

INTRODUCTION:

For the better part of two years, the issue of predatory lending has commanded the attention of bankers, regulators, real estate and community development professionals and consumer advocates. As an issue or practice best characterized as fraud or violations of current consumer protection and lending laws, predatory lending defies easy solutions. Proactive measures are critical in any effort to eliminate this offensive and intractable problem. This article seeks to offer resources and ideas about how you and your organization can play a role in curbing predatory lending and financial fraud.

Combating predatory lending and financial abuse of elders requires the cooperation of front-line professionals such as bank employees, mortgage lenders and community organization representatives. Tougher legislation, heightened regulatory inspection, consumer education and increased disclosure requirements are not enough to guard against the superior tactics of unscrupulous players. The effort to combat predatory lending and other examples of financial fraud must also involve personal accountability.

For example, personal accountability includes a willingness to report individuals whose unscrupulous conduct poses reputational risk to the industry and, in some cases, nullifies the efforts of legitimate organizations to increase homeownership. Personal accountability includes taking the initiative to report suspected fraudulent and abusive activity targeted at elderly customers. Personal accountability also extends to developing strategies for collaborating with appropriate agencies to create innovative models and best practices. The information and programs that follow will serve as models for how your organization can take such steps.



Predatory Lending and Financial Fraud: What You Can Do

*Introduction by Lena Robinson, Associate Community Affairs Specialist,
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The following articles spotlight efforts and resources focused on preventing home equity fraud and protecting the assets of those who are most vulnerable or at risk of being defrauded. The Los Angeles County Real Estate Fraud and Information Program illustrates the effectiveness of strategic cooperation among law enforcement, legal aid and real estate industry professionals. A list of agencies that regulate mortgage brokers throughout the Fed's 12th District is also provided to emphasize the importance of industry self-regulation

and due diligence in weeding out habitual offenders. Finally, the California Community Partnership for the Prevention of Financial Abuse underscores the importance of training and building relationships with law enforcement and social service agencies such as Adult Protective Services.

Most importantly, these models are intended to empower those in the best position to make a difference—you. As a professional working directly with clients, you may at some time or another encounter a situation or scenario

that “looks like” predatory lending or financial fraud. Hopefully your response will not be indifference or helplessness, but rather empowerment to uphold your personal and fiduciary duty. Knowing that there are mechanisms in place is encouraging and helps to defeat cynical thinking that hampers our willingness to get involved. “An ounce of prevention is worth a pound of cure.”

Fighting Home Equity Fraud and Predatory Lending ...One Community's Solution

by Joan Potter, Research Analyst, Federal Reserve Bank of Cleveland

On a warm, sunny day in Los Angeles, Bruce Provan left his home for the last time. Provan, severely disabled by multiple sclerosis, planned to go away for a few days while some home improvement work was completed. A friend from church had graciously offered to find a contractor to “fix up the place a bit” and had even taken care of the paperwork and financing. Provan had only to sign a few documents. He thought he was signing a contract for home improvements—but in fact, he had signed away his home entirely.

Stories of predatory lending like this one appear almost daily in newspapers nationwide. You might guess how the story ends: Provan loses his home, loses his home equity, and ends up living in his car. Legal? No.

Provan's misfortune was a case of home equity fraud. In 1994, such fraud was already illegal and carried criminal penalties in Los Angeles. But in most of the country, Provan's friend would have walked away free and clear, with a substantial amount of cash and more confidence to prey on the next victim. Home equity fraud is strik-

ingly similar to predatory lending and, despite its illegality, occurs quite often. In many instances, fraud plays a key role in predatory lending cases (see figure 1). According to attorney Ben Diehl of Bet Tzedek Legal Services, more than half of the predatory lending cases he sees involve criminal fraud. Other investigations into the practices of predatory lenders confirm that fraud occurs regularly.¹

The lesson to be learned from these cases is that making the abusive lending practices of predatory lenders illegal is not enough: enforcement is essential in curbing the practices that have catastrophic consequences for American homeowners.

Predatory lending is a complex problem, requiring a broad policy response that combines actions at local, state, and federal levels. Policy actions must

address the underlying causes of predatory lending. This report focuses on two of those factors, insufficient laws and little enforcement.

