of the deal. The Treasury Department estimates that mortgage fraud causes losses to consumers and the mortgage industry of between \$15 billion to \$25 billion every year. Unfortunately, the problem does not appear to be going away. Reports of potential fraud filed with the Treasury Department's Financial Crimes Enforcement Network exceeded 65,000 in 2008, up from 25,000 in 2005 and just 5,400 in 2002.

In my hometown of Chicago, as in many large urban areas, the proliferation of mortgage fraud activities is particularly disturbing. The Chicago Crime Commission, an independent, non-partisan crime watchdog organization, reports that the profile of the typical Chicago gang leader has evolved into a picture of a graying, suburban, and technology-friendly convict who oversees mortgage fraud operations to supplement such traditional gang enterprises as drug trafficking. And unfortunately, according to the FBI Financial Crime Report to the Public for Fiscal Year 2006, "mortgage fraud perpetuated by real estate industry insiders accounts for 80% of all reported mortgage fraud losses."

On May 20th, 2009, President Obama signed into law both the Fraud Enforcement and Recovery Act and the Helping Families Save Their Homes Act in an effort to combat the mortgage fraud crisis.

The Fraud Enforcement and Recovery Act provides the federal government with more tools to investigate and prosecute mortgage, corporate, and other financial frauds, and authorizes substantial funds for hiring fraud prosecutors and investigators at the Justice Department. With this funding, the FBI will almost double its mortgage-fraud task forces nationwide. In addition, the law makes a number of important improvements to fraud and money laundering statutes. The purpose of these improvements is to ensure that individuals and companies are held fully accountable under federal fraud statutes. Most importantly, the Act amends the definition of "financial institution" in the criminal code (18 U.S.C. § 20) in order to extend federal fraud laws to mortgage-lending businesses not directly regulated or insured by the federal government, thereby applying the federal fraud laws to private mortgage businesses.

The Helping Families Save Their Homes Act establishes a Nationwide Mortgage Fraud Task Force within the Justice Department to address mortgage fraud in the United States. The Task Force is required to: (1) establish federal, state, and local coordinating entities to organize initiatives to address mortgage fraud; (2) provide training to federal, state, and local law enforcement and prosecutorial agencies with respect to mortgage fraud; (3) collect and disseminate data with respect to mortgage fraud; and (4) perform other functions determined by the Attorney General to enhance the detection, prevention, and response to mortgage fraud in the United States. The Task Force is authorized to: (1) initiate and coordinate federal mortgage fraud investigations and, through the coordinating entities, state and local investigations; (2) establish a toll-free hotline for reporting mortgage fraud and providing the public with access to related information and resources; (3) create a database about suspensions and revocations of mortgage industry licenses and certifications to facilitate the sharing of such information by states; and (4) make recommendations and propose federal, state, and local government legislation.

Common mortgage fraud schemes include:

- Property flipping where property is purchased, falsely appraised at a higher value, and then quickly sold. The scheme typically involves one or more of the following: fraudulent appraisals, doctored loan documentation, or inflating buyer

income, kickbacks to buyers, investors, brokers, appraisers. Unfortunately, participation of title company employees is common in this scheme.

- A “silent second,” where the buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes that the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.
- Nominee loans or straw buyers where the identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.
- The use of a fictitious or stolen identity in the loan application where the applicant may be involved in an identity theft scheme: an applicant's name, personal identifying information, and credit history are used without the actual person's knowledge.
- Inflated appraisals where an appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender which inaccurately states an inflated property value.
- Equity skimming where an investor may use a straw buyer, false income documents, and false credit reports to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.
- An air loan which is a non-existent property loan where there is usually no collateral. An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments, and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.
- “Liar loans,” also know as stated income loans, NINA Loans (no income, no asset), or NINJA Loans (no income, no job, and no assets) which were originally created for high-income individuals or businesses that preferred not to document all assets and income. These loans required simply that the applicant state their income and assets. In order to compensate for the slightly higher risk, these loans often come with a higher interest rate. In fraudulent transactions, these loans are provided to applicants who would not otherwise qualify for a loan.
- “Loan slamming,” where the borrower applies for several loans at the same time on the same property, and times the closings so that they occur within a few days

of each other. It is important to note that the transactions happen so close to each other that they often go undetected. This is particularly troubling to the title insurance industry because the gap between the time a transaction is recorded and the document is indexed provides a prime opportunity for fraudulent activity.

