The Florida Senate

PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Banking and Insurance Committee

BILL: SB 240

INTRODUCER: Senator Bullard

SUBJECT: Florida Residential Mortgage Fraud Act

DATE: March 3, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	**Pre-meeting**
2.			CM	
3.			CJ	
4.				
5.				
6.				

I. Summary:

In 2005, Florida was ranked first or highest in the United States for loans that contained alleged fraud against the lenders according to the Mortgage Asset Research Institute Inc. Senate Bill 240 creates the Florida Residential Mortgage Fraud Act, to provide additional enforcement and investigative tools for prosecuting perpetrators of residential mortgage fraud. The bill:

- Defines the term, "residential mortgage fraud," to mean one or more misstatements, misrepresentations, or omissions made during a mortgage lending process that involves residential property and specifies certain acts that are deemed to constitute "residential mortgage fraud." Any person engaging in a single incident of residential mortgage fraud commits a felony of the third degree.
- Defines a "pattern of residential mortgage fraud" to mean one or more misstatements, misrepresentations, or omissions made during the mortgage lending process which involve two or more properties and which the same or similar intents, results, accomplices, victims, or otherwise are interrelated by distinguishing characteristics. Any person engaging in a pattern of residential mortgage fraud commits a felony of the second degree.
- Allows flexibility for the venue for prosecution and investigation by allowing the venue to be in the location of the transactions or the property.

This bill creates an undesignated section of the Florida Statutes.

II. Present Situation:

Mortgage fraud is one of the fastest growing white collar crimes in the U.S. Mortgage fraud is defined as a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan.[1]

According to the Federal Bureau of Investigations' (FBI) statistics, the number of reported mortgage fraud cases more than tripled from 6,890 in 2003 to 21,944 in 2005, based on Suspicious Activity Reports required to be filed by financial institutions and certain other entities with the Financial Crimes Enforcement Network of the U.S. Department of the Treasury. The extent or dollar amount of the fraud is unknown; however, the dollar amount potentially exposed to mortgage fraud is significant, as shown by the sheer volume of U.S. annual mortgage originations, estimated to have reached $2.8 trillion in 2004, according to the Mortgage Bankers' Association. It is estimated that up to 10 percent of all residential loan applications have some form of material misrepresentation, both inadvertent and malicious.[2]

What accounts for this ranking? In recent years, there has been a dramatic growth in the housing market accelerated by low interest rates. This area is vulnerable for exploitation as credit is strong, profits are high, and technology is enhancing criminals' ability to access financial institution data.

Mortgage fraud is divided into two types: fraud for property and fraud for profit. Fraud for property is a misrepresentation made by a borrower or other party in order to qualify for a mortgage loan. The applicant may alter or falsify tax returns or misrepresent income or expenses. Generally, the buyer intends to repay the loan. The FBI estimates that this type of fraud accounts for 20 percent of all the fraud.

Fraud for profit generally involves multiple loan transactions with several financial institutions involved. Parties to these schemes, generally perpetuate the transaction by using fictitious, forged, or altered documents, fraudulently transferring deeds, grossly inflating the value of purchased homes, and submitting fraudulent escrow letters or other documents to mortgage companies. This type of fraud may involve numerous gross misrepresentations regarding the true identity of the buyer or seller, income, assets, collateral, and employment. Documents relating to title insurance, which confirms that the stated owner has title and right to transfer the property, can be altered to change the financial institution lender or omit prior liens. Often, the borrower assumes the identity of another person (straw buyer). The following scenarios are forms of fraud for profit:

- Rapid buildup of a real estate portfolio with an inflated value to perpetrate a land flip scheme. In these scenarios, the appraised value and sales price is inflated for each transaction and the mortgage loan advances increase with each purchase until the amount of the mortgage greatly exceeds the actual value of the property. The goal of this scheme is to extract as much cash as possible from the property.

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[1] Federal Bureau of Investigations website: http://www.fbi.gov/page2/dec05/operationquickflip121405.htm.

[2] *The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: White Paper,* Federal Financial Institutions Examination Council, February 2005.

