

Mortgage fraud against lenders

***A thematic review of lenders' systems and
controls to detect and prevent mortgage fraud***

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1. Executive summary

1.1. Introduction

1. This report describes how mortgage lenders (lenders) in the UK are managing the risks mortgage fraud poses to their businesses. It sets out the findings of our recent review of the adequacy of lenders' systems and controls to detect and prevent mortgage fraud. The report contains some disappointing findings. Lenders must consider carefully how vulnerable their own systems and controls are to the issues identified.
2. Mortgage fraud became a feature of the pre-2007 lending boom and has proved a resilient phenomenon, despite the downturn in lending and tightening of lending standards. In January 2011, the National Fraud Authority published its second annual fraud indicator which estimated the cost of mortgage fraud in the UK to be £1 billion.¹
3. Mortgage fraud can range from stretched borrowers misleading a lender to secure a loan, to organised criminal rings defrauding lenders with the help of corrupt brokers, solicitors and valuers. In theory, lenders will act out of self-interest to reduce losses from fraud. However, the desire to acquire business and economise on process may cause lenders to run fraud risks.
4. Since 2007, we have taken steps to make life harder for mortgage fraudsters and also to encourage lenders to improve their defences. Our work has included enforcement action against mortgage brokers, working with other agencies to secure criminal convictions, a more intensive and intrusive approach to supervision, and initiatives to encourage collaboration and information sharing within the industry, including our 'Information From Lenders' (IFL) scheme.
5. We expect senior management of all lenders to consider our findings, and translate them into more effective policies and controls where necessary. The report also contains proposed guidance in the form of examples of good and poor practice which, following post-consultation implementation, we will expect firms to take into account. The finalised guidance will be included in *Financial crime: a guide for firms*, on which we are currently consulting in CP11/12. Should you have any comments on the guidance contained in this report, please respond to the consultation on the guide.
6. Our visits to lenders were made in conjunction with their FSA supervision teams and, where appropriate, remedial programmes designed to strengthen anti-fraud systems and controls have been implemented with oversight by supervisors.

¹ See www.attorneygeneral.gov.uk/nfa/WhatAreWeSaying/Documents/AFI%202011.pdf

7. It is noticeable that some lenders' systems and controls may be adequate for their current levels of business but they are not sufficiently forward-looking to accommodate potential changes to market volumes or structures. What might appear to be reasonable fraud prevention systems and controls today may not be sufficient as business models change in response to market pressures.
8. Mortgage fraud remains a current issue with increasing levels of sophistication and innovation from fraudsters. Lenders must stay vigilant and apply the strongest possible systems and controls to aid prevention, learning lessons from the past. We will continue to focus on lenders' compliance in this area and will not hesitate to take action against firms where necessary.

Findings

9. Our project population was selected to be a representative sample of the mortgage lending market. The firms we visited accounted for 56% of the mortgage market in 2010.
10. During our review we identified examples of good management of mortgage fraud risks, but also identified weaknesses common to many firms. The main findings follow.

1.1.1. Governance, culture and information sharing

11. We found examples of robust governance and management information at some firms and we generally believe the industry now devotes greater attention to the risks of mortgage fraud than it has done in the past. However, some lenders failed to define what constitutes mortgage fraud, and produced inadequate management information, which led to the apparent disengagement of senior management. Firms, and their senior management, should consider how management information can be improved and used more effectively to mitigate the risk of mortgage fraud.

1.1.2. Applications, processing and underwriting

12. Some underwriters demonstrated a sound understanding of mortgage fraud risks, and many lenders identified the 'flags' that indicated an application was higher risk. In addition, some lenders' mortgage processing teams contacted customers to discuss their application, even when intermediaries submitted the business. This appeared to be an effective deterrent to fraudsters.
13. However, we were concerned that underwriting staff appeared stretched in some firms. Service standards often demanded that applications were reviewed quickly by junior staff who appeared to lack the experience and ability to identify mortgage fraud risk. In addition, we found that, although smaller firms

moving into niche business (eg buy-to-let or subprime) were currently able to apply rigorous underwriting scrutiny to mortgage applications, there were some questions over the sustainability of this scrutiny were business volumes to increase. Such firms should therefore consider how they would continue to mitigate adequately the mortgage fraud risk associated with niche mortgage products in a high volume environment.