- Property theft which is usually targeted at owners who leave their homes for a significant amount of time throughout the year, known by those of us in Oak Park as snowbirds. The culprit moves into the house, puts it up for sale and sells it to an unsuspecting buyer. No one knows the truth and, when the sellers return, they find a new family living in their home.
- Foreclosure rescue schemes where the perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. The perpetrator misleads the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The perpetrator remortgages the property and/or pockets fees paid by the homeowner.
- Asset rentals where real estate agents or mortgage brokers misrepresent the borrower's ability to qualify for a loan by fabricating employment history, income verification, credit records and/or bank statement balances. For a fee, an "asset rental" company transfers money into the borrower's bank account to show the lender that the borrower has ample funds to close and even enough for reserve. Once the closing takes place however, the funds are transferred back to the asset rental company. These types of companies can also issue fake appraisals, credit reports, and employment verifications and even give the borrower a new Social Security number usually taken from someone who had died in the early part of the 20<sup>th</sup> century.
- "Chunking," where a borrower attends a "seminar" about how to invest in real estate with no money down, and a third party, possibly a presenter at the seminar/program, encourages the borrower to invest in 3 properties and acts as the borrower's counsel or agent. Under the perpetrator's guidance, the borrower completes the applications and perpetrator submits the applications to multiple lenders for multiple properties, let's say 10, instead of the original 3 that the borrower knows about. This scheme requires an appraiser, broker, and/or a title professional to ensure that the borrower does not have to bring money to the multiple closings. The perpetrator acts as the borrower's agent at closing, and while the borrower receives loan proceeds for 3 closings they are aware of, the perpetrator pockets the proceeds from the other 7 closings. Lenders are stuck with loans to a borrower who does not have the ability to repay the debt and are often forced to foreclose on the properties.

In addition, new mortgage fraud schemes are emerging all of the time. Some ALTA members are even seeing evidence of fraud using the recently-passed \$8,000 First Time Homebuyer Tax Credit where loans are made to "monetize" the tax credit with exorbitant up-front fees or interest rates. All of these schemes contribute to mortgage fraud.

## **How does the title industry facilitate real estate transactions?**

The “ownership” of real estate really involves the ownership of a bundle of rights that relate to the use and disposition of the property that we have come to associate with the general term “ownership” or, the more technically correct phrase, fee simple title. Ownership rights to real estate may be divided in a number of ways and over a period of time. Prior owners may have created interests in the property or suffered liens against the property that take precedence over the interests acquired by a new purchaser. And because of the value, permanence, and immovability of real estate, federal, state, county, and municipal governments have created or recognized a vast array of rights, liens, and encumbrances that may be asserted against real estate to encourage compliance with the law. Each of the documents used to determine ownership rights has the potential to be made fraudulent. These documents represent:

- liens against the property that serve as security for the payment of an obligation, such as mortgage liens, judgment liens for unpaid court judgments, tax liens, state and local liens for failure to pay real estate taxes or assessments, mechanic’s liens to secure payment for improvements, liens for recovery of child support payments or, as in New York City, for unpaid parking tickets;
- easements that have been created by contract or arisen through use of adverse prescription, such as rights of way for utilities, rights acquired by neighbors because of an encroachment;
- building or use restrictions contained in a recorded plats, agreements or deeds; and
- rights or claims arising out of bankruptcy.

However, in any real estate transaction, the buyer must be certain that they will ultimately be acquiring ownership of the property subject only to those liens and encumbrances they know about and are willing to accept. Likewise, the seller has an interest in ensuring that the title obtained by the buyer will not be subject to any claims that will trigger any liability on their part. The mortgage lender must be certain that in providing financing for the transaction, the buyer, in fact, will own the property and that the mortgage lender will obtain a valid and enforceable first mortgage lien that is not subject to any other lien or claim that could adversely affect that mortgage interest.

Nowhere else in the world is the creation and transfer of interests in real property accomplished more efficiently and securely than in the United States. Economic success in America relies on a clear system of property rights. This system was created during the times of the American frontier and is the basis for entrepreneurship and the creation of wealth and capital in our country. Our property recording and title insurance system, served by local public officials and the title industry, provides us with

the legal underpinning that fosters the trust necessary for mortgage credit to flow and make homeownership possible.

