

Investment Banks Eye Mortgage Fraud

Wave of suits related to subprime may rival pace seen in dotcom and Enron failures

BY JESSICA PAPINI

Swamped by losses in securities pooling home loans, Wall Street's investment banks have stepped up efforts to uncover fraudulent activity among mortgage brokers who, by some accounts, underwrite as much as 60%-70% of all the nation's mortgages. In cases of fraud, the Wall Street banks are expected to sue the brokers to recoup some of their losses.

Last year, Wall Street underwrote \$1.9 trillion worth of bonds backed by mortgage securities. The US mortgage bond market is the world's largest credit market. Leading issuers of mortgage bonds last year included Lehman, Bear Stearns and Morgan Stanley, according to Thomson Financial.

Deutsche Bank, which was among the top 10 underwriters of mortgage debt in 2007, filed as many as 15 lawsuits against mortgage companies last year. Other investment banks are likely to follow suit. The lawsuits filed by Deutsche Bank claim a breach of contract.

Typically, when a home loan is delinquent, the mortgage originator has to repurchase the loan. When a borrower misses the first payment, there is a good chance that the loan is fraudulent, experts say.

Deutsche Bank is suing mortgage originators because they failed, the bank alleges, to repurchase mortgage loans with early payment defaults. These lenders included Coon Rapids, Minn.-based Greater Northern Financial Group which is being sued for \$11 million, San Luis Obispo, Calif.-based Cameron Financial Group Inc. which is being sued for \$8.2 million. Lancaster Mortgage Bankers, which exited the

mortgage banking industry in June, is being sued for \$14 million.

"Everyone is being more introspective as a result of the subprime losses," says Scott Moritz, executive director at Daylight Forensic & Advisory. "It's still early days and banks are struggling to get their arms on the records of all their subprime holdings," he says.

Banks are looking for patterns of fraudulent activity among mortgage brokers and appraisers. "They are looking to see if there was a disproportionate amount of failed mortgages in certain portfolios," according to Moritz, who added that the banks are also investigating if borrowers got appropriate loans and if they were honest about their loan documents. Ascertaining all this takes time because many loans have been repackaged, so locating the records and tracking down loan officers proves difficult.

"There is plenty of room to go back and forth in regards to blame and liability," says Paul Schieber partner at law firm Blank Rome. Some consumers lied and misrepresented themselves, while some mortgage brokers put consumers in loans in which they didn't belong. Certain mortgage lenders had to have known something suspicious activities were going on, but didn't ask questions, says Schieber. "Lastly, the company that securitized the loan might have known what was going on, but they had a lot of pressure to get volume together, and didn't say anything."

Zamansky & Associates's Jacob Zamansky, who specializes in securities arbitration and securities fraud litigation, also believes that there will be widespread suits and counter-suits involving Wall Street banks. "The subprime crisis is the new dot-com era," he says, adding that

"the types of lawsuits and accusations that happened in 2000 will start happening to an even larger scale in the subprime area."

All firms with exposure are looking to point the finger, and lawyers are looking into what holds merit and what doesn't, says Zamansky. "Several will be successful and find they are able to recoup some losses."

However, litigation is dependent on recoverable assets, and banks will evaluate who to sue on a case-by-case basis. Banks will need to pick and choose targets to bring suits against, according to Schieber, who pointed out that banks may find that, in some cases, it does not pay for them to sue a mortgage lender or broker who can't afford to pay them back.

Many subprime originators closed up shop or filed for bankruptcy, but there are still large financial institutions that are significant players, Keith Miller, lawyer at Paul, Hastings, Janofsky & Walker said.

Mortgage fraud is nothing new. But it has been getting progressively worse and it may be behind a rise in late payment and defaults by borrowers. "Some portion of underlying mortgages that contributed to the subprime crisis were fraudulent," says Moritz.

Last year, mortgage fraud was responsible for an almost 15% increase in suspicious activity reporting last year, according to the FBI, which has in recent years worked with industry trade groups and the US housing agencies to uncover fraud in housing. There were 46,700 mortgage-related filings during the fiscal year that ended Sept. 30, 2007, up from 37,313 mortgage fraud reports filed in 2006.

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