ONE COMMUNITY'S SOLUTION

Homeowners in L.A. County who suspect fraud or predatory lending may call the Real Estate Fraud Hotline and speak with a trained investigator about their loan; if the call is made immediately, they may exercise their right to rescind the loan within three days under the Truth in Lending Act. Borrowers may also make an appointment with L.A. County's Department of Consumer Affairs, and a member of the Real Estate Fraud Division will examine and explain their loan documents.

In Los Angeles, whenever property is pledged as security for a loan (by the recordation of a deed of trust), property owners are notified by mail and provided a copy of the deed, disclosing the full amount of debt against the property. Also included is a tip sheet—written in plain English (or Spanish)—explaining the documents and the possibility of foreclosure if they fail to make payments.

¹ For example, in the 1998 Senate Special Committee on Aging hearing, a former finance company employee testified, “I've seen finance company employees commit forgery on a massive scale. These employees have forged everything from insurance forms, RESPA documents, income verification forms, and even entire loan files.”

Los Angeles consumers are urged to call the Real Estate Fraud Hotline to speak with Department of Consumer Affairs staff if they have any questions or concerns about their loan documents. In addition, the department provides counseling, information, referrals, investigation, and mediation of complaints—all free of charge—and conducts outreach programs targeting high-risk groups such as the elderly and homeowners in low-and moderate-income neighborhoods.

In many predatory lending cases consumers believe they are getting a home equity loan but are, in fact, refinancing. Therefore, L.A. County homeowners are notified that their entire mortgage has been refinanced, leaving them with a substantial outstanding debt that is secured by their home. If criminal fraud is suspected, law enforcement agents and the district attorney begin an investigation, which may lead to criminal prosecution. Additionally, the Department of Consumer Affairs refers complaints against contractors and mortgage brokers to their respective licensing agencies.

A PARADIGM SHIFT

During the early 1990s, legal aid attorneys in Los Angeles saw the number of home equity fraud cases increasing. Although the county had laws in place making home equity scams a crime, few criminal prosecutions occurred. Civil litigation was just as ineffective in deterring such fraud: according to attorney Manuel Duran, “judgments meant nothing to these scammers. The scammer would just get a new name and continue on with the same scam.” Therefore, a way to address the barriers to effective criminal prosecution was needed.²

Why were so few home equity fraud cases prosecuted? Many homeowners were routinely turned away because the police had little knowledge of home equity fraud and told victims their cases were civil in nature. On rare occasions when allegations of home equity fraud were investigated, the detectives assigned to the cases were not properly trained to understand the

complicated legal documents involved, and therefore could not assess whether a crime had taken place. Because of poor investigations, there was rarely sufficient evidence to prosecute.

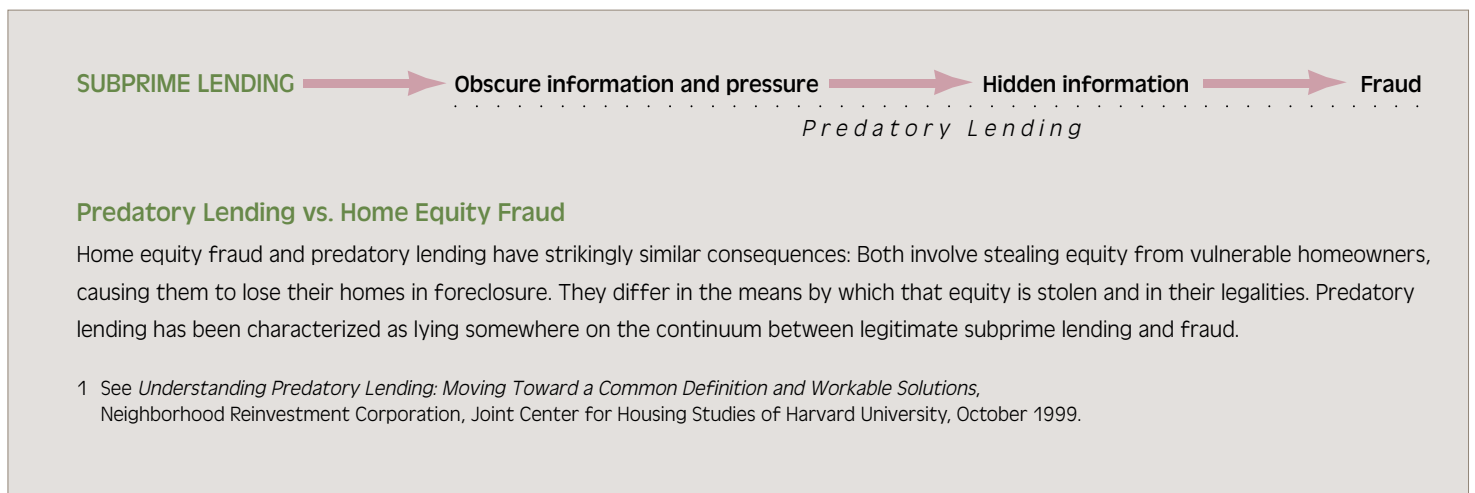
In 1994, a home equity fraud prosecution committee was established, comprising two legal aid attorneys, a deputy district attorney, and representatives of the Department of Real Estate and the Los Angeles County Consumer Affairs Office. Additionally, legal aid attorneys invited law enforcement agencies to participate in a two-day training session.