The willingness of individuals and businesses to invest in real estate anywhere in the United States, or to loan money to those who own or are acquiring real estate and the ready marketability of those interests and loans is fostered and preserved by the title insurance industry. We do this by issuing insurance policies and completing the significant work title agents perform which is required to issue the policies. This effort has rendered real estate investments safer, more secure, and more marketable than at any time in history.

In general, there are two major types of title insurance policies, both of which are typically issued after the closing of a real estate or mortgage finance transaction: an owner's policy and a loan policy. Both policies are issued for a one-time fee, often simultaneously, which is paid during the closing. There are no renewal premiums for title insurance. Under both policies, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim, including fraud.

An owner's policy insures the purchaser against financial loss or damage that may arise from defects in the title as insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The policy includes protection against title defects that may be found in public records but were not discovered during the search of those records or their significance was not appreciated, and against defects that even the most comprehensive search of the records would not reveal. These risks include, among others:

- fraud or forgery in the execution of documents in the chain of title, including deeds, mortgages or mortgage satisfaction pieces;
- mistakes in the interpretation of wills, divorce decrees, bankruptcy court directives and other legal documents;
- the execution of documents by minors or incompetent persons who could not legally convey property interests;
- the existence of undisclosed heirs who did not consent to a prior transfer;
- deeds executed under an expired power of attorney or on behalf of someone who has died; and
- mistakes in the recording or indexing of documents in the public records.

A loan policy essentially insures the lender that they will have a valid, enforceable lien on the property should they need to reacquire the underlying asset by foreclosure and that no other claimant, other than those specifically noted in the policy,

has a prior, superior claim. The loan policy continues in force so long as there is a balance due on the loan. It is typically assigned in the secondary mortgage market to a purchaser of the loan or Mortgage Backed Security pool in which the loan is placed.

Because the history and current status of each parcel of property is unique, title insurance policies are not issued on a “casualty” basis, that is by making an actuarial assumption of risk. Rather, title insurance policies are issued on the basis of a thorough search and examination of the relevant public records pertaining to the ownership of the particular property to be insured, so as to determine whether the seller, in fact, owns the fee simple title rights they have contracted to convey to the buyer, and what liens or encumbrances exist that would limit the use or value of the property when it is acquired by the buyer.

The title search and exam, which is performed by title agents and is discussed in more detail below, is critical from the insurer’s standpoint for proper underwriting in connection with the issuance of the policy, but also in that it identifies errors in the record, including potential fraud. The search and exam is also vital to the potential buyer because the preliminary title commitment or report, given by the insurer or agent to the prospective policyholder, identifies matters of record found in the title search and examination process that, if not resolved prior to closing, will be excepted from coverage when the policy is issued. This information enables parties to the transaction to detect fraud and provides the buyer, and/or their representative the opportunity to determine whether any action needs to be taken by the seller or others to eliminate defects identified in the commitment before the transaction is closed.

Title insurance is fundamentally different than other forms of insurance in three ways which provide an extraordinary incentive to detect and eliminate mortgage fraud. First, title insurance is issued for a one-time premium, and there are no recurring premiums that can be collected to boost claims reserves. Title insurers cannot simply raise rates the following year to make up for claims loss. Second, title insurance protects against existing title defects which arose before the policy is issued. While a claim may not be asserted until after the policy is issued, it must be based on matters which existed prior to the issuance of the policy. If fraud occurred before the policy was issued, an insurer, through their agent, would need to detect and eliminate or correct the fraud to prevent paying a claim. Third, the underwriting process for title insurance differs greatly from other forms of insurance. The underwriting of title insurance operates almost entirely on the basis of identifying, evaluating, and addressing title problems before a policy is issued. Through a thorough search and examination of the title, it is theoretically possible to identify all the defects that may exist and then to either eliminate them, insure over them, or exclude them from coverage.<sup>1</sup> While claims and

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<sup>1</sup> Just as no homeowner’s insurance company would insure a house if it knew at the time that a fire was raging in the basement, a title insurer will not insure against a significant lien or claim it knows to exist and to be enforceable against the property. Having informed the prospective insured in its preliminary commitment that the matter will be excepted from policy coverage, it is up to the prospective insured to decide whether to accept that defect as a limitation on the title, to negotiate with the seller for its removal, or to decline to go ahead with



losses are inevitably bound to occur, title insurers seek to do all that they can to minimize the possibility of a future claim.<sup>2</sup>