14. We also continue to be concerned that ‘fast track’ loans allow anti-fraud checks to be bypassed. Firms should consider what measures can be taken to lessen the likelihood that these products are abused. More generally, we are considering the risks associated with fast track loans as part of the Mortgage Market Review.²

1.1.3. Managing relationships with third parties

15. Many lenders identified third parties such as solicitors, brokers and valuers as the main source of mortgage fraud risk. In the past few years, there have been substantial improvements in lenders’ oversight of some relationships, particularly those with solicitors. However, there is scope for significant improvement in how lenders manage relationships with brokers. We were very concerned that some lenders relied solely on a mortgage broker’s entry in the FSA Register to vet them. Checking the FSA Register can be the first step of a due diligence process but it cannot be regarded as sufficient to provide complete assurance. Recent FSA enforcement action has shown very clearly that even FSA approved brokers do not always act with integrity or take steps to mitigate mortgage fraud risk. Lenders must take steps to satisfy themselves of a broker’s suitability on an ongoing basis.

1.1.4. Compliance and internal audit

16. We were concerned to find that very few lenders’ internal audit and compliance teams regularly monitored the adequacy of underlying customer take-on arrangements, the application process or third party relationships.

1.1.5. Staff training and awareness

17. We were concerned to find that only a few lenders specifically focused on mortgage fraud in their staff training programmes; instead we found financial crime training tended to discuss fraud in more general terms. In addition, there was often no detailed training for staff who played a key role in fighting mortgage fraud.

² See www.fsa.gov.uk/pubs/cp/cp10_16.pdf and www.fsa.gov.uk/pubs/discussion/dp09_03.pdf

1.1.6. Mortgage fraud prevention, investigations and recoveries

18. Most firms were able to undertake fraud investigations. However, we were concerned that anti-fraud teams often appeared stretched, and sometimes appeared to lack the training or experience necessary to allow investigations to be performed to a satisfactory standard. In addition, some small firms did not consider fraud prevention during their product development process, although most large firms did.
19. Most lenders had policies to encourage potentially fraudulent activity to be reported to fraud teams; however, many firms' procedures were unclear about how and in what circumstances reports should be made. We also found that a number of firms, including some larger lenders, were not fully engaged with the IFL scheme, undermining the efforts of the sector as a whole to reduce mortgage fraud.
20. We were also concerned to find that many firms in our sample had not reviewed their back book of mortgage business and were therefore unaware of the nature and scale of the risk of mortgage fraud and potential losses they might face.

1.1.7. Remuneration structures

21. We judged that most firms' remuneration structures generally did not encourage staff to disregard fraud risks to achieve sales. However, at some firms the element of remuneration composed of sales commission appeared excessive.
22. We were disappointed that few lenders measured or rewarded staff members' efforts to prevent mortgage fraud and we found only one example of a firm clawing back commission from staff who wrote business that was later found to be fraudulent.

1.2. Conclusions

23. Last year's National Fraud Authority report, *Working together to stop mortgage fraud* suggested lenders had some way to go to contain the threat of mortgage fraud. Our review found the industry has made progress in getting to grips with this problem over recent years. Defences are now stronger, and the value of cross-industry cooperation is better recognised. However, we continue to believe many in the industry could do better still, and we hope this document will challenge firms to further strengthen their efforts to combat mortgage fraud.

2. Introduction

2.1. Objectives

24. This project aimed to assess the adequacy of lenders' systems and controls to detect and prevent mortgage fraud.
25. One objective given to the FSA by Parliament is to reduce the possibility regulated firms are used for a purpose connected with financial crime, which of course includes mortgage fraud.³ This thematic review seeks to further our pursuit of this objective. Mortgage fraud can damage lenders' prudential health, so reducing its incidence will also promote the achievement of our objectives to enhance the stability of, and maintain confidence in, the UK's financial system.

2.2. Background

26. In the years leading up to 2007, a buoyant and confident mortgage market saw lenders offer consumers a range of mortgages. It is now clear a number of mortgages obtained during this period were secured under false pretences. Some lenders suffered substantial losses as a result, with Bradford and Bingley and the Chelsea Building Society two prominent victims.
27. Mortgage fraud has remained a resilient phenomenon despite the falls in lending following the financial crisis. A 2009 scheme allowing lenders to check prospective borrowers' income details against data held by HM Revenue & Customs was able to stop £111 million of suspect lending, and the National Fraud Authority recently estimated mortgage fraud losses to be in the region of £1 billion.⁴ These are not trivial sums.
28. The FSA's *Business Plan* for 2010, published in March 2010⁵, set out our intention to review lenders' systems and controls to counter mortgage fraud. This initiative is part of a wider mortgage fraud strategy. Since 2007 we have taken steps to make life harder for mortgage fraudsters and also to encourage lenders to improve their defences. Alongside our ongoing supervision of firms' anti-fraud systems and controls, we have encouraged cross-sector collaboration, and increased the flow of intelligence through our 'Information from Lenders' scheme. Investigations into misconduct by mortgage brokers have led us to prohibit more than 100 individuals from working in the industry, and to impose more than £2 million in fines since the beginning of 2009.