Although these efforts allowed law enforcement to better recognize home equity fraud and conduct more productive investigations, the prosecution model remained flawed.

The county’s prosecution model was ineffective, for two reasons. First, many homeowners did not realize they had been scammed until the foreclosure process had already begun. Such cases are difficult to investigate and prosecute because so much time has passed; in some cases, the statute of limitations may have expired. The Real

² See “Getting Law Enforcement Involved in Predatory Lending Cases,” *The Consumer Advocate*, January/February 2000, p. 38.

FIGURE 1



Estate Fraud Notification Program and Hot-line were created to address this problem. Consumers are notified within 30 days of the recording of a deed or deed of trust and victims are able to recognize and report fraud much more quickly.

Second, few resources were dedicated to investigating and prosecuting home equity fraud cases. Thus, the Real Estate Fraud Prosecution Trust Fund was established, funded by a \$2 fee added to deeds and deeds of trust at the time of filing. The fund pays for local police real estate fraud investigation units and an expanded district attorney's real estate fraud prosecution unit.

THE SUCCESS OF THE LOS ANGELES MODEL

The Real Estate Fraud Hotline receives about 2,000 calls a month, answered by three Department of Consumer Affairs investigators. Of those calls, 50 percent require formal action. The program's positive public reception—it has a 99

“A significant component of predatory lending involves outright fraud and deception, practices that are clearly illegal. The policy response should simply be better enforcement.”

— Federal Reserve Governor **Edward M. Gramlich**
to the Fair Housing Council of New York, April 14, 2000

Home Equity Fraud and Predatory Lending Defined

<i>Legitimate subprime lending</i>	<i>Predatory lending</i>	<i>Predatory lending plus fraud</i>	<i>Home equity fraud</i>
<p>Legitimate subprime lending refers to lending at rates above the prime rate to cover the increased risk and transaction cost of lending to borrowers with non-traditional credit histories or who pose greater credit risks. The premium above the prime rate reflects the increased risk and transaction cost.</p> <p>The loan structure is related to the borrower's income stream and promotes the borrower's ability to repay the loan.</p> <p>Lending terms and costs are fully disclosed to the borrower. Borrowers' questions are answered honestly, and all applicable disclosure laws are followed.</p>	<p>Predatory lending typically refers to the abuse of mortgage provisions that are generally desirable. Lending rates are usually substantially above the prime rate and large fees and points are typically charged, added to the principal, and financed as part of the loan.</p> <p>The total cost of the credit often far exceeds the credit risk; however, sometimes the credit risk is so high that the loan seems to have been made with the expectation of borrower default.</p> <p>In many cases, loans are originated based on the equity in the home, without regard to the borrower's ability to pay.</p> <p>Many times the initial loan terms disclosed to the borrower are substantially different in the contract.</p> <p>Frequently the borrower has little time to review the documents and is pressured to sign quickly without asking questions.</p>	<p>Fraud often accompanies predatory lending, and it may be present in a number of ways, since fraud laws vary by local community and states. Behaviors that constitute fraud vary as well: Practices include falsifying borrower income on loan documents, forging the borrower's signature, and diverting funds away from the borrower.</p>	<p>Home equity fraud differs from "predatory lending plus fraud" in that home equity fraud may occur with or without a loan. The circumstances under which home equity is "taken" can vary, but it typically occurs through deception, trickery, forgery, and identity falsification.</p> <p>For example, one case successfully prosecuted in Los Angeles involved a "borrower" who had forged a deed and was attempting to get a loan secured by the property. The original owner had no knowledge of the forgery or the debt. The lender suspected the forgery and called the Real Estate Task Force, which conducted an investigation and arrested the forger.</p> <p>Bruce Provan's case also involved home equity fraud without a loan: Provan was tricked into signing papers that would give another power of attorney.</p>

percent approval rating—has prompted several other California counties to pass initiatives for similar programs.