- The identity of the borrower is concealed through the use of a straw buyer who allows the borrower to use the straw buyer's name and credit history to apply for a loan. This scheme is accomplished by convincing a person to apply for credit in his own name and immediately remitting the loan proceeds to the third party who may be unable to or may never intend to make payments. Subsequently, a default occurs. The straw borrower may or may not be paid a fee for his or her involvement or know the full extent of the scheme.
- Acquisition of residential property by preying on financially distressed homeowners who are desperate to sell due to a delinquent loan or past due taxes. The perpetrator misleads the homeowner into believing that they can save their homes in exchange for a transfer of the deed and payment of up-front fees by the homeowner. The perpetrator profits from these schemes by re-mortgaging the property or pocketing the fees paid by the homeowner.
- Misrepresentation of personal identity, i.e., use of illegally acquired personal financial information to illegally obtain a loan or to sell or take cash out of equity on a property with no intention of repaying the debt.
- Acquisition of property through a phantom sale occurs when a perpetrator identifies an abandoned property and records a fictitious quit claim deed to transfer the property into his or her name, and ultimately applying for and receiving the proceeds of a loan, and absconding with the proceeds.

The FBI estimates that 80 percent of all mortgage fraud involves collaboration or collusion by industry insiders. However, the FBI estimates that, on an overall basis, external fraud schemes are higher than those involving insiders as a result of the pervasiveness of check fraud and counterfeit negotiable instrument schemes, technological advances, as well as the availability of personal information through illicit means.

Residential Mortgage Fraud in Florida

In recent years, the investigations, arrests, and prosecutions of mortgage cases have increased dramatically. According to the Miami-Dade Police, the number of reported mortgage and real estate fraud cases increased from 16 in 2003 to 78 in 2006. The FBI reported 1,191 cases of real estate and mortgage fraud cases in Miami, thereby ranking Miami fourth highest in the top ten spots for fraud for the quarter ending September 30, 2006. Los Angeles was ranked first with 2,293 reported cases.

The following is a summary of a recent case in Florida. According to the Florida Department of Law Enforcement (FDLE), 24 straw buyers were recruited from Miami and Naples to purchase houses in the Ocala area. Most of the straw buyers did not speak, read, or write English or had very limited English vocabulary. They were recruited by a third party who purportedly told them that no down payment was required and they would not have to occupy the house because the builder would rent the house for them and make the mortgage payments for several years. Then, the buyer could move into the house or sell it for a profit and increase their credit ratings for future purchases. The straw buyers were told that the developer/seller of the properties would pay the first month's mortgage and then use subsequent monies received from the buyers to pay its bank loans, free its credit line, and qualify for purchases of lots in a new project. Ultimately, the straw buyers were left with bank mortgages after the builder received its money. Many of the buyers had to file for bankruptcy and suffered severe damage to their credit.

In February 2006, the Office of the Statewide Prosecution in the Department of Legal Affairs and the FDLE arrested several persons for allegedly conducting this mortgage fraud. The mortgage broker completed the loan applications, which included false credit information of the borrowers. A title company approved the transactions with knowledge of false information being filed. These activities resulted in fraud against mortgage lenders in an amount exceeding $3.7 million. Six persons were charged with participation in an enterprise through a pattern of racketeering activity, racketeer influence and corrupt action (RICO) and conspiracy to commit RICO, under ch. 895, F.S., both of which are first–degree felonies.

Regulation of Mortgage Brokerage and Lender Transactions

The Financial Services Commission (commission) consists of the Governor, the Chief Financial Officer, the Attorney General, and the Commissioner of Agriculture. The commission is an independent entity housed within the Department of Financial Services. The Office of Insurance Regulation and the Office of Financial Regulation are under the commission. The Office of Financial Regulation (OFR) is responsible for all activities of the commission relating to the regulation of financial institutions, mortgage brokers and lenders, finance companies, securities industries, and money transmitters.[3]

Mortgage brokers, lenders, and transactions are regulated by the OFR pursuant to chapter 494, F.S., the Mortgage Brokerage and Lending Act. The OFR also is charged with enforcing the Florida Financial Institutions Code, chs. 655-667, F.S. Mortgage brokerage businesses, lenders, and brokers must apply to the OFR and meet certain licensing standards before they may offer their services to the public. Monetary fines and civil sanctions can be levied if a person or company is discovered to be operating in Florida without being properly licensed or exempt. These entities are subject to periodic examinations to ensure compliance with the laws.

