

Without Better Use of Narratives, SARs Fail to Show Extent of Mortgage Fraud

June 11, 2009

The current design of federally-mandated suspicious activity reports makes it difficult for banks to report important information tied to suspected mortgage fraud, say former law enforcement agents and consultants.

Under U.S. regulations, banks must inform the U.S. Treasury Department of possible mortgage fraud through the same regulatory filing they use for suspected terrorist financing and money laundering. The reports, known as SARs, allow compliance staff to detail information on potential mortgage schemes through freeform input fields.

But the forms fall short in directing bank compliance staff to provide law enforcement agents information on potential co-conspirators, including mortgage brokers and appraisers, who may be tied to a scheme, according to James Stubbs, a managing director with BDO Consulting.

"Part of the problem is that a lot of the documentation is contained in free-form fields," said Stubbs. Because the information isn't divided into separate data fields, filers aren't prompted to consistently provide some information, making it harder for investigators to connect the dots in a case, he said.

The Treasury Department's Financial Crimes Enforcement Network (FinCEN), which receives and processes SARs before disseminating the information to law enforcement agents, should reconsider its dropped plan to create a SAR specific to mortgage schemes, said Dennis Lormel, a managing director with IPSA International in Herndon, Va.

"The heart of the mortgage fraud problem is generally with the broker," said Lormel, a former special agent with the FBI. Any new SAR form should direct a bank compliance officer to identify and report on not only that person but individuals who might be straw buyers and the bank employees who signed off on the transaction as well, he said.

Lormel recalls that the mortgage-specific SAR plan was dropped by FinCEN several years ago because Congress pressed the bureau to pursue other priorities, including improved data collection and warehousing of existing SARs.

FinCEN spokesman Steve Hudak acknowledged the shortcomings of the current form and said that the agency is moving slowly in considering potential revisions.

"It's important to note that changing a form, or creating a new form, is a significant undertaking and each data field and each box on a form directly corresponds to a piece of software or an algorithm in the [Bank Secrecy Act] database," said Hudak. Even small changes can affect millions of records in the database and private sector software at thousands of different banks, he said.

In the near term, FinCEN is considering issuing guidance on how current SARs might be better used to report mortgage fraud, said Hudak, adding that the bureau is working with the FBI on the project.

Despite promptings from the law enforcement community, financial institutions are likely to balk at adding a new regulatory form that will involve more training and take up more time, said Lormel, adding that the existing SAR would be "adequate" if bank compliance staff "put everything down."

The American Bankers Association, an influential Washington, D.C.-based lobbying group, gave a nod to the problem in a newsletter that, unsurprisingly, didn't call for a new form and instead recommended that compliance officers augment their mortgage fraud reporting by including information on any professional involved in the transaction as well as buyers and sellers.

FinCEN may ultimately find that revising the current form rather than adding a new one is the best solution, said Peter Djinis, an anti-money laundering consultant based in Sarasota, Fla., who was executive assistant director for regulatory policy at FinCEN from 1999 to 2003.

Creating a new form that deals with just mortgage fraud may lead to agencies making a proprietary claim on the data they produce, rather than feeding the Currency and Banking Retrieval Database System run by the IRS, he said. To avoid such problems, FinCEN "should put the fields requiring more mortgage data on the current form," said Djinis.

Even such a revision will, in some cases, do little to help investigators uncover a mortgage scheme, according to David Caruso, chief executive officer of Centreville, Va.-based AML consultancy Dominion Advisory Group and a former IRS agent. While SAR forms are inadequate for reporting on mortgage fraud, banks generally deal only with the borrower and don't have information or ask questions that would reveal the other parties to the suspected mortgage fraud, he said.

"Banks are ill-equipped to know there's actually been mortgage fraud unless a customer tells the story" to the bank, Caruso said, adding that a primary reason mortgage fraud reporting has increased is because banks are reacting to media coverage on the crime. Some banks are filing mortgage fraud SARs almost automatically when a borrower defaults, even though there's no suspicious activity and the default is related to a lost job or interest rate increase, according to Caruso.

Depository institutions in the United States filed 62,084 mortgage loan fraud suspicious activity reports from July 1, 2007 to June 30, 2008, a 44 percent increase from the previous twelve-month period, according to FinCEN data. That number could grow with the passage of the Fraud Emergency Recovery Act, signed into law by President Obama on May 20.

Already, the FBI's mortgage fraud caseload has increased from 295 cases opened in 2003 to 734 cases in 2008, according to published bureau data. The agency currently has over 2,000 mortgage fraud cases pending and annual losses from the crime are estimated to range from between \$4 billion to \$6 billion, the FBI said.