Risk identification and elimination is of unquestioned benefit to the purchaser, seller, lender, title agent, title underwriter and the public. The process identifies any possible problem with the title that affects the use of the property or its value before purchaser or lender buys or invests in the property. They have less risk of being challenged on their title and having to make a claim. The seller is notified of any liens or claims against them which affect their ability to sell the property. The title agent's constant search and clearance of the public record results in errors being found and corrected, reducing the instances of claims and cleaning the record they use each day to determine title. The title underwriter pays fewer claims, creating a more predictable, stable claims trend and the public benefits from thousands of experts constantly searching public records, discovering and correcting errors and identifying fraud. In fact, a 2008 ALTA study found that the public benefits as a result of this process since:

- At no cost to taxpayers, the title industry collects \$1.75 billion per year in back income taxes.
- At no cost to taxpayers, the title industry collects \$3 billion per year in delinquent real estate taxes.
- At no cost to taxpayers, the title industry collects \$325 million per year in delinquent child support payments.
- The title industry spends \$225 million per year to correct errors in the public property records that otherwise would lead to serious impairment of the property rights of millions of Americans.
- The title industry is an important source of revenue for local governments, paying \$170 million per year to purchase copies of recorded documents.

In addition, a study by Association Research<sup>3</sup> found if problems were not eliminated prior to closing, one in three property purchasers and their lenders would be subject to a claim due to an error in the public record. These claims cost time, money and great anxiety amongst the homeowners who would otherwise risk the loss of their homes and lenders who would otherwise risk loss of their investment.

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the transaction if the defect is serious enough (e.g., it could affect the marketability of the property).

<sup>2</sup> In this regard, title insurance is somewhat akin to boiler insurance, where significant portions of premiums are devoted to inspecting and correcting any problems with the boiler before the policy is issued.

<sup>3</sup> "2005 Abstracter and Title Agent Operations Survey," Association Research, Inc. (April 2006)

## **Real estate closing process**

The first step after an order for title insurance is received is to collect the relevant records and information pertaining to the property to be insured, as well as information regarding possible claims against the seller (or owner in a refinance transaction) that could affect the title to the insured property, including fraud. This is the “title search,” and the information collected is “title evidence.”

Having collected the title evidence, individuals experienced in real estate law and title insurance principles examine the title evidence to determine whether the seller has, and can convey, their title to the buyer, as well as what other liens or other objections must be resolved or cured, and what title defect exceptions may have to be included in the policy. It is at this “title examination” stage that the title agent performs one of the most valuable services, which is an inherent part of the title insurance underwriting function: curing defects and problems that may exist in the title records. This curative action includes obtaining releases or pay-offs for discovered liens including prior mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner’s association debts, mechanic liens; obtaining releases for deeds and mortgages; and correcting typographical recording and indexing errors that could create problems like misspelled names or incorrect legal descriptions.

On the basis of the title examination, a commitment to insure is then sent to the prospective policyholder, which sets forth the conditions that must be met for a title insurance policy to be issued such as documents to be produced. This may include the execution of a deed, the execution of a new mortgage in favor of the buyer’s lender, as well as items to be removed such as payoff of mortgages, judgments, liens, taxes, municipal bills, in addition to exceptions to the policy coverage that were found during the title search and examination process. All of this information is discovered in the public record, not by simply finding a document, but through the tedious reading and reviewing of all the documents whether they are found in an electronic form, as they are in 406 counties across the country, or whether they are found through a tedious search of multiple physical documents as they are in roughly 3,200 counties and other record-keeping jurisdictions across the country.

If exceptions pose problems for the prospective policyholder, an attempt may be taken by the parties, with the assistance of the title agent, to eliminate those exceptions. If an exception cannot be removed, the title underwriter may be willing to insure over it, either because the title underwriter concludes that the risk of assertion or financial damage is small, or because an indemnity is obtained from the seller. An exception that cannot be removed will be listed on the policy as an exception. If an exception is serious enough, the buyer may seek to modify the terms of his purchase contract with the seller or, in an extreme case, decline to proceed with the transaction. Because the title industry has been so effective over time in detecting and clearing titles errors and preserving the integrity of the public records it is rare that a seller’s title is so defective as to be uninsurable or unmarketable. This fact keeps U.S. real estate markets exceptionally liquid.