3 The Financial Services and Markets Act 2000 (FSMA) defines financial crime 'to include any offence involving (a) fraud or dishonesty; (b) misconduct in, or misuse of information relating to, a financial market; or (c) handling the proceeds of crime'.

4 See: www.attorneygeneral.gov.uk/nfa/WhatAreWeSaying/Documents/AFI%202011%20Breakdown%20A3%20Sheet.pdf

5 See: www.fsa.gov.uk/pubs/plan/pb2010_11.pdf

29. This is our first thematic review to focus on lenders' systems and controls to counter mortgage fraud. In 2004 we did, however, carry out a review of lending controls over self-certification mortgages.⁶

2.2.1. Types of mortgage fraud

30. The British Bankers' Association and the Council of Mortgage Lenders define two categories of mortgage fraud in their 2008 joint best practice note⁷:

- Mortgage fraud for property – this is usually committed by an individual to obtain a mortgage on a property they would not otherwise be able to purchase through, for example, exaggerating their income, or providing false employment details.
- Mortgage fraud for profit – this is usually perpetrated by a 'fraud ring' involving more than one individual. It can have links to serious organised crime.

31. Mortgage applicants can mislead lenders about their income and its source in a number of ways:

- inflating their income;
- stating they are self-employed when they are not;
- not declaring where income was a bonus or overtime payment; and
- failing to declare poor health or impending redundancy.

32. They may also provide misleading documentary evidence:

- using false identity documents (e.g. driving licence, passport, bank statements, utility bills);
- providing false pay slips; and
- producing false employment references or false employer addresses.

33. There are additional risks when mortgages are sold through brokers. For example, there may be confusion as to whether the broker or lender is responsible for verifying whether borrowers' declarations are true. Brokers may also be complicit in criminal activity: the chart below illustrates some examples drawn from our Enforcement actions against mortgage brokers. Many of these can be mitigated by due diligence checks on third parties, which is a focus of this review (see Section 3.4).

⁶ www.fsa.gov.uk/Pages/Library/Communication/PR/2004/012.shtml

⁷ Access to this joint best practice note can be obtained via the CML website, cml.org.uk

| Fraud involving brokers... | ...and how lenders can contain it |
|---|---|
| A broker diverts mortgage proceeds to their own account. | Third-party take-on and vetting. |
| A broker colludes with a solicitor and valuer to provide false valuations, secure loans against non-existent property, conceal sale and rent back, or secure buy-to-let applications for residential mortgages. | Third-party take-on and ongoing vetting aligned with applications and underwriting processes. |
| A broker makes misleading declarations about the source of deposits, or fails to disclose gifted deposits. | Applications and underwriting processes. |
| A broker uses its FSA authorisation to develop its own property portfolio. | Third-party take-on and vetting. |
| A broker uses migrants' details. | Third-party take-on and vetting. |
| A broker works for a criminal gang. | Third-party take-on and vetting. |
| A broker colludes with an insider at the lender. | Third-party take-on and vetting, aligned with lenders' staff recruitment and vetting processes. |

2.3. Method

34. Our fieldwork took place between April 2010 and February 2011. We conducted intrusive visits to 20 banks and building societies, and consulted various stakeholders including the Council of Mortgage Lenders, the British Bankers' Association, the Building Societies Association, the Law Society of England and Wales, the City of London Police, CIFAS, and the National Fraud Authority. We also discussed lenders' mortgage fraud standards with forensic accountants and consultants who provide services to the industry.

Extracts from discussions with stakeholders

“Smaller lenders found fraud prevention more labour intensive – but this worked to their advantage and their losses tended to be lower”

“Small lenders still had a lot of human contact from application to underwriting. They do not have the level of sales to justify the regular use of CIFAS, National Hunter, etc where costs are volume driven”

“One of the major problems is the speed at which lenders are attempting to complete mortgage applications. Staff working in the application processing departments are required to complete a number of applications each day and their annual pay award is, in part, based on their performance in this area”

“Fraud is only understood by those working in the fraud world. Other departments within lenders have limited understanding of fraud and therefore it is sometimes disregarded”