The comprehensive partnerships and collaborative efforts among several agencies are what make the initiative so effective. According to Manuel Duran, an attorney formerly with Bet Tzedek Legal Services and an early initiator of the partnership, “[i]t is not difficult for a legal aid attorney to call the Department of Real Estate and start the process of revoking the license of a broker or the district attorney’s office to start a criminal investigation. Just as easy, a police detective can call a legal aid attorney for information that will assist the detective in an investigation or in obtaining a search warrant.” Because the district attorney’s office plays such a key role in the partnership, cases are turned over for prosecution more quickly and effectively. Many times, law enforcement units discover they are investigating the same people, and they can team up and share evidence to develop a case.

A MODEL OF INTEGRATED EFFORT

Because no legislation has made predatory lending a criminal offense, such practices often must be fought indirectly. In fact, according to Supervising Investigator Nicholas Aquino, Los Angeles Department of Consumer Affairs, the most disturbing calls received by the hotline are cases with allegations of abusive lending practices and verbal misrepresentations of loan terms, but few elements of fraud or other criminal behavior. Although many such cases have been successfully tried in the civil courts, consumers hesitate to incur the legal expense of a civil court battle.

The fraud-fighting partnership is a model of an integrated effort to stop unscrupulous scam artists from stealing home equity, causing homeowners to lose their home in foreclosure, leaving their victims with a pile of legal bills, and causing them substantial stress and misery. In Los Angeles, the collaborative efforts of many players are helping people get back their home

equity, prevent foreclosure, put scam artists behind bars, and deter others from entering this line of work.

The views in this report are those of the author and do not necessarily represent those of the Board of Governors of the Federal Reserve System or of the Federal Reserve Bank of Cleveland.

Reprinted from CR Report, Summer 2000, a community affairs publication of the Federal Reserve Bank of Cleveland. If you would like additional copies of CR Report, contact the Community Affairs office at 216/579-2135.

The story ends...

Bruce Provan was fortunate to live in Los Angeles. Provan’s case—a clear case of home equity fraud—was the first to be prosecuted by the Task Force. His “friend”—who had abandoned Provan in a motel 90 miles away from home with a bag of groceries and no money, so that he could return and sell the house—did spend some time in jail. Although Provan never got his home back, the man who stole it got his due.

Special thanks to Supervising Investigator Nicholas Aquino of the Los Angeles Department of Consumer Affairs for many lengthy interviews regarding the Los Angeles program. Thanks also to attorneys Manuel Duran, in practice at Duran and Flanagan, and Ben Diehl of Bet Tzedek Legal Services.

MORTGAGE BROKERS AND LENDERS

by Lena Robinson, Associate Community Affairs Specialist, Federal Reserve Bank of San Francisco

As the name suggests, predatory lending is most often a lending transaction where the victim has been specifically solicited with a loan product that is unfavorable. By itself, this may not be illegal. But a pattern and practice of such conduct is, and can be prosecuted. At the very least, such conduct should be made known to the appropriate licensing or regulatory agency. Because the act of deceit and fraud often appears to occur with a non-depository mortgage broker or lender, contact information has been provided for the state agencies that regulate this group.

Realistically, it is not easy to uncover predatory practices. The unfortunate

reality is that fraud is usually discovered after the fact. For instance as a lender, you may detect irregularities in a previous transaction during an attempt to re-finance. Or perhaps as a community development professional helping a client workout of a foreclosure you suspect deception in the original transaction. These transactions may be isolated, but if they raise predatory “red flags”, they are probably worth reporting. The most practical opportunity for detection may be during the underwriting process for securitizing brokered loans. The emphasis here is really on industry self-regulation and due-diligence.

The departments that license and regulate mortgage brokers and lend-

ers vary by state. In the Fed’s 12th District, Alaska appears to be the only state that does not regulate mortgage brokers although they are required to be licensed. In general, regulatory responsibility includes periodic audits, investigation of complaints regarding fraudulent conduct, and authority to revoke their license if the complaint is substantiated. Most of these departments do not have civil or criminal jurisdiction and advise that these efforts must be pursued independently and often concurrently to safeguard statutory limitation guidelines. If your concern or complaint is outside the purview of these agencies listed, they can direct you to the appropriate agency.

