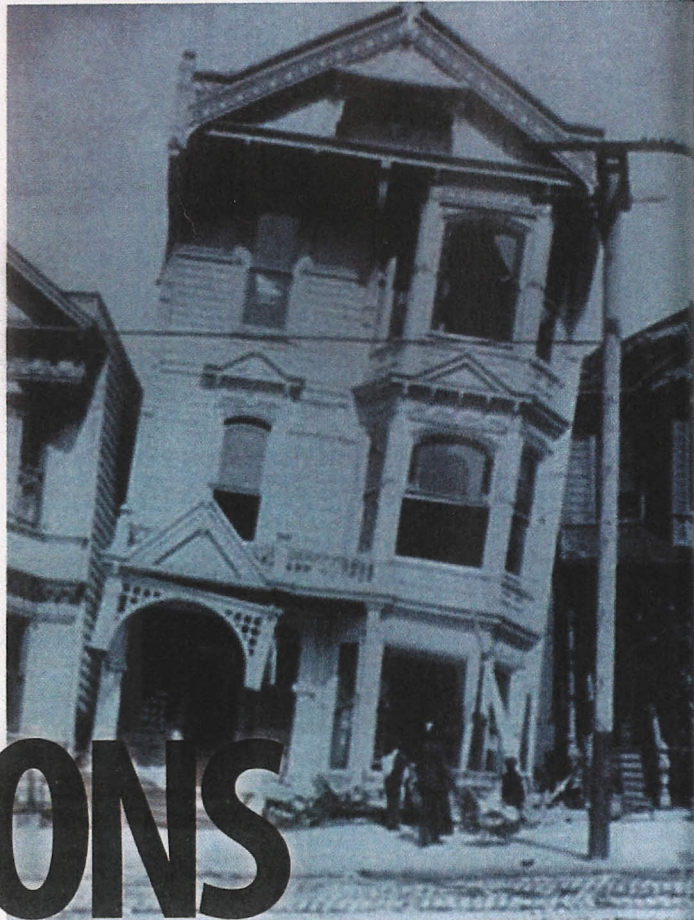


ROCKING THE FOUNDATIONS



The FSA is targeting 'corrupt professionals', including accountants, in its battle against mortgage fraud. **Ian Brown** and **Paul Doxey** explain what you need to know

In July 2008, an accountant was arrested by Northumbria Police and charged with offences of deception relating to an alleged £2.2m mortgage fraud in which a mortgage broker was also charged.

Also in July, the Financial Services Authority banned a mortgage broker and fined her £129,000 for submitting seven mortgage applications containing false information, including information about her earnings that was supported by an accountant's certificate.

As part of its enhanced drive to combat mortgage fraud, the FSA has recently indicated that it will increase its focus on 'corrupt professionals', and this includes accountants as well as mortgage brokers and valuers.

How big is the problem?

Nobody can be sure exactly how big this problem is, nor to what extent professional advisers have been knowingly or unwittingly involved.

In March 2008, the Association of Chief Police Officers (ACPO) issued a statement following research undertaken with 47 UK police forces and 45 mortgage lenders representing 75% of the market. The ACPO research quantified losses from what it called 'confirmed mortgage fraud' at around £700m. However, this is likely to be only the tip of the iceberg, as most mortgage fraud is probably unconfirmed, either because the mortgages are still being serviced for the time being, or because losses have simply been written off as bad debts.

Recent research by Navigant Consulting indicates that mortgage lenders could have more than £7bn of fraudulent loans sitting on their residential mortgage books that have not yet given rise to losses. While house prices were rising, this fraud was hidden and lenders did not register big losses. However, falling house prices will expose lenders

and other mortgage firms (such as brokers, professionals and insurers) to large potential losses – possibly over £3bn if property prices fall by 10% in the next two years.

Who does it hurt?

It is not only the banks and building societies that lose. In fact, during the property boom years running up to the middle of 2007, banks and building societies reported relatively few losses from mortgage fraud.

Lenders have been relatively unscathed because rising property prices have eroded the overvaluations and because, in many cases, the fraudsters have tended to hold on to the properties so they can benefit from price rises and use the properties for other purposes. However, as property prices fall, fraudsters will be increasingly likely to walk away from these mortgages, causing losses to lenders.

The wider socio-economic harm arising from mortgage fraud is equally, if not more important, than actual lender losses. A harmful side-effect of mortgage fraud has been the inflationary effect on flat prices: large fraudulent overvaluations of certain new flat developments have fed a price bubble in a number of fraud hotspots and distorted the general price level. This is bad news for two reasons. First, because the environment has been downgraded by the illegal activities and repossessions (with flats left empty and derelict), and second, the collapse in confidence in house prices could cause them to overshoot downwards.

Long gone are the days when mortgage fraud was concentrated around individuals inflating their income to purchase their own home. The police and the FSA have reported that fraud today is now big business, with highly organised gangs thinking of innovative ways of beating the system.

Case study

A Nigerian couple who had previously been deported from the UK returned using false passports. They created 26 false identities through which they obtained benefit payments from the Department of Work and Pensions. They used the proceeds of the benefit claims to acquire 11 properties through fraudulently-obtained mortgages using some of the false identities. The properties were let to illegal immigrants, and the rental income together with the proceeds of the benefit claims were used to pay off the mortgages. At the time of their arrest the couple owned properties that were valued in excess of £4m.