35. The 20 lenders were chosen as a representative, structured sample of the industry in terms of size, complexity and volume of business. Product sales data provided to us by lenders showed five of our 20 firms consistently featured among the top ten of lenders in 2010, measured by the total amount lent. Taken together, the 20 firms accounted for 56% of lending.
36. Before our visits, each firm was asked to provide information, including:
 - a) mortgage lending policies; b) anti-mortgage fraud systems and controls;
 - c) customer application procedures; d) third-party vetting procedures;
 - e) organisation charts; f) relevant extracts from financial crime risk assessments covering mortgage fraud; g) committee structures relevant to mortgage fraud;
 - h) mortgage fraud investigation procedures; i) relevant internal audit or compliance reports for the past two years; and j) staff recruitment and training processes. In addition, we requested 2009 data relating to mortgage sales, including gross lending figures, arrears rates, fraud losses and fraud provisioning, broken down by delivery channel.
37. During the visits, we interviewed staff in management and operational roles in each firm. This usually included staff responsible for:
 - a) countering financial crime and mortgage fraud; b) fraud investigations; c) mortgage processing and underwriting; d) fraud recoveries; e) controls over brokers, solicitors and valuers;
 - f) human resources and training; g) compliance; and h) internal audit.
38. We also reviewed samples of customer mortgage files to assess the quality and completeness of customer due diligence carried out during the mortgage approval process.
39. We assessed the following matters in relation to mortgage fraud:
 - governance, culture and information sharing (section 3.1);
 - applications processing and underwriting (section 3.2);
 - mortgage fraud prevention, investigations, and recoveries (section 3.3.);
 - managing relationships with solicitors, brokers and valuers (section 3.4);
 - compliance and internal audit (section 3.5);
 - staff recruitment, and vetting (section 3.6);
 - remuneration structures (section 3.7); and
 - staff training and awareness (section 3.8).

40. We recognise that firms will choose to focus their anti-mortgage fraud work where it will have the greatest effect, and that strong defences in one stage of the mortgage process may lessen the need for deploying resources elsewhere. But firms should seek to ensure this is the result of a considered effort to identify where resources can be used to best effect.
41. We should like to thank the firms that participated in the review for their cooperation before and during our visits. We are also grateful to the stakeholders we spoke to for their advice and assistance.

2.4. Firms' regulatory responsibilities related to mortgage fraud

42. The FSA's Principles for Businesses require that "a firm must conduct its business with due skill, care and diligence" (Principle 2), "a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems" (Principle 3), and "a firm must deal with its regulators in an open and cooperative way, and must tell the FSA promptly anything relating to the firm of which the FSA would reasonably expect prompt notice" (Principle 11).
43. The Systems and Controls chapter of the FSA's Handbook or Rules and Guidance requires firms to "establish and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives (or where applicable, tied agents) with its obligations under the regulatory system and for countering the risk that the firm might be used to further financial crime."
44. Firms are also obliged to notify the FSA of significant fraud, errors and other irregularities under the supervision manual of the FSA's Handbook.⁸
45. Some measures taken by lenders, for example to verify the identity of their customers, are also necessary to meet their obligations under the Money Laundering Regulations 2007.

8 See SUP 15.3.17R

3. Findings

3.1. Governance, culture and information sharing

46. Senior management have a key role in countering mortgage fraud; setting the tone, assessing the risks, and deciding how resources can be applied to counter those dangers. Good governance can ensure the different elements of a firm's anti-fraud defences, discussed later in this report, are coordinated and aligned.
47. We assessed the adequacy of: a) governance structures; b) management information; c) senior management engagement (including the Board and relevant committees; and d) policies and procedures related to mortgage fraud. We also formed a view on the extent to which an anti-fraud culture was embedded in the firms we visited.
48. We found examples of robust governance across the sector; effectiveness of governance arrangements was not necessarily dependent upon the size of the lender or on the resources the firm devoted to the issue. In most firms we visited, the lessons learnt from the financial crisis, and the large losses incurred by some lenders, had led to a reappraisal of the appropriateness of anti-mortgage fraud systems and controls, and of their anti-fraud culture.
49. We did, however, identify weaknesses at some lenders. Some should engage more fully with cross-industry information sharing efforts, while others should consider how internal data about mortgage fraud can be improved.
50. We are concerned that engagement with industry-wide initiatives to counter mortgage fraud is inconsistent between lenders. Many firms highlighted the importance of information sharing to combat mortgage fraud; various initiatives exist including HM Revenue & Customs' income verification scheme (HMRC scheme) and the FSA's Information From Lenders (IFL) scheme.
51. The HMRC scheme allows information submitted by borrowers to be compared with that submitted for tax purposes. A pilot scheme allowed the participating lenders to identify significant volumes of mortgage fraud. We welcome HMRC's work with lenders to counter mortgage fraud.
52. Our IFL project was launched in April 2006 with the backing of the Council of Mortgage Lenders (CML). IFL gives lenders a means of telling us about intermediaries they suspect are involved in mortgage fraud.⁹ It was re-launched in 2008. In an open letter to the CML¹⁰, the FSA explained that we saw engagement with the IFL project as "one yardstick by which to judge a lender's 'state of

⁹ www.fsa.gov.uk/pages/doing/regulated/supervise/mortgage_fraud.shtml

¹⁰ www.fsa.gov.uk/pubs/other/MF_letter_CML.pdf

readiness' to confront mortgage fraud". Since its launch in April 2006, the IFL scheme has received 1,089 notifications, with 373 submitted during 2010.