AK:	Division of Banking, Securities and Corporations	http://www.dced.state.ak.us/bsc/mortgagelender.htm
AZ:	State Banking Department—Consumers Affairs	http://www.azbanking.com/conaff.htm
CA:	Department of Real Estate	http://www.dre.cahwnet.gov/
	Department of Corporations	http://www.corp.ca.gov/enf/enforcement.htm
HI:	Regulated Industries Complaints Office	http://www.hawaii.gov/dcca/rico/
ID:	Department of Finance	http://www2.state.id.us/finance/dof.htm
NV:	Nevada Real Estate Division	http://www.state.nv.us/b&i/red/comp.htm
OR:	Division of Finance & Corporate Securities	http://www.cbs.state.or.us/external/dfcs/mortgage/mortmain.htm
UT:	Utah Division of Real Estate	http://www.commerce.state.ut.us/re/udre1.htm
WA:	Department of Financial Institutions, Div. of Consumer Services	http://www.wa.gov/dfi/cs/home.htm



FINANCIAL ABUSE OF ELDERS AND DEPENDENT ADULTS

by Kimberly Petrini, President/CEO, Novato Community Bank

Financial exploitation of the elderly and dependent adults is a significant problem affecting millions of Americans across the county. Elders comprise an increasing segment of our population, and elder financial exploitation and other forms of abuse are occurring at alarming rates as the population gets older and accumulates more wealth. Still, only a small percentage of estimated financial abuse cases are reported each year.

Adult social service agencies find that approximately 25–35 percent of their caseload involves financial abuse by persons, often relatives or friends, known to the victims. California's state attorney general's office reports that an increasing number of criminal prosecutions involve financial abuse against elders. The number of financial abuse cases are currently estimated between 80,000–100,000 cases per year and rising. And this problem can only get worse. By 2010, the number of persons over 65 is projected to increase by 63 percent from 1990 statistics to almost five million.¹

“Staff training is important not only as a means of helping to identify potential abuse, but also in helping staff differentiate between financial exploitation and legitimate situations where family members must act on behalf of their elderly relatives.”

¹ California Department of Finance, *Population Projections 1993*.

TRAINING TO PREVENT ELDER FINANCIAL FRAUD

Cases of elder fraud often involve someone that the victim knows and trusts such as a family member, friend or caregiver. This makes detection less obvious and the decision to report more sensitive. For this reason, it is important that bank employees receive training to recognize signs of fraud and receive guidelines on how to proceed. In addition to the CCPPFA project highlighted on this page, a number of excellent resources exist to promote such training.

Several bankers associations in the 12th District have undertaken a campaign to educate bank employees on how to recognize and prevent financial exploitation. In 1997, the Utah Bankers Association in cooperation with the State Division of Aging and Adult Services developed and conducted "train-the-trainer" workshops for bank trainers on how to recognize elder exploitation and their state mandated obligation to report suspected abuse. Because of this effort and the active participation of bank personnel, several cases were reported and resolved. Similarly, The Oregon Bankers Association has launched a new initiative in partnership with their state attorney general's office, AARP and a state social service agency, to train bankers on how to identify and report suspicious activity.² The involvement of the state attorney general is a strong endorsement of this effort and an implicit indication that banks are shielded from liability for "good faith" reports based on reasonable suspicion. The Nevada Bankers Association also distributes handouts with tipsheets for consumers and bank employees that include the contact numbers for appropriate state agencies.

Financial Watch is an employee training video created by Union Bank of California. The five-minute video, which portrays a number of scenarios to acquaint employees with the possibilities of elder fraud, is augmented by a discussion of the Bank's procedures and individual branch considerations. The four banking regulatory agencies are currently working to develop a similar product that will be available to banks districtwide.

THE PROBLEM

Financial abuse is one of the most destructive forms of abuse because the elderly are generally unable to recoup their losses. If seniors lose their homes, they may not be able to feed themselves, pay for medications and other crucial medical care they may need today or in the future. This type of abuse not only financially devastates seniors, but has the potential to result in the unnecessary institutionalization of elders and possibly their death from depression. Often it is difficult to restore someone's physical well-being, pride and dignity after the cruel crime of elder abuse has occurred.

