SUBJECT: Investigating and prosecuting mortgage fraud

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 7 ayes — Solomons, Flynn, Chavez, Anchia, Anderson, McCall, Orr

0 nays

WITNESSES: (*On original bill*:)
For — Robert Doggett, Texas Low Income Housing Information Service; Olga Kucerak, Texas Association of Mortgage Brokers; Karen Neeley, Independent Bankers Association of Texas; Ben Streusand, Texas Mortgage Bankers Association; John (Jack) F. McComb, Jr.; (*Registered, but did not testify*: David Emerick, HSBC, North America; John Heasley, Texas Bankers Association; Deborah Polan, Texas Financial Services Association; Larry Temple, Texas Mortgage Bankers Association)

Against — John Brewer, Harris County District Attorney's Office; Lori Levy, Texas Association of REALTORS; Scott Norman, Texas Association of Builders; Allen Place, Texas Land Title Association; (*Registered, but did not testify*: J.E. Buster Brown, Fidelity National Title and Financial; Nick Kralj, Fidelity National Financial Services)

On — John C. Fleming, Texas Department of Savings and Mortgage Lending; Danny Payne, Texas Department of Savings and Mortgage Lending

BACKGROUND: The Financial Crimes Enforcement Network (FinCEN) is an agency under the U.S. Department of the Treasury that collects Suspicious Activity Reports (SARs) from all federally insured financial institutions. According to recent FinCEN statistics, the number of mortgage fraud incidents is increasing. During 2005, FinCEN reviewed SARs to determine the frequency with which the borrower's address was associated with different states. Texas was among the top five states for the number of SARs filed. Texas also ranks in the top 10 in the nation for mortgage foreclosures.

Penal Code, sec. 32.32 addresses fraud offenses involving false statements to obtain property or credit and the associated penalties. Penalties under this section range from a class C misdemeanor (maximum fine of $500) if the value of the property or the amount of credit involved is less than $50. The most severe penalty is a first-degree felony (life in prison or a sentence of five to 99 years and an optional fine of up to $10,000) if the value of the property or the amount of credit is $200,000 or more.

DIGEST:

CSHB 716 would require the attorney general to establish the residential mortgage fraud task force to form a strategic partnership between federal, state, and local law enforcement agencies to better enable law enforcement and state agencies to track and prosecute mortgage fraud and its perpetrators. The task force would share information and resources and enforce administrative and criminal actions against perpetrators of mortgage fraud. The task force could request assistance from specified federal agencies.

The task force would include the attorney general, consumer credit commissioner, banking commissioner, credit union commissioner, commissioner of insurance, savings and mortgage lending commissioner, presiding officer of the Texas Real Estate Commission, presiding officer of the Texas Appraiser Licensing and Certification board, and a designee of any of these officers in lieu of the officer noted. The agencies represented by the task force members could share confidential or restricted information among one another for the purpose of investigating mortgage fraud and its perpetrators in Texas. These agencies also could share information with one another, law enforcement, the State Securities Board, the Texas State Board of Public Accountancy, and the Public Utility Commission regarding the possible commission of mortgage fraud or corporate fraud by a person regulated by these agencies.

The task force would have to submit an annual report on the progress of each agency represented on the task force to the governor, the lieutenant governor, and the speaker of the House. The Office of the Attorney General would oversee the administration of and provide staff and facilities for the task force. The attorney general could solicit and accept grants, donations, services, or property on behalf of the state for disbursement to state agencies and law enforcement to aid in the investigation and prosecution of mortgage fraud.

CSHB 716 would make it an offense punishable under Penal Code, sec. 32.32 to knowingly make a materially false or misleading written statement to obtain a mortgage loan. The agencies represented on the task force would assist prosecuting attorneys and law enforcement in the investigation of such an offense. Penal Code, sec. 32.32 would prescribe the penalties applied for committing this offense based on the value of the property or the amount of credit involved. CSHB 716 would set the statute of limitations at seven years for presenting a felony indictment for money laundering or making a false statement to obtain property or credit.