Senior management at a large lender regarded the IFL initiative as an effective medium for assisting the market in identifying and preventing mortgage fraud. They felt participation should be compulsory, and that a similar compulsory scheme should be in place to oblige lenders to report concerns about solicitors.

One small lender had never submitted any IFL reports to the FSA but said it was something they would look into in the future.

The MLRO of a small lender had seen cases where he believed a broker had been negligent or naïve, but not necessarily complicit in crime, and was unsure whether to report this to the IFL.

53. We are concerned that a number of firms, including some larger lenders, are not fully engaged with the IFL and have made few referrals. We believe some firms' failure to participate in collaborative action undermines the efforts of the sector as a whole. Several lenders suggested the IFL scheme should be made compulsory; this stance is supported by the Council of Mortgage Lenders (CML).

In a large lender, the fraud strategy (with specific strategies for mortgage fraud) was owned by the business as a whole, with the financial crime team providing expert support. Bids for work to mitigate fraud risks were compiled each year from across the business and the financial crime team gave guidance on these bids so that fraud was dealt with in a holistic manner. The firm believed the product knowledge of operational staff could be harnessed to understand how fraudsters might attempt to abuse the firm's services.

In a small lender, the CEO had wide industry experience and direct experience of dealing with mortgage fraud issues at the firm. The Non-Executive Directors also played an active part in managing these risks within the firm. The CEO sought actively to promote an anti-fraud culture and motivated staff to tackle these risks.

54. Several large lenders embed responsibility for countering mortgage fraud in 'front-line' customer-facing teams. A central team supports this work by, for example, preparing policies, monitoring mortgage fraud trends and disseminating good practice. We agree this devolved approach can be effective, as long as there is strong management oversight.
55. Good management information (MI) allows senior management to understand and counter the risk of mortgage fraud. Its accuracy may be compromised by, for example, staff identifying fraud but not reporting it because the lender's definition of fraud lacks clarity, or fraud losses are misclassified (perhaps as credit losses).

56. A significant minority of lenders produced limited or insufficient management information on mortgage fraud. In several firms, senior management were unclear about the data that would help oversight of mortgage fraud work. One small lender produced no MI related to fraud, and we were not convinced the general mortgage data allowed fraud trends to be discerned. Some firms had a general definition of fraud in their procedures, but not a specific definition of mortgage fraud. We are concerned this would compromise their ability to gather data about mortgage fraud trends and hence to understand the risks.

At one large lender the director of financial crime reviewed 'fraud loss' data every day. This was disseminated to his team so trend analysis could allow threats to be pre-empted.

One firm's collection team identified that a property valued at £3 million was worth £800,000. The firm had recorded a loss of £2.2 million. This loss had not been included in the fraud cases data because the firm did not have a working definition for mortgage fraud.

One small lender could not identify whether individual brokers, solicitors or valuers were connected with multiple mortgage applications, making it difficult to identify collusion.

Various lenders apportioned losses related to fraud to the budget of the department deemed most responsible for the loss occurring. They considered this a good way to encourage effective fraud controls throughout the business.

At a medium-sized lender, senior management said they suffered a 'low or zero' level of mortgage fraud. We were concerned the firm had no definition of mortgage fraud and no process for staff to refer suspected fraud to a central point.

At a medium-sized lender, we detected reluctance among staff to raise issues or concerns. There was a general lack of flexible thinking when it came to identifying opportunities to mitigate mortgage fraud. The firm had never modelled a stress scenario on mortgage fraud or gauged its impact on the firm.

One large lender had not defined mortgage fraud in their policies and procedures, but did have a definition in their training materials.

57. Some lenders had recently merged with other firms, which complicated the compilation of consistent management information. For example, multiple 'legacy' IT systems produced incompatible data, which prevented the easy preparation of aggregated information.

At a small lender, although MI was voluminous, it was not properly analysed; the firm demonstrated a limited ability to identify trends.

At a large lender the identification of concentration risk was a resource-intensive manual process which did not allow the prompt identification of potential fraud ‘hotspots’ such as in particular postcode areas.

3.1.1. Governance, culture and information sharing – examples of good and poor practice

Good practice

- A firm’s efforts to counter mortgage fraud are coordinated, and based on consideration of where anti-fraud resources can be allocated to best effect.
- Senior management engage with mortgage fraud risks and receive sufficient management information about incidents and trends.
- A firm engages in cross-industry efforts to exchange information about fraud risks.
- A firm engages front-line business areas in anti-mortgage fraud initiatives.

