FRAUD Insights

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WRATH of a wrap

By Lisa A. Tyler
National Escrow Administrator

Today is your lucky day! We have republished the proof HUD does **not** allow FHA loans to be wrapped. At the end of the article entitled "ALLEN clussive" we have included HUD's letter from 1990 declaring administrative sanctions against title companies and brokers, who have structured and facilitated the wrapping of their loans. Use the article as proof to your customers that you have to turn away transactions that put you and your Company at risk of closing future government-backed loans!

The "ALLEN clussive" story is the perfect segue way into the "EXCLUDED parties list system" article, which discusses how the government debars those industry professionals who ignore the rules and regulations, established for closing and insuring transactions involving the government. Be sure to read about the "EPLS" so you do not end up on the list and jeopardize your career.

The last story "REFERRAL fee" is a reminder no payments can be made to a borrower without lender approval. In this story a borrower employed at JetCity was moonlighting as a real estate agent. The selling broker attempted to divert funds to the buyer/agent through a commission disbursement authorization, but the assistant escrow officer put a halt to the payment when the lender denied any knowledge of the referral fee prior to our notification.

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ALLEN clussive

Early on in Allen Clussive's career he agreed to close a transaction wrapping around an existing loan. The sale price on the transaction was $185,000. The buyer could not qualify for new financing and asked the seller to carryback a new loan in the amount of $180,000. The seller agreed, with the understanding that without the buyer obtaining a new loan he would not have the financial means to pay off his existing first loan in the amount of $157,000. The buyer and seller agreed to wrap the existing $157,000 loan with the new seller carryback loan. The underlying loan was an FHA loan originated after 1989.

At closing, the buyer brought in $5,000 for his down payment plus his closing costs. Allen closed the transaction. After closing, the buyer paid the seller every month. Upon receipt of the buyer's payment the seller paid the monthly principal, interest, taxes and insurance (PITI) payments to the lender servicing his FHA loan, and pocketed the balance. Everything was working perfectly until the 13th month when the buyer suddenly stopped making his monthly payments and abandoned the property.

The seller panicked and started to look for an attorney to start foreclosure in order to take the property back and put a renter in the house. In the meantime, the seller kept fronting the payments to the FHA loan to keep the payments current. The seller was making two house payments – one on his old home and one on his new home. Eventually the seller ran out of money and stopped making payments on the FHA loan.

The lender servicing the FHA loan started foreclosure and took the property back. The lender listed the property as an REO – bank-owned property - and resold it. They resold the property for $107,000, which was $50,000 less than they were owed. The lender filed a claim with FHA to be reimbursed the loss of $50,000. FHA sent the lender the $50,000 to cover their claim and the loan file was turned over to an investigator at the U.S. Department of Housing and Urban Development (HUD), the agency who regulates FHA loans.

The HUD investigator discovered the property was transferred to a new buyer, but the buyer's funds were not used to pay off the FHA loan. The investigator was curious how that could happen and sent a subpoena for Clussive's file.

The HUD investigator discovered Clussive had facilitated a closing where title was transferred - yet the new owner's credit did not qualify for the existing FHA loan.

[Continued on top of pg3]

EXCLUDED parties list system

For years your Corporate Escrow Administrators have warned you about the ramifications of closing a wrap of an existing FHA loan. The story of Allen Clussive demonstrates how the office of Housing and Urban Development takes this offense seriously. If that was not enough, the letter from HUD makes it crystal clear. But it makes you wonder what the debarment process is and how FHA knows if a settlement agent has been barred?

When the U.S. Federal Government discovers an individual or Company has acted inappropriately there is policy and procedure for suspending or debarring. The U.S. Federal Government halts the individual and/or Company from doing further business with or providing services in relation to a contract or transaction.

Companies or individuals who have been suspended or debarred are listed on the Excluded Parties List System (EPLS). This system is in place to protect the public interest so the Government does business only with responsible parties.

Settlement agents, title and escrow companies are subject to suspension or debarment if it has been determined they acted inappropriately on a transaction involving the U.S. Government; for example, wrapping a new loan around an existing FHA loan. Additionally, any affiliate or division of a company which has been barred is subject to the same fate.

The lender is responsible for ensuring all service providers in a real estate transaction (including the settlement agent and title officers and their companies) do not appear on this list for any new FHA or VA loans. The lender must log on to https://www.epls.gov and enter the name of the individual and company.

In most cases the search will result in no matches. If there is a potential match, the lender will need additional information to determine whether or not the provider is the individual or entity shown on the EPLS.

