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NEWS & INSIGHTS

Did Big Lenders Cross The Line?

Lawsuits assert some firms doctored loan documents

Mary Overton isn't like most other troubled homeowners who suddenly found themselves struggling under the weight of rising mortgage payments. Sure, like many, her monthly bill was high—nearly triple the \$825 or so she collects from Social Security, her main source of income. But lawyers for the grandmother say her lender, Ameriquest Mortgage Co., is the one to blame; they contend in a lawsuit that Ameriquest crossed the line from lax underwriting to outright fraud.

Until now prosecutors and pundits have laid much of the blame for the recent surge in mortgage fraud at the feet of the independent brokers who arranged the loans. But a growing number of lawsuits and complaints suggest that some big lenders may have also played a role. Eager to keep up loan volume and generate sales, the two groups allegedly colluded to falsify loan documents by beefing up income and lowballing outstanding debts. And some suits allege that lenders perpetrated the fraud on their own, even deploying teams of employees that resembled boiler-room operations.

This new wrinkle in the subprime saga may mean the mortgage woes battering the financial markets could get worse. It's clear that the problems go beyond risky loans based on poor underwriting. The FBI says industry fraud hit a record \$1 billion in 2006, with insiders—brokers and underwriters—accounting for 80% of it. But given the spike in defaults and foreclosures, the abuse may prove to be far more widespread. "The true level of fraud [will be] closer to \$6 billion," says Damien Weldon, a vice-president for risk analytics at First American LoanPerformance ([FAF](#)), a research firm.

That's not hard to imagine if cases like Overton's continue to emerge. Her lawsuit alleges that loan officers at a Brooklyn (N.Y.) branch of Ameriquest "coerced Overton into signing a loan. Unbeknownst to Ms. Overton, Ameriquest created fake tax returns, employment records, and a 401(k)—to make it appear that the loan was affordable." According to other court filings, at least 40 other borrowers allege Ameriquest doctored loan documents or increased borrowers' income, charges Ameriquest denies. "Mortgage fraud is an evolving challenge that affects every lender. We have a solid record of working with law enforcement to convict those responsible," says Chris Orlando, a spokesman for Ameriquest. "This is an unfortunate situation where a rogue former employee conspired to take advantage of Ameriquest and Ms. Overton." *BusinessWeek* could not identify the employee. Ameriquest forgave Overton's loan a year ago, but the suit has not been settled.

In some cases the lender fraud appears to have involved forged signatures and other deceptive practices. Before closing on her \$147,000 mortgage in July, 2006, which included a second loan for a 20% down payment, Lorna Reddy, a 38-year-old salesperson, noticed the interest rate and payments on that second loan were higher than the original offer. She rescheduled the appointment to sort out the numbers. But a few days later, the Pataskala (Ohio) resident claims, she got a package of signed loan documents from her lender, Fifth Third Bancorp, ([FITB](#)) that showed her annual income inflated by \$20,000, erroneously indicated she was married, and included a forgery of her signature. A forensic expert hired by Reddy's attorney found that "the signature and initials were not authentic."

Cincinnati's Fifth Third, the No. 17 U.S. bank by assets, has sued Reddy for \$29,500, the amount of the second loan, for not making payments, according to court documents. A spokeswoman for Fifth Third says the bank does not comment on legal matters.

The most common ploy, inflating a borrower's income, accounts for 25% of all incidents of mortgage fraud, according to Fannie Mae. Fraud like this has been made easier by the emergence of a new breed of mortgages called "stated-income" loans, in which

borrowers merely sign papers certifying their income, with banks verifying only the source of that income, not the amount. These risky loans carry greater interest rates—and therefore higher potential profits for the banks that underwrite them. An April study by the Mortgage Asset Research Institute found that 60% of stated-income loans had exaggerated the borrower's income by more than 50%.

Elouise Manuel's story shows how shaky stated-income loans can be even if the lender doesn't commit fraud. In March, 2004, Manuel, a 67-year-old retired cafeteria worker from Atlanta, applied for a \$25,000 loan to pay off some credit-card debt and other bills. She says she gave her independent mortgage broker, a relative, proof of her income and its source. But loan documents show that her monthly income was reported to be \$1,100, more than twice the real amount. A letter from the Social Security Administration served as backup documentation, but the amount of income had been blacked out. A conditional loan approval letter from her lender, Pasadena (Calif.)-based IndyMac Bancorp Inc. ([IMB](#)), notes: "Need [Social Security] benefit letters for last two years with income blacked out." Now Manuel says she can afford to pay only the interest on her loan, \$210 a month.

IndyMac says it followed standard procedure to document the source of Manuel's income and adds it is not policy to verify the amount of income in that type of loan. It relies on the broker and the applicant, who signs the document, as Manuel did, to submit accurate information. IndyMac also says it believes Manuel is better off now because the payments on her loan are lower than those on her previous bills. IndyMac remains open to restructuring the loan—an offer it says Manuel's lawyer has rejected. As for IndyMac's direction to black out the income, company spokesman Grove Nichols says it was the action of an individual underwriter and not company practice: "It was an error of judgement." *BusinessWeek* could not identify the employee. Multiple calls to Manuel's brokerage firm were not returned.

It's the ignorance of pertinent information that surprises even some industry veterans. "It doesn't matter if the lender instructed the broker to black out the income or the broker blacked it out and the lender didn't ask [about it]," says Joseph Falk, legislative chair of the National Association of Mortgage Brokers. "Misrepresenting income is just wrong."

By Mara Der Hovanesian and Brian Grow

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