Using Technology as a Weapon to Combat Fraud:

Tool Helps New Century Catch Bad Loans Early in the Process, Saving Millions and Increasing Performance

Mortgage fraud has become such an attractive opportunity for criminals that even drug dealers are getting in on the action. "They consider [it] a safer alternative," says Thurbert Baker, Georgia Attorney General, who's recently prosecuted some big cases. "The profit potential is at least as high and they're less likely to get a bullet in the head."

Once simply a headache for just a few lenders, mortgage fraud – such as inflated appraisals, bogus paystubs, doctored tax records and straw buyers – has blossomed into one of the fastest-growing white-collar crimes in the country. Last year, lenders lost more than $1 billion to scams, up from $429 million a year earlier and $156 million in 2000, according to the FBI. Losses from mortgage fraud range from 7 to 20 basis points (or 0.07 to 0.2 percent) of lenders' total loans.

And it's not easy to spot fraud. Just ask Tricia Lindsay, Vice President, Corporate Risk Management, who oversees a seven-member team devoted to doing just that. They scour multiple reports on suspect borrowers or brokers and fake credit scores, as well as internal information from Servicing, QA and Investor Relations. "We've always relied on our experienced Underwriters and Risk Managers to detect suspicious activity and we're an industry leader at this," says Tricia "Yet we believe that with improved technology we can be even better."

It's for these reasons that New Century implemented the Predictive Analytics Tool project and began using a software application called FraudMark™ earlier this year to supplement its fraud-finding efforts. The cutting-edge tool, provided by BasePoint Analytics, uses unique technology to examine historical loan processing patterns, New Century's policies, and years of applicant data, then deliver a score for a loan application. Since February of this year, it's caught over 1,400 loans that had either confirmed misrepresentations or suspicious information. Suspending production on those loans has prevented nearly $26 million in losses to the company.

As New Century's top legal officer, Terry Theologides is pleased with the results so far – but not surprised. "We chose the application because it allows us to maximize loan quality and profitability, while also reducing loan application review costs," says Terry, Executive Vice President and General Counsel of New Century Financial Corporation. "It can foresee deception with amazing accuracy and help us to stamp it out before we add bad loans to our portfolio."

More Schemes Require More Weapons

Before the recent housing boom, fraud was pretty straightforward, according to Tricia. "The most common instances New Century experienced were phony employment and income claims, such as W-2 alterations or a borrower reporting his annual income was $75,000 as a greeter at Wal-Mart for example."

But as the mortgage financing market also ballooned, swindlers have focused on other ways to exploit the lending process. One scheme is to inflate the appraisal of a home's value to secure a higher loan amount, which can be leveraged for profits. Another ploy is to use one person's solid financial background to secure a loan (a "straw" buyer) for a less qualified borrower who will attempt to make the mortgage payments. Plus, everyone's getting in on the action: applicants, brokers, loan officers, correspondent lenders and appraisers.

The software application helps to zero in on the myriad types of suspicious activity by combining two techniques: scanning behavioral trends and sifting through historical patterns. Behavioral trends are applied to applicants, brokers, loan officers, lenders and appraisers, while historical patterns are applied to both fraudulent and non-fraudulent loan applications. The software also lets New Century score loan applications multiple times during the loan origination process as additional information is accumulated.

"It's a powerful weapon for us," explains Tricia. "By combining both techniques, the software provides a much higher degree of predictability in identifying the applications that present the greatest risks. And besides helping us to avoid the costs of bad loans, we no longer have to pay for expensive data to match against loan applications, as we did before."

Production Boost Expected

Surprisingly, Tricia has fielded some concerns from Associates that software will have an adverse impact on loan production. Her response: "It's quite the opposite," she says. "By detecting fraud early in the process, we can redirect our efforts toward legitimate applications that will produce a greater number of healthy loans. And let's face it – if loans don't produce, we've wasted our time and the company loses money."

Tony Meola, Executive Vice President, Loan Production, believes that it also supports the company's brand, which brokers and borrowers alike have come to rely on. "We've been successful as a company because we've built a reputation as a lender with integrity," he says. "Our customers have come to expect that from us as part of the value we provide. We're known for doing business the *right* way - this is just another example of how we do that."

###