Each lender has their own requirement of what information they will accept in order to clear the potential match. In the case of an individual, this information could be their social security number, middle name, previous name or driver's license. Settlement agents

[Continued in middle of pg3]

TELL US HOW YOU STOPPED FRAUD

settlement@fnf.com or
949.622.4425

[ALLEN clussive - continued]

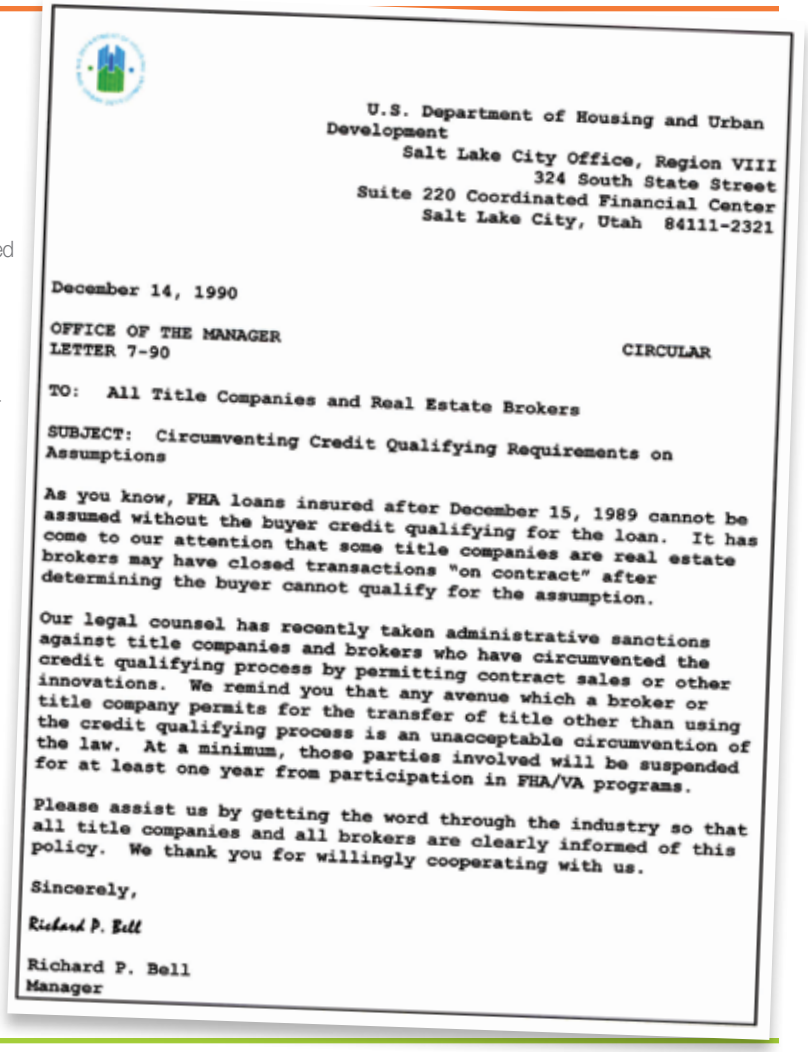
The investigator deemed the act unlawful and debarred Clussive from closing another FHA or VA insured loan transaction.

Now, to be honest with you, the action by HUD did not damage Clussive's career. He lived and worked in an affluent community where FHA and VA loans were not prevalent due to their low loan limits. Sure, every once in a while one of Clussive's customers would present a contract reflecting new FHA or VA financing and Allen would have to steer the customer to one of his associates to close the transaction, but for the most part it had little to no effect on his career. However, Clussive would be the first to tell you it definitely had a psychological effect on him.

Had Clussive known HUD issued a directive in 1990 (see right) banning the wrap of an FHA loan by any means – a land contract, a deed of trust, mortgage – he would have never accepted the transaction and agreed to close it. Unfortunately Allen's ignorance of the HUD rules did not exempt him from action by HUD.

In order to ensure Clussive never closed another FHA or VA loan, they placed his name on the Excluded Parties List System (EPLS) and Limited Denial Participation list. By placing his name on the list it ensured Clussive would never be able to close another FHA or VA loan or any other transaction involving the Federal Government, such as a HUD or VA REO sale.

At right is a letter from the U.S. Department of Urban Development issued back in 1990 addressing the ramifications of circumventing the credit qualifying process.



U.S. Department of Housing and Urban Development
Salt Lake City Office, Region VIII
324 South State Street
Suite 220 Coordinated Financial Center
Salt Lake City, Utah 84111-2321

December 14, 1990

OFFICE OF THE MANAGER
LETTER 7-90 CIRCULAR

TO: All Title Companies and Real Estate Brokers

SUBJECT: Circumventing Credit Qualifying Requirements on Assumptions

As you know, FHA loans insured after December 15, 1989 cannot be assumed without the buyer credit qualifying for the loan. It has come to our attention that some title companies are real estate brokers may have closed transactions "on contract" after determining the buyer cannot qualify for the assumption.

Our legal counsel has recently taken administrative sanctions against title companies and brokers who have circumvented the credit qualifying process by permitting contract sales or other innovations. We remind you that any avenue which a broker or title company permits for the transfer of title other than using the credit qualifying process is an unacceptable circumvention of the law. At a minimum, those parties involved will be suspended for at least one year from participation in FHA/VA programs.

Please assist us by getting the word through the industry so that all title companies and all brokers are clearly informed of this policy. We thank you for willingly cooperating with us.

Sincerely,

Richard P. Bell

Richard P. Bell
Manager

[EXCLUDED parties list system - continued]

may choose whether they will provide their personal, non-public information to the lender or not.

The Company does not require the settlement agent to provide such information if they are uncomfortable complying with the request. If they choose not to, the file should be transferred to another settlement agent who is not a potential match or is willing to provide their personal, non-public information to the lender.