If a person reasonably suspected fraudulent activity had been or would be committed, that person would be required to report this information to the attorney general; a local, state, or federal law enforcement agency; a U.S., county, or district prosecuting attorney; or one of the agencies represented on the residential mortgage fraud task force. Fraudulent activity would be defined as any act that violated a penal law and was an attempt to defraud any person.

Upon receiving a fraud report, the attorney general would notify each agency represented on the task force. If a financial institution or person voluntarily reported fraudulent activity, neither the reporting party nor the notified agency could disclose to anyone involved in the fraudulent activity that the act had been reported. Any party voluntarily reporting possible fraudulent activity would not be liable under state or federal law or regulation for the report. This would not eliminate or diminish any common law or statutory privilege or immunity.

CSHB 716 would require lenders, mortgage bankers, or licensed mortgage brokers to provide applicants for home loans with a notice at closing that would have to include information regarding the name, employment information, and annual income information of the loan applicant as stated on the mortgage loan documents. The notice would include a warning statement regarding the penalties in the Penal Code associated with knowingly making a materially false or misleading written statement to obtain property or credit, including a mortgage loan. The loan applicant would be required to verify and execute the notice.

CSHB 716 would take effect September 1, 2007. The change in law regarding the statute of limitations would not apply to an offense if the prosecution of that offense became barred by the statute of limitation in effect before September 1, 2007. Should a conflict arise, the provisions of this bill would prevail over any other act of the 80th Legislature, regular session.

SUPPORTERS SAY:

CSHB 716 would help combat mortgage fraud by providing prosecutors, agencies, and law enforcement the tools necessary to fight fraudulent conduct in the mortgage lending process. Mortgage fraud increases the cost of financing for consumers and the risk to all participants in the mortgage process.

The bill would enable the Attorney General's Office to solicit and accept money to distribute to state agencies or local law enforcement to aid in the investigation of mortgage fraud. Many private parties are harmed by mortgage fraud, and these parties, such as title companies, have the means and motivation to provide funds that could be distributed to local prosecutors to better address their cases. Financial crimes often require lengthy investigations following complicated paper trails in an attempt to prove intent. CSHB 716 would provide the financial resources necessary to address the increasingly pervasive problem of mortgage fraud through criminal prosecutions.

In addition to financial resources, CSHB 716 would arm local law enforcement with increased investigative resources. The residential mortgage fraud task force could share information that would facilitate local investigations and highlight additional cases or offenses by someone under investigation. Each agency unknowingly could hold the key to prosecuting a case. The task force would open lines of communication to bring this information to light so that local prosecutors could share their information needs and more efficiently conduct investigations. In addition, the statute of limitations on a mortgage fraud offense would increase from three to seven years, providing more time to investigate single offenses as well as discover if fraud perpetrators had committed a chain of offenses extending over many years.

The notice to borrowers at closing would provide both a preventive and punitive advantage against fraud. A common way in which mortgage fraud is perpetrated is to convince unwitting people with good credit that they can make quick money on real estate deals by purchasing houses and receiving money up front for turnaround sales. In reality, the fraud perpetrator has purchased the property at a lower than market rate and has falsified documents to qualify the potential borrower to purchase the property at a higher-than-market rate. The fraud perpetrator takes the proceeds of the sale and leaves borrowers to grapple with mortgages that they cannot afford and eventual foreclosures.

If a legitimate borrower saw the notice proposed in CSHB 716 and recognized that his or her income or employment had been falsified, the individual could halt the purchase and prevent the fraud occurrence. However, if the borrower was a knowledgeable party to the fraud and signed the notice prior to purchase, district attorneys would have solid grounds on which to prosecute the borrower.