Poor practice

- A firm fails to engage with the FSA’s Information From Lenders project.
- A firm fails to define mortgage fraud clearly, undermining efforts to compile statistics related to mortgage fraud trends.
- A firm does not allocate responsibility for countering mortgage fraud clearly within the management hierarchy.

3.2. Applications processing and underwriting

58. The mortgage underwriting process is often the first opportunity a lender has to identify where applications are based on misleading information, particularly if applications arrive from a third party. Firms often rely on the underwriting process to identify high-risk applications for referral to financial crime teams for investigation.
59. A firm’s lending policy should set the context for all underwriting decisions. While many firms will make some loans outside the policy, these should be subject to oversight and controls. Should those controls be insufficient, so that the firm routinely agrees loans outside the lending criteria, there is potential for criminals to identify and exploit those weaknesses.

A small lender revised the lending policy twice a year and published it on the intranet, alongside the procedures manual. Each product offered by the lender had set parameters (e.g. for a maximum income multiplier and loan-to-value ratio); breaches of these parameters were flagged by the processing system.

In a large lender, the lending policy was a reference point for underwriters, who were free to exceed thresholds providing they attached sufficient justification to their approval.

60. Individual lenders will decide what balance is appropriate between automated and manual underwriting. Automated processing was particularly common to larger lenders; systems often had fraud identification systems built in, with higher risk applications referred to underwriters or anti-fraud staff for their review. Many smaller firms relied on manual underwriting.

A small lender believed a manual mortgage application process was the best defence against fraud.

A small lender's underwriting process was entirely manual, with a pool of highly experienced underwriters. Applications appeared to be checked thoroughly, and concerns were flagged and escalated promptly.

Manual underwriting systems were working effectively for some small lenders, although one lender undertook an internal review that found a high rate of human error.

61. Several firms used inexperienced underwriters or sales staff, for example, to gather evidence of an applicant's income. This may introduce conflicts of interest, particularly where staff are strongly incentivised to make sales. Firms should consider measures to manage these risks.

In one large lender, the branch sales team were responsible for verifying whether bank statements and payslips were genuine.

One large firm subjected large losses to a monthly review by senior management. Feedback was given to the underwriters involved in each 'large loss'.

62. We were concerned that underwriting staff appeared stretched in some firms. This was not solely a matter of resourcing. Demanding service-level standards, designed to ensure customers received timely responses, might also compromise underwriters' ability to identify suspicious applications. A future upturn in lending could aggravate these weaknesses. We were not convinced that some firms would be able to expand their underwriting teams' anti-fraud capabilities in response to a growth in lending.

A small lender was manually underwriting each introduced loan. We were not convinced the firm would be able to maintain this approach if lending volumes were to increase.

In a small lender the underwriting team had five working days to complete their checks and occasionally took longer if the cases were more complicated. They felt no pressure to ‘rush through’ an application.

A large lender had only three experienced underwriters, plus two team managers; the remainder of the underwriting team mainly consisted of information checkers. When we interviewed underwriting staff we noted that the senior underwriter showed expertise and a focus on risk and fraud underwriting. However, the more junior underwriters’ approach appeared more focused on adherence to narrow processes.

A medium-sized lender set targets for processing staff which were affected by the number of errors. Frauds discovered subsequently were fed back to the team; if the fraud related to an error made at the processing stage, these would adversely affect team scores.

In a large firm, assistant underwriters were expected to process an average of eight applications per day. This was based on an expectation of spending 45 minutes on each application.

63. Some firms failed to consider emerging mortgage fraud risks arising from changes in their lending policy (e.g. moving into higher risk lending such as bridging, packaged cases, and subprime). We expect firms to consider mortgage fraud risks when designing new lending products and factor any additional risks into the decision-making process. This is discussed further in Section 3.3.

One small lender intended to strengthen their underwriting team and mortgage controls before offering higher-risk lending such as bridging loans and subprime products; their plans to do this were at an early stage.

64. A number of firms discouraged underwriters from liaising with brokers, customers or other parties connected to the mortgage application, thus limiting their ability to scrutinise and verify information. Other lenders allowed underwriters to initiate these contacts, and felt this was a valuable deterrent to fraudsters. Telephone conversations with customers were often effective at revealing inflated incomes, for example, as well as ensuring the customer was aware of all the details in the application.
65. However, lenders should also be alert to the risk of brokers putting pressure on underwriters – for example, where there is a process requiring underwriters to contact brokers to explain declined cases. In these circumstances underwriters may approve borderline decisions when this is not appropriate.

A small firm encouraged sales staff to speak to applicants about any missing or incomplete documents even where they came through an intermediary. The firm would be concerned if an intermediary did not allow access to their customers.