It is important to note HUD does not simply suspend or ban someone without going through a notification period. Once notified they have 30 days to respond with information opposing the action and request a hearing.

Access to EPLS is free and the system only contains the names of individuals or companies who have been suspended or debarred by the Federal Government. Some of the investors in the lending industry are including requirements for the originating lender to ensure participants in the loan do not appear on this list. Here is an excerpt from Fannie Mae's Single Family Selling Guide:

> ***Responsible Lending Policies***
> *The following summarizes Fannie Mae's policies on responsible lending. As noted below, other sections of the Selling Guide provide additional information with respect to Fannie Mae's responsible lending requirements.*
>
> *Qualified Participants:*
> *Any loans originated, underwritten, or serviced by parties on the Excluded Party List or the HUD Limited Denial of Participation List (LDP List) are ineligible for delivery to Fannie Mae. Therefore, Fannie Mae is requiring that lenders confirm that any parties to the mortgage transaction are not on the lists prior to delivery of the loan.*

A Limited Denial of Participation (LDP List) is an action taken for failure to comply with the specific standards for a HUD program. A LDP Listing excludes a party from further participation in a specific HUD program area. A LDP Listing generally expires in one year. For access to the LDP List log on to: http://portal.hud.gov/hudportal/HUD?src=/topics/limited_denials_of_participation

It is up to each lender to determine their compliance with FHA, VA and Fannie Mae requirements. As a result, some lenders have decided to contract with third party vendors to assist them. Some of these third party vendors charge for their services and lenders might try to pass this charge on to the escrow or title company.

Settlement agents who receive a request to sign up with a third party company should decline such request, especially if the third party charges a fee. Remember access to the EPLS and LDP List is free. Settlement agents may log on, enter their own information and send it to the lender in order to prove they are not an exact match.

Keep in mind all individuals and companies must be cleared for any contract or transaction involving the U.S. Government. FHA and VA loans are the most common instances where the settlement agent might receive a request for additional information but is not limited to these types of transactions. Transactions involving HUD REOs, USDA financing and VA REOs also require clearance of the EPLS.

FRAUD Insights

REFERRAL Fee

Teresa Varnes, REO escrow department manager for Chicago Title's Everett, Wash. office, was working on a purchase transaction for another escrow officer who was out on vacation. The sale price was $325,000 with a new loan in the amount of $292,500. The buyer's loan package had arrived and Teresa was inputting the lender fees – which was not an easy task given the lender redrew the loan documents five times!

After the borrower signed the documents, Teresa started preparing the file to be disbursed. Teresa reviewed the Commission Disbursement Authorization from the selling broker. On the form, it directed the settlement agent to send a referral fee to Sunset Real Estate Attn: C. Smith. The buyer's name in the transaction was Cindy Smith. Teresa thought it could not be a coincidence the buyer's name and the referral fee payee's name matched.

Teresa reviewed the lender's instructions to verify no credit was supposed to be paid by the selling broker to the buyer at closing. She then looked at the loan application to see where the buyer was employed. The buyer's loan application indicated she was employed at JetCity. Whew! Cindy was not employed at Sunset Real Estate after all. Smith is a common name, Teresa did not give it another thought. She continued working on the file without further questioning the payment of the referral fee.

Once the file was balanced and ready for disbursement, Teresa handed the file off to Shelley Wiese, an escrow assistant. Shelley reviewed the file and brought it back to Teresa when she discovered the same likeness between the buyer's name and the referral fee payee's name at Sunset Real Estate.

Shelley found email correspondence in the file from the buyer. Most of the emails were generated from the buyer's personal email account, but there was one email the buyer sent to Shelley months ago with a signature block that showed her as a real estate agent from Sunset Real Estate!

Together Shelley and Teresa emailed the lender the Commission Disbursement Authorization reflecting a disbursement to Sunset Real Estate, to the attention of C. Smith in the amount of $5,875 and asked if the payment was approved by the lender.

The lender did not approve the payment and insisted Teresa close the loan and pay 100% of the commission to the selling broker without payment of the referral fee, which she did. Shelley notified the broker the referral fee would not be paid at closing.

For Shelley's sleuthing abilities and ferreting out the buyer's part-time employment as a real estate agent; and more importantly for her diligence in notifying the lender of a payment of a referral fee from the broker, she has received a $1,000 reward.

MORAL OF THE STORY

Funds paid to or on behalf of a borrower by the seller, real estate agent, mortgage broker or anyone else must all be reflected on the settlement statement and approved by the lender prior to closing.

Had the disbursement been made back to the borrower and later the loan went into default, the lender could have made a claim against the Company's closing protection letter and/or title insurance policy for allowing funds to be paid to the borrower without their knowledge.

Additionally, this same type of payment could invalidate a short pay approval letter. Had this transaction been a short sale, the Company could have been in double jeopardy by being responsible for any unpaid balance to the short pay lender and the new lender. If the short pay lender rescinds their short pay approval they can also refuse to release their lien. Since we would have insured the new lender in first lien position, they would have reason to file a claim against their policy as well.