The closing package is then prepared and a “bring-down” search is run to ensure that nothing has been filed of record since the date of the original search. This search is particularly important in detecting mortgage fraud perpetrated by individuals recording fictitious documents in the time between the title search and when the policy is issued.

The last steps in the process involve the closing of the transaction. The relevant deeds, mortgage instruments, and other documents are executed and funds are exchanged. The new deed and mortgage lien are recorded and title insurance policies are issued to the lender and the new owner. At this point, depending on the location, a gap may occur. A gap period is the time between when a deed or mortgage is recorded and the date that the recording office enters the instrument in the index which title agents use to conduct the title search. If a document is recorded “in the gap,” a title agent simply will not find a document which has been recorded in the gap. The size of the gap depends on the local jurisdiction. For example, in Fairfax County, Virginia, the gap is almost non-existent. In some counties in Michigan, the gap can be several months long. This is particularly troubling to the title insurance industry because of the gap in the time between a transaction is closed and the mortgage instrument is recorded is a prime opportunity for fraudulent activity. The fraud risk arises because a dishonest borrower or other party could convey an interest in the property during the gap period. Title insurance policies insure against the risk that a mortgage instrument might be recorded during the gap. We protect borrowers, sellers and lenders during this vulnerable period of time to ensure that the transaction can go through quickly, safely and efficiently.

It is important to note that because of the differences in laws, customs, and practices in various parts of the country – and even within different areas of a single state – the title insurance issuance process described above is subject to numerous variations throughout the country. In some of the eastern United States, attorneys still play a significant role in residential real estate transactions and frequently act as title insurance agents on behalf of a title insurance underwriter or a “bar-related” title insurance entity. In the Midwest, abstracters generally prepare the title evidence (compiled in a document called an “abstract”) from which a lawyer, title agent or a title underwriter will perform the examination. In some areas, the closing takes place when parties gather together around a “closing table” to sign and exchange documents, funds and keys. Closings in other areas are conducted electronically, at the buyer’s preferred location or through an escrow agent, where the transaction is closed pursuant to written instructions received by the escrow holder from the parties. In California and other parts of the western United States, title companies or independent escrow companies handle this escrow function.

In addition, the extensive search of public records that is performed prior to the issuance of a policy is codified in many states through a minimum search requirement to ensure that a search is always performed and that title insurance is not issued on a “casualty” basis. These requirements are intended to preserve the integrity of the title industry by minimizing claims, but they have the added benefit of protecting the public

record against fraud and by ensuring these records are reviewed on multiple occasions, increasing the likelihood of errors being detected and corrected.

To minimize title claims and thereby serve the primary need of their customers, title companies expend a substantial amount of time collecting and evaluating the title evidence, curing defects, making underwriting decisions relative to the issuance of the policy, issuing a title commitment that will enable the prospective policyholder to review and consider the exceptions to coverage. Each of these functions requires highly trained and experienced employees and professional personnel. In order to evaluate the condition of title, professionals must be familiar with local customs and practices as well as all applicable legal aspects of title, including real property law (which often varies by state and even communities within a state) as well as bankruptcy, probate and family law.

Title industry professionals look for a number of mortgage fraud indicators including:

- Ensuring the earnest money deposit comes from someone other than the borrower, or lack of information about the source of the deposit.
- Seller carry-back documents that are not being disclosed to the lender.
- Payments to third parties in the form of loan proceeds, fees, or checks being made payable to individuals that will not appear on the HUD settlement statement. The HUD-1 Settlement Statement must show all receipts and disbursements.
- Wide swings in mortgage amount which often mean costs are being rolled into the loan amount, or additional funds may be for future property improvements which prompt a call to the lender.
- Recent sales with increases in price and checks to others at closing which could be a sign of “flipping”.
- Substitution of sales contract for a higher amount.
- The signing of blank documents.
- Changes or increases in purchase price. Sometimes, the sale price may be adjusted to cover closing costs. If the original contract price has been increased, the lender should be made aware.