The UK's 10th largest mortgage lender, Bradford & Bingley, said on 2 June 2008 that it had lost £15m due to 'a small number of organised mortgage frauds'. It added that insurance recoveries may be available against these losses, but this had not been taken into account.

Commenting on 2 June, chairman Rod Kent said it was a 'collusive fraud', involving 'a bent property developer, a bent solicitor and a bent valuer, allegedly'.

What is mortgage fraud?

There are two main types of mortgage fraud, which are often combined: fraud for property and fraud for profit.

Fraud for property is where fraudsters obtain a property through a fraudulently obtained mortgage and then use that property in one or a number of ways, usually servicing the borrowing. This type of fraud is often accompanied by identity fraud/theft and in many cases is connected to other types of criminal activity.

Money laundering is a key feature of this type of fraud. Other criminal activities include: drug production/dealing; illegal immigration; prostitution; credit card fraud; benefit fraud; terrorism and terrorist financing. Running hand in hand with these criminal activities is the socio-economic damage that such activity causes.

Fraud for profit is where the fraudster's sole purpose is to make money from the fraud. A typical variation of this is known as a flip fraud. This is where properties, usually flats, are purchased and resold within a very short period of time at an inflated price, the average 'flip' being between £30,000 and £46,000.

There is a third aspect to mortgage fraud, which may well increase as the property market continues to deflate. New developments of flats and apartments have sprung up in most towns and cities, many of which the developers are now finding hard to sell. The use of cash incentives, sometimes referred to as 'gifted deposits', has often assisted developers in selling those difficult-to-dispose-of properties. However, there is evidence to demonstrate how gifted deposits can be misused and how they contribute to house price inflation, setting exaggerated sale prices that are subsequently used as a benchmark by surveyors when valuing similar properties.

For example: a developer selling a flat actually worth £225,000 may advertise it for £250,000, stating that he will pay the deposit of £25,000 on behalf of the purchaser. The purchaser obtains a 90% mortgage on the advertised purchase price of £250,000 and the developer provides the additional £25,000 which, as the developer is also the vendor, he gets back upon completion. The result is that the lender has in fact lent 100% of the actual value.

There are many variations of this type of fraud, most of which have one common denominator: collusion with one or more professionals. Anecdotal evidence shows that although valuers may provide inflated valuations, this may be the result of deception practised on the surveyors themselves.

Although it is difficult to measure the cost or level of mortgage fraud, concentrations have been found particularly in the new-build market, and even more specifically in apartment developments that are part

of regeneration projects.

New-build, apartment-style properties are often associated with the buy-to-let market. Although there is no concrete evidence to show that buy-to-let mortgages have had a direct impact on the instances of mortgage fraud, there is anecdotal evidence to suggest that fraudulent activity is often concentrated around this type of development.

What can you do to protect yourself?

When being asked to provide certificates or to support financial statements, accountants must be aware of the use to which they may be put, and ensure accuracy and consistency with any parallel statements.

If approached by a new client who only wants assistance with a mortgage application, you need to ask yourself: 'Why is he using me for this purpose? Who usually prepares his accounts and why is the client not using his usual accountant?'

Be vigilant. There is little doubt that regulators and law enforcement agencies, including the newly formed National Fraud Strategic Authority, have mortgage fraud high on their agendas and will be using all their powers to combat the fraudsters.

Key mortgage fraud red flags

- The same mortgage brokers, valuers, conveyancers/solicitors, accountants appear in a number of transactions.
- Property resold at a substantial profit within a short timeframe, sometimes within the same day, indicating that the property might have been 'flipped' with the value falsely inflated.
- Connected or affiliated parties to the transaction, eg, same family or within the same ethnic group or with a local community link.
- Actual price paid for the property is different from that stated in the mortgage documentation.
- Hidden 'incentives' or 'allowances' not disclosed to lender, eg, deposit or stamp duty paid by seller.
- Pre-signed documentation not in the presence of a witness, eg, a solicitor or an accountant, or someone else has signed on behalf of the applicant.
- Questionable transactions, eg, several residential mortgages under the same borrower's name or use of an alias on mortgage applications.
- Buy-to-let property is represented as owner-occupier.
- Mortgage applicant has no or little credit history.
- Valuation of the mortgaged property appears high, and the comparable valuations used are either dissimilar in characteristics to the mortgaged property or sourced outside the immediate areas.
- False documentation used to support the mortgage loan application, eg, use of fictitious or stolen identity, or of fake documents to exaggerate income claimed by applicant.

The flip fraud

On 30 September 2005, Mr Big purchases a flat for £160,000. He sells it on the same day for £200,000 to Mr Smith, who does not exist but has been created with a false or stolen identity. An accomplice provides a false valuation.

Mr Smith obtains a mortgage from a bank for £190,000 and pays this, plus a deposit of £10,000, to Mr Big. In reality the £10,000 deposit is never paid but is merely recycled from Mr Big back to himself via Mr Smith. Mr Big's immediate profit is £30,000. No repayments are ever made and eventually the property is taken into possession by the lender and sold at a substantial loss.



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