In a small lender, customers received a customer care call after the offer but before completion. This served two purposes: to ensure the customer had received a good level of service and to check that there were no irregularities in the application.

In a large firm, underwriters were discouraged from contacting customers or valuers.

66. We noted marked differences in underwriters' understanding of fraud risks. We saw encouraging examples of underwriters engaging with mortgage fraud prevention, regularly referring financial crime issues to their financial crime team, who in turn cascaded examples of suspicious lending patterns and emerging mortgage fraud types. In other firms, however, common fraud risk flags (for example, many applicants claiming to earn £100,000 or to work in preferred occupations, properties being long distances from the applicant's workplace etc.), were often not identified by underwriters, despite internal procedures relying on them doing so.

One medium-sized firm flagged features that required applications to be referred to the financial crime team. For example, incomes which seemed particularly high given the applicant's age, long distances between the buyer's current address and their new property, high-risk postcodes, and new developments known to be of concern.

Another medium-sized firm identified disguised buy-to-lets as a significant fraud risk. To tackle this, the firm required borrowers to confirm in writing they would live at the address and to give consent for the lender to conduct a credit check three months after completion. The firm commented this initiative had resulted in most suspicious customers not proceeding with their application. It had also led them to seek similar assurances from buy-to-let borrowers that the property would be let to tenants.

67. Some lenders 'fast track' cases with low loan-to-value ratios for borrowers with good credit scores. We were concerned where this allows applications to bypass checks on, for example, income declarations. There is also a risk that brokers will learn different lenders' internal fast track thresholds and exploit this to submit fraudulent business that escapes internal scrutiny.

A large lender sampled 5% of 'fast track' policies. This was done at the point of application, so the broker knew instantly whether the case required income verification. However, the broker was then able to withdraw the application. We were concerned that the remaining 95% of cases were not subject to any income verification.

68. However, we did see a number of lenders where income was always verified and affordability was assessed using a comprehensive budget sheet including average costs for household bills, travel, clothes and food.

In a medium-sized lender, the underwriters reviewed the customer's finances and looked against the possible worst case scenarios that the customers could face (e.g. payments relating to unsecured debt, childcare and commuting costs) and checked whether the mortgage would remain affordable. They used an 'outgoings form' to review whether the customer had declared all their debts against those revealed during the credit check. The highest debt amount would always be used.

69. Lenders who 'fast track' mortgage applications should ensure that appropriate anti-mortgage fraud defences are in place.

3.2.1. Applications, processing and underwriting – examples of good and poor practice

Good practice

- A firm's underwriting process can identify applications that may, based on a thorough assessment of risk flags relevant to the firm, present a higher risk of mortgage fraud.
- Underwriters can contact all parties to the application process (customers, brokers, valuers, etc) to clarify aspects of the application.
- The firm verifies that deposit monies for a mortgage transaction are from a legitimate source.
- New or inexperienced underwriters receive training about mortgage fraud risks, potential risk indicators, and the firm's approach to tackling the issue.

Poor practice

- A firm's underwriters have a poor understanding of potential fraud indicators, whether through inexperience or poor training.
- Underwriters' demanding work targets undermine efforts to contain mortgage fraud.
- Communication between the fraud team and mortgage processing staff is weak.
- A firm relying on manual underwriting has no checklists to ensure the application process is complete.
- A firm requires underwriters to justify all declined applications to brokers.

3.3. Mortgage fraud prevention, investigations, and recoveries

70. Lenders should maintain systems and controls dedicated to the detection and prevention of mortgage fraud. This should include procedures to consider fraud risks presented by new products, to identify where borrowers (both new and existing) misrepresent their circumstances, to investigate fraud cases, and to recover losses from fraudsters. We assessed the adequacy and effectiveness of these controls.
71. Fraud risks should be identified when mortgage products are developed, particularly when the firm engages in a new field such as subprime or buy-to-let lending. We saw evidence of this happening in large lenders, but evidence was more variable among smaller firms.

In one small lender there was a formal process to take financial crime considerations into account at mortgage product development stage.

At another small lender there was no financial crime input to the new mortgage product development process.

72. We observed that many lenders had invested in one or more commercially available fraud prevention systems and used them to identify discrepancies in customer application data. At least one small lender, however, decided that the cost of such services was too great to justify their use, given the small size of their business.

The fraud investigations manager at a large lender informed us that the team used CIFAS and Hunter as search tools and also loaded cases onto these systems if they suspected fraudulent activity. They also had an internal intelligence spreadsheet where relevant information from CML meetings was stored.

One lender's fraud team suggested common flags for organised fraud included multiple applicants claiming to earn an identical high salary or to work in the same preferred occupation, as well as properties being long distances from the applicant's workplace.