Finally, the committee substitute addresses concerns regarding HB 716 as filed. CSHB 716 would add prosecution of mortgage fraud to the existing fraud statute in the Penal Code. This would address initial concerns that prosecution of mortgage fraud would be complicated by having its own statute with a different set of penalties than other instances of fraud. CSHB 716 also would address the concern that the original bill was too broad. HB 716 as introduced could have brought innocent parties under suspicion, such as a title company that unknowingly was processing falsified documents. CSHB 716 would not criminalize unintentional or inadvertent misstatements. It would punish only the bad actors without harming innocent participants in the mortgage process.

OPPONENTS SAY:

While the proposed criminal approach in CSHB 716 is measured and reasonable, the bill should go further by including a civil remedy. District attorneys have limited resources and must make tough decisions about which cases to pursue. A district attorney would be much more likely to prosecute a violent crime with straightforward evidence than a financial crime that required lengthy investigations to uncover complicated paper trails.

It is particularly difficult for a consumer taken advantage of by a lender to sue, because other statutes such as the Deceptive Trade Practices Act do not apply to lending of money. A civil remedy specifically designed to address mortgage fraud would help both consumers and other private parties pursue their interests in the event that local resources were not adequate for a criminal prosecution.

While CSHB 716 would provide for the attorney general to collect funds that could aid in local prosecutions, there would be no guarantee that private parties truly would contribute funds for this purpose. The distribution of any funds collected also would be at the attorney general’s discretion, and there would be no guarantee that funds would go first to district attorney’s offices in particular need. Having appropriate resources to prosecute financial crimes is particularly difficult in smaller jurisdictions that might be overlooked in the distribution of funds.

NOTES:

A floor amendment will be offered that would change the requirements for the contents of the notice that would have to be provided to borrowers at the closing of a home loan. The notice would not specify the borrower's employment and annual income. The amendment instead would state that in executing the notice, the borrower would attest that statements in the loan application were true and correct regarding identity, employment, annual income, and intent to occupy the property. The amendment would also state that failure to provide the notice to each home loan applicant would not affect the validity or enforceability of the home loan.

The committee substitute would make mortgage fraud punishable under the existing fraud chapter of the Penal Code. The original version of the bill would have created the Residential Mortgage Fraud Act in the Business and Commerce Code. The Residential Mortgage Fraud Act would have defined mortgage fraud offenses and prescribed penalties. It also would have defined:

- residential mortgage loans and residential real property; and
- the mortgage lending process and documents related to this process.

The bill as introduced included a definition of mortgage fraud offenses specifying activities to be considered an offense if a person undertook or conspired to undertake those activities to mislead a party in the mortgage lending process. Mortgage fraud offenses also would have included knowingly deriving a financial benefit in connection with a residential mortgage closing that involved mortgage fraud.

In HB 716 as introduced, a mortgage fraud offense would have been a second-degree felony (two to 20 years in prison and an optional fine of up to $10,000) and each subsequent offense would have been a first-degree felony if the offenses involved two or more residential properties and were interrelated in specified manners. HB 716 as filed would have described the possible venues where mortgage fraud could have been committed.

The notice provided to a mortgage loan applicant proposed in HB 716 as filed would be similar to that included in CSHB 716; however, it would have referenced the penalties defined in the Texas Residential Mortgage Fraud Act rather than the Penal Code.

HB 716 as filed did not include the definition and intent for the residential mortgage fraud task force or direction for how the agencies represented by the task force could share information and participate in the investigation of mortgage fraud.

In the fiscal note, the Legislative Budget Board (LBB) estimates that the Texas Real Estate Commission (TREC) would incur costs of $574,593 through the end of fiscal 2008-09 to investigate 40 additional mortgage fraud complaints. The cost would include the addition of five FTEs. These costs would be paid for by assessing or increasing fees at TREC.

The LBB estimates a cost to a Texas Department of Insurance (TDI) general revenue-dedicated fund of $392,373 through the end of fiscal 2008-09 to carry out 12 more investigations per year. The cost would include an additional three FTEs. TDI would generate revenue equivalent to its cost of operations.

The LBB projects that CSHB 716 would have no net impact to general revenue and no significant impact on the criminal justice system.