In addition, as settlement services providers, we help prevent fraud by:

- Carefully checking all aspects of the parties’ identification. We know of a case in which a caregiver stole the information of the elderly gentleman he worked for by

acquiring a replacement driver's license with his picture on it. The caregiver applied for a refinance and walked away with \$65,000. In this case, a check of the birth date would have been a tip-off that something was wrong.

- Knowing our customers. A settlement services provider should call the mortgage broker's or banker's main office line on occasion, not just the direct or cell phone number. They can also make periodical checks with their local Better Business Bureau.
- Checking lenders' or realtors' licensing status to determine whether any complaints been filed.
- Always receiving lender approval for any HUD-1 Settlement Statement changes and accepting and distributing funds directly to and from the lender.
- Prohibiting employees from notarizing documents that they did not witness.
- Not accepting closing instructions from third parties.
- Never rendering legal advice to any party.
- Keeping all matters pertaining to the closings in strict confidence. Requests from outside parties unrelated to the closing for information regarding transactions, should be declined. If outside parties are entitled to information relating to a closing they can obtain a subpoena.
- Warning borrowers during the closing of potential future risk of fraud such as verifying letters indicating a transfer of mortgage servicing companies.
- Having parties sign deeds of trust and other documents by signing over the signature line and over the typed name – this makes signature scanning much more difficult.
- Calling the lender to verify when you see something that might look suspicious.
- Offering to serve as a resource to clients if questions about potential fraud arise in the future.
- Serving as a resource to local, state and federal law enforcement officials about mortgage fraud.

All of this work in the back office and at the closing table adds up to a successful and fraud-free transaction.

## **Fraud Protection**

The single most important aspect of the title insurance industry that cannot be overlooked is that we are the independent third party to the transaction whose only interest is to the integrity of the transaction and the protection of our customers. We are the people who handle the money that comes from the borrower and the lender and disburse it to the appropriate parties in the transaction. Our job is to get the deal closed honestly, fairly, and in accordance with the agreed-upon instructions and to get the money into the right hands.

This is the key component of the transaction. At the end of the day, you can buy or sell a property without the assistance of a realtor, you can agree on a price of the property without the assistance of an appraiser, but what is absolutely essential, what must always be there is an independent closer; someone who ensures the transaction is legal and recognized and who ensures that when money changes hands, it is distributed properly.

When we as settlement services providers fail to do this, intentionally or not, a defalcation occurs. This is the type of fraud that worries our members the most because it involves a misappropriation or diversion of other people's money by those entrusted to get that money into the right hands. Unfortunately, the temptation to do this is something which we will never be able to eliminate, but our industry works very hard to prevent, detect and correct by establishing rigorous audit standards.

While we are not law enforcement officials, we must use our expertise and bring the human element to the transaction.

Title agents are the people who actually sit face-to-face with the parties at the closing table. It is in this setting that mortgage fraud is detected in many, many cases. If the loan application shows the borrower is a doctor, making a handsome salary, but the person appearing at the closing is agitated or does not appear to have the vocation listed on the application, it should be cause for further investigation. We look at people's identification and we see them face to face. We continually train our professionals to "ask someone" if they suspect fraud.

In addition to our human side, our industry has a fiduciary responsibility to protect our policyholders in the event of a claim, including mortgage fraud. The title industry pays millions of dollars each year in claims to protect mortgage lenders and consumers from the effects of fraud. We absorb that loss so that they don't have to.

Fraud is the second most leading cause of title claims. Our experiences indicate that mortgage fraud schemes change with the changing economy. For instance, in a more robust economy we witnessed claims involving inflated values. As prices have fallen and equity has dried up, we now see loan slamming claims on first lien mortgages. Additionally, with the large numbers of mortgage defaults, short sale mortgage fraud claims are becoming more prevalent. Through May of this year, one ALTA member has paid \$11.6 million in fraud related claims, which represents 11.5

percent of all claims payments they have made so far this year. Another ALTA member has paid over \$12 million in fraud related claims, which represents 10 percent of all claims payments they have made so far this year. We believe that the actual losses may be significantly higher because many fraud-related claims are difficult to detect or are only discovered after a different type of claim has been already been made. In addition, fraud is not always detected.