THE SOLUTION

Financial institutions are in a unique position to witness financial abuse. They administer accounts, trust and other financial assets of elders and dependent adults. Employees get to know their customers' spending patterns such as denominations and amount of money regularly withdrawn. They can detect a decline in a senior customer's ability to conduct transactions or know whether or not a customer has the physical ability to make certain types of transactions. Yet, until recently, because of lack of information about identifying and reporting these transactions and the industry's practice of keeping customer's financial affairs confidential, banking institutions rarely reported these cases to public authorities. This has placed banks, as well as their customers, at risk.

Financial abuse is a significant problem demanding a comprehensive community response. The California Community Partnership for the Prevention of Financial Abuse ("CCPPFA") is

1 Preventing Elder Financial Exploitation:
How Banks Can Help (*training kit*),
Senior and Disabled Services Division
503/945-6399

California's first statewide public/private partnership initiative developed in response to this increasing social problem.

CCPPFA's mission includes:

- 1) training employees of financial institutions to recognize and report suspected financial abuse of elders and dependent adults;
- 2) raising community awareness of financial abuse through a regional public awareness campaign scheduled for January 31, 2001;
- 3) increasing communication between banks/credit unions, adult protective service and law enforcement agencies;
- 4) educating and empowering seniors; and
- 5) becoming a funding source for the many underfunded and understaffed programs in our communities who support financial abuse prevention.

CCPPFA's initiative offers a turn-key program that can be readily incorporated into almost any financial institution's existing public relations or training structure. Because CCPPFA was founded and developed by banks, the curriculum and topics are highly relevant and reflect the concerns of financial institutions. Currently, representatives of CCPPFA are working with the FDIC to receive CRA consideration for participation in this type of program. Many senior citizens fall within a low-mod income classification given that their financial support comes primarily from public benefits.

WHAT BANKS CAN DO TO HELP PREVENT FINANCIAL ABUSE

- Train bank personnel to recognize potential warning signs of elder financial abuse or fraud.

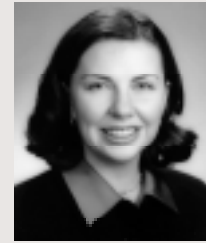
- Encourage staff to get to know their elderly customers and become familiar with their banking practices and account activity.
- Establish internal bank procedures that outline the appropriate staff responses to suspected abuse.
- Develop or sponsor education and consumer outreach programs targeted to elders (e.g. financial literacy and techniques for reducing risk to financial abuse and exploitation).

LEGAL AUTHORITY TO INTERVENE

Banks have existing civil, criminal and welfare and institutions codes to protect them when reporting suspected financial abuse cases. Such cases should be reported to the county office of Adult Protective Service for investigation. If the situation appears to be urgent and threatening, the sheriff or police department should be contacted immediately. Additionally, some banks have developed advanced directives for financial management which allow account holders to name someone they would like the bank to contact if their banking practices become "unusual".

In the State of California, Senate Bill 1742 was recently signed into law and will become effective January 1, 2001. This bill effectively allows specially trained peace officers to immediately freeze financial accounts of an elder whom they suspect is being abused. The system currently in place often takes months to establish a freeze. In the meantime, assets can be bled dry. For specific laws and regulations in your area, check with your local district attorney's office. *Remember... financial abuse can be reported anonymously anytime by anyone. CI*

For more information about CCPPFA, contact Kimberly Petrini at 415-898-5400 or email her at kpetrini@ncbanking.com.



ABOUT THE AUTHORS

JOAN POTTER joined the Federal Reserve Bank of Cleveland's Community Affairs staff as a research analyst in January 2000. She is responsible for researching and analyzing community reinvestment, economic development, and fair lending issues to illustrate the impact of the Community Reinvestment Act and other community development programs. Potter previously worked in the Bank's Research Department, where she obtained and analyzed economic data and worked with economists on long-term research initiatives.

KIMBERLY PETRINI is the president/CEO of Novato Community Bank, a locally owned and operated financial institution in Marin County, CA. Ms. Petrini is also the president of CCPPFA. She has been featured on KFTY 50, BayTV and the Marin Report.

Ms. Petrini is active in many community organizations including Rotary (former board member), Novato Chamber of Commerce (former financial committee member), Boy Scouts of America, Junior Achievement and Novato Community Health Foundation Board. Ms. Petrini received her bachelor's degree in accounting from California State University, Hayward and is currently pursuing her MBA at the University of Phoenix, Novato.

Novato Community Bank received the Small Business of the Year Award, 2000.