Section 494.0025, F.S., provides that it is unlawful for any person, engaging in a mortgage transaction, to knowingly or willingly employ any scheme to defraud, obtain property by fraud, willful misrepresentation, and to falsify, conceal or cover up a material fact, make any false or fraudulent statement or representation or make or use any false writing or document. Section 494.0018, F.S., provides that any person who knowingly violates s. 494.0025, F.S., is guilty of a felony of the third degree. If the value of the land and property exceeds $50,000 and involves five or more victims, then it is a felony of the first degree. Section 655.0322(5) and (6), F.S., provides criminal penalties for fraudulent transactions involving land or property for the purpose of obtaining a loan. Any person who makes any false statement or willfully overvalues any land or property for the purpose of influencing a financial institution or any other entity authorized to extend credit is guilty of a felony in the second degree. Any person who knowingly executes or attempts to execute a scheme to defraud a financial institution or other entity authorized to extend credit by means of false representations or fraudulent representations is guilty of a felony of the second degree.

The Bureau of Financial Investigations in the Office of Financial Regulation routinely investigates cases involving alleged fraud in mortgage transactions. These investigations involve various forms of fraud. In general, however, the OFR's investigations focus on persons licensed

[3] Section 20.121(3), F.S.

or subject to licensure by the OFR. If, during an investigation, the OFR has reason to believe that any criminal law of this state has or may have been violated, it will refer the case, along with the supporting evidence, to the appropriate law enforcement or prosecutorial agency, and provide investigative assistance to that agency, pursuant to s. 20.121(3)(a)2, F.S.

Prosecution of Residential Mortgage Fraud in Florida
According to prosecutors in South Florida, various criminal provisions are used to prosecute residential mortgage, including ss. 494.0018 (discussed above), 812.014, 817.03, 817.034(4)(a)(1), 817.54, and ch. 895, F.S.

Section 812.014, F.S., provides that:

(1) A person commits theft if he or she knowingly obtains or uses, or endeavors to obtain or to use, the property of another with intent to, either temporarily or permanently:
(a) Deprive the other person of a right to the property or a benefit from the property.
(b) Appropriate the property to his or her own use or to the use of any person not entitled to the use of the property.

The section also provides that if the stolen property is valued at $100,000 or more or the offender commits grand theft in the first degree, punishable as a felony of the first degree.

Pursuant to s. 817.03, F.S., any person making false statements in writing to his or her financial condition, assets, or liabilities with a fraudulent intent of obtaining credit, property, or money is guilty of a misdemeanor of the first degree, punishable as provided in s. 775.082 or 775.083, F.S. Venue for prosecution may begin in the county where the statement was written.

Section 817.034(4)(a), F.S., provides that if a person engages in a scheme to defraud and obtains property is guilty of organized fraud and is subject to certain penalties, based on the value of the property obtained. For example, if the aggregate value of the property is $50,000 or more, the violator is guilty of a felony of the first degree.

Section 817.54, F.S., addresses criminal penalties for obtaining a mortgage, promissory note, or other instrument by false misrepresentation. Any person who, with intent to defraud, obtains any mortgage or other instruments or obtains the signature of another person evidencing debt by false misrepresentations or pretenses is guilty of a felony of the third degree.

Chapter 895, F.S., is the Florida RICO (Racketeer Influenced and Corrupt Organization) Act. Racketeering activity means to commit, to conspire to commit, or to solicit another person to commit any crime that is chargeable, as delineated in s. 895.02, F.S. This list includes ch. 812, F.S. relating to theft and ch. 817, F.S., relating to fraudulent practices. Section 895.03, F.S., provides that it is unlawful for any person who with criminal intent receives any proceeds derived from a pattern of racketeering activity Section 895.04, F.S., provides that any person convicted of engaging in activity that is a violation of s. 895.03, F.S., is guilty of a felony of the first degree.

According to the Miami-Dade Police Department, the incidents that involve false quit claim deeds involve an actual theft of the equity in the house and a theft under s. 812.014, F.S., is not an appropriate charge because the house remains intact on the property, although the equity has been taken and mortgaged. In regards to the fraud or falsification of information on the application process, s. 817.54, F.S., covers the signature on the debt however, not the filing of false W-2 forms, tax returns, bank statements etc. or any other misstatement, misrepresentation submitted to obtain a loan, also the other parties that are involved in the entire lending process such as a notary public, notarizing a false quit claim deed, or if an appraiser artificially inflates the property value so the mortgage can be acquired.

III. Effect of Proposed Changes:

Sections 1-3 provide legislative findings, create definitions, and create criminal penalties. The section provides definitions for the following terms: mortgage lending process, residential mortgage fraud, pattern of residential mortgage fraud, and residential mortgage loan:

Mortgage lending process is defined to mean the process through which a person seeks or obtains a residential mortgage loan, including, but not limited to, solicitation, application, or origination, negotiation of terms, third-party provider services, underwriting, signing and closing, and funding of the loan. The documents involved in this process include, but are not limited to, uniform residential loan applications or other loan applications, appraisal reports, HUD-1 settlement statements, and specified supporting personal financial documentation for the loan application.