### **Additional steps**

ALTA has taken its own steps to combat mortgage fraud and promote consumer protection. On September 18, 2007, we launched "The Title Industry Consumer Initiative," which details our five-point strategy for improving industry oversight and educating and protecting consumers. The initiative includes a consumer education program, the adoption of our "Principles of Fair Conduct," enhanced member education on regulatory compliance and ethical standards, and a strategy to work more closely with state and federal regulators to ensure that the title industry continues to meet the needs of consumers.

The thrust of ALTA's Consumer Initiative is to help consumers understand the closing process. ALTA has developed a consumer Web site, [www.homeclosing101.org](http://www.homeclosing101.org), which provides an overview of the closing process and explains the purpose of title insurance including the process of the title search and repairing title defects.

A major component of the Consumer Initiative is our "Principles of Fair Conduct," which state what ALTA expects of its members: (1) to engage only in business practices that are lawful and consistent with a high standard of ethical behavior, (2) to encourage a culture of compliance within their organizations for federal and state laws that govern the title insurance business, (3) to treat consumers in a fair and ethical manner, (4) to provide consumers with timely and comprehensive information regarding their policies, services, products, and prices so as to enable consumers to shop effectively among providers of title-related services, and (5) to encourage and assist consumers to be educated purchasers of title insurance and title-related services.

We work with the Property Records Industry Association (PRIA), HUD and law enforcement agencies to actively detect and counteract fraud within the industry. All of us in the real estate industry are in this together. The realtor needs to work with the appraiser who needs to work with lender who needs to work with secondary mortgage market who needs to work with title and escrow officer who needs to work with the recorder, and so on. Once the fraud case has come to law enforcement, it is too late to prevent harm. We need to avoid, prevent, detect and deter mortgage fraud before it takes place, and we all have to be a part of that solution.

ALTA's educational subsidiary, the Land Title Institute, Inc., has developed a presentation entitled "Ethics in the Title Industry" which will soon become an online course to educate Title Industry professionals about the dangers of mortgage fraud. The course includes specific steps that individuals and companies can take to combat fraud. In addition, we are developing a "Mortgage Fraud Resource Center" for the

ALTA website as a clearinghouse for the title industry regarding common fraud schemes and include information from the many organizations that combat mortgage fraud including state governments, BITS, MBA, PRIA, MISMO and the FBI.

Additional common-sense steps can be taken to assist in the prevention of mortgage fraud. One simple step which Congress can take is to protect a Borrower Right of Inspection by requiring that borrowers be given their closing documents prior to closing to prevent confusion when borrowers are presented with myriad complex forms and are pressured to sign documents that may be incorrect or against their best interests. Unfortunately, consumers often do not see their loan documents until they arrive at the closing and are asked to sign them. Congress should consider requiring that borrowers receive their key closing documents in advance of closing – a consumer protection measure which is strongly supported by HUD.

Under the Real Estate Settlement Procedures Act (RESPA), consumers currently have the right to request and review closing documents 24 hours before the closing. Few know of or make use of this option, nor is there a corresponding requirement that the documents be complete. In many cases documentation is still being faxed to the closing agent while the borrower is seated at the closing table.

A Borrower Right of Inspection would remedy the plight that borrowers face at settlement and strengthen the remedial disclosure provision of RESPA by giving borrowers 24 hours to review the following closing documents which, with the exception of extenuating circumstances, would be complete and finalized by the lender and settlement agent: the HUD-1 Settlement Statement, the promissory note, mortgage or deed of trust, and the final Truth-in Lending Act disclosure.

The consumer benefit conferred by the proposal is enormous: borrowers would be able to review the key documents, ask questions, obtain third party counseling and renegotiate terms during this one to two business days before the scheduled settlement. This would facilitate their understanding of the closing process and help to ensure that they do not enter to an unsuitable loan transaction that leads to non-performance down the road. It would also help prevent mortgage fraud by providing the settlement services provider and the borrower more time to review the documents on which fraud is perpetrated.

Finally, ALTA is an ideal gateway to stakeholders who can assist other organizations working to detect and prevent mortgage fraud, and ALTA can offer assistance, referrals, and expertise from title industry professionals around the country. We can leverage our nationwide network of land title associations, underwriters, agents and industry vendors. Simply put, on matters of detecting and preventing mortgage fraud, ALTA is eager to assist.

I thank you for the opportunity to serve as a resource to help combat mortgage fraud.