Residential mortgage loan means a loan or agreement to extend credit made by a person, which loan is secured by a deed to secure debt, or other documents representing a security interest or lien upon any interest in one-family to four-family residential property located in Florida and includes the renewal or refinancing of any such loan.

Subsection (2) provides: The offense of residential mortgage fraud is committed when a person:

1. Knowingly makes any deliberate misstatement, misrepresentation, or omission during the mortgage lending process with the intention that the misstatement; misrepresentation, or omission will be relied upon by a mortgage lender, borrower, or any other party to the mortgage lending process;
2. Knowingly uses or facilitates the use of any deliberate misstatement, misrepresentation, or omission knowing the misstatement, misrepresentation, or omission contains misstatement, misrepresentation, or omission, during the mortgage lending process with the intention that the misstatement, misrepresentation, or omission will be relied upon by the a mortgage lender, borrower, or any other party to the mortgage lending process;
3. Receives any proceeds or another funds in connection with a residential mortgage closing that the person knew resulted in a violation of (1) or (2);
4. Conspires to violate any of the provisions of (1)-(3); or
5. Files or causes to be filed with the clerk of the circuit court for any county any document involved in the lending process which tat person knows to contain a deliberate misstatement, misrepresentation, or omission.

These provisions would address potential misrepresentations by various parties to the loan, including the appraiser, title insurers, broker, lender, seller, and borrower. Any person who violates this section commits a *felony of the third degree*, punishable as provided in s. 775.082, 775.083, or s. 775.084, F.S. Any person who engages in a pattern of such fraud or conspiracy to engage in such fraud commits a felony of second degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084, F.S. This provision is very similar to the current criminal violation provided in s. 494.0025, F.S., which provides that it is unlawful for any person, engaging in a mortgage transaction, to knowingly or willingly employ any scheme to defraud, obtain property by fraud, willful misrepresentation, and to falsify, conceal or cover up a material fact, make any false or fraudulent statement or representation or make or use any false writing or document and any person who knowingly violates s. 494.0018, F.S., is guilty of *a felony of the third degree*. Ch. 494, F.S., provides a more severe penalty, if the value of the land and property exceeds $50,000 and involves five or more victims, then it is a *felony of the first degree*.

The bill provides that a "pattern of residential mortgage fraud" is defined to mean one or more misstatements, misrepresentations, or omissions made during the mortgage lending process which involves two or more properties and which the same or similar intents, results, accomplices, victims, or otherwise are interrelated by distinguishing characteristics. Any person engaging in a pattern of residential mortgage fraud commits a *felony of the second degree*.

According to prosecutors and criminal investigators, the venue for prosecuting residential mortgage fraud needs to provide greater flexibility for the investigation and prosecution of the cases. Some cities or counties might not have the resources to pursue such cases. Presently, a property that is the subject of a loan could be located in Dade County; however, the actual closing transaction might occur in Broward County. For purposes of venue, the bill provides that any violation delineated in this act is considered to have been committed:

- In the county in which the property for which the residential property loan is being sought is located;
- In any county in which any act was performed in furtherance of the violation;
- In any county in which any person alleged to have violated this section had control or possession of any proceeds of the violation;
- If a closing occurred, in any county in which the closing occurred; or
- In any county in which a document containing a deliberate misstatement, misrepresentation, or omission is filed with the clerk of the circuit court for such county.

Section 4 provides that this act will take effect October 1, 2007.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill provides greater enforcement tools and more severe criminal sanctions for prosecuting unscrupulous participants engaged in mortgage fraud, which will provide greater protection for homeowners and potential homeowners.

A reduction in fraudulent mortgage loans, as a result of greater investigations and prosecutions, could reduce the number of mortgage loan defaults. A study has linked loans that had egregious loan misrepresentation with higher default rates within the first 6 months than loans that did not have such misrepresentations.[4]

C. Government Sector Impact:

The bill will provide greater investigative and enforcement tools, which will assist in the prosecution of persons engaging in residential mortgage fraud in Florida.

VI. Technical Deficiencies:

None.

VII. Related Issues:

Senate Bill 240 is an earlier version of Senate Bill 352, which was subsequently filed by Senator Margolis.

[4]*Fraud Linked to Up to 70 percent of Early Payment Defaults,* BasePoint Analytics. 2007.

VIII. Summary of Amendments:

None.