73. Most lenders had policies to encourage internal reporting of potentially fraudulent activity. We were concerned, however, that many firms' procedures were unclear about how reports should be made. It was rare for the criteria for formally investigating a mortgage fraud case to be clearly articulated in firms' procedures.

A small lender stated that they would investigate a suspect mortgage where payments had been missed (one missed payment would be enough to prompt an investigation) or in the event that post or correspondence was returned.

Another small lender had comprehensive procedures in place setting out how to carry out an investigation but these failed to indicate when a fraud investigation should begin.

In two firms we found that the procedures in place were vague about the likely circumstances in which staff were expected to make an internal suspicious activity referral.

A large lender encouraged suspected frauds to be reported via telephone, email or internal correspondence. But there were no formalised or standard processes for reporting or methods to encourage and maintain good practice.

74. Most large lenders had specialist anti-fraud teams that investigated reports of mortgage fraud. At smaller lenders, responsibility was often given to ad hoc teams drawn from across the firm, including from compliance, risk management, internal audit, and specific business areas. We were concerned that anti-fraud teams often appeared stretched, and sometimes appeared to lack the training or experience necessary to allow investigations to be performed to a satisfactory standard. It is important that firms maintain an appropriate level of resource in anti-fraud teams, and give consideration to what training is appropriate.

The teams of underwriters and investigators at a large lender were stretched and had no capacity to deal with an increase in applications or investigation referrals.

In two firms, investigatory staff lacked experience or appropriate training.

In a medium-sized lender, the investigation team lacked the tools or expertise to investigate suspected fraud rings.

75. While the majority of firms had systems in place to track and manage mortgage arrears, few lenders were exploring ways to link mortgage fraud considerations into their arrears management practices. We were also concerned that many lenders had not assessed the fraud risks posed by existing mortgages through a 'back-book' review. Some lenders may therefore be unaware of the full extent of their exposure to mortgage fraud and it is likely that there are cases of mortgage fraud that have yet to be identified and accounted for.

A large lender noted that they had looked at retrospective lending, which included back-book investigations, where third parties had been identified as a problem, or selectively by product type on the back of an exposure assessment. The same lender commented that this was largely a manual process and they were considering ways to improve their approach.

Another large lender explained that they had not carried out a back-book review for mortgage fraud losses but that they would discuss any loss over £1 million. Normally, if a large mortgage was in arrears by more than 15 days they would have a fraud discussion, but the lender said this was not a formal process.

One lender carried out a comprehensive back-book review that considered all suspected fraud and arrears cases and resulted in the firm conducting extensive investigations. On one occasion the firm was heavily involved in identifying an organised fraud ring.

A small lender commented that a back-book review was not a pressing concern for them, given the low number of mortgages on their book.

A small lender said they checked which brokers were involved after any borrowers fell into early arrears.

Another small lender had no formal process for dealing with mortgage arrears.

3.3.1. Mortgage fraud prevention, investigations, and recoveries: examples of good and poor practice

Good practice

- A firm routinely assesses fraud risks during the development of new mortgage products, with particular focus on fraud when it enters new areas of the mortgage market (such as subprime or buy-to-let).
- A firm reviews existing mortgage books to identify fraud indicators.
- Applications that are declined for fraudulent reasons result in a review of pipeline and back book cases where associated fraudulent parties are identified.
- A firm has planned how counter-fraud resources could be increased in response to future growth in lending volumes, including consideration of the implications for training, recruitment and information technology.
- A firm documents the criteria for initiating a fraud investigation.
- Seeking consent from the Serious Organised Crime Agency (SOCA) to accept mortgage payments wherever fraud is identified.

Poor practice

- A firm's anti-fraud efforts are uncoordinated and under-resourced.
- Fraud investigators lack relevant experience or knowledge of mortgage fraud issues, and have received insufficient training.
- A firm's internal escalation procedures are unclear and leave staff confused about when and how to report their concerns about mortgage fraud.

3.4. Managing relationships with solicitors, brokers and valuers

76. Cases of collusion between criminals and rogue professionals (such as solicitors, conveyancers, mortgage brokers and valuers) to commit organised mortgage fraud led to losses for a number of lenders. We looked at firms' systems and controls to approve and manage relationships with these third parties, focusing on the vetting of new providers and arrangements for managing panels.
77. We found a range of different practices. Some smaller firms operating in one region chose to work with a small number of local providers with whom they were able to maintain close relationships. In contrast, many firms, particularly larger national lenders, managed third-party relationships using a panel of approved providers. Panel sizes depended on a range of factors, including lending volumes, the geographical area covered by the firm, and the type of lending undertaken by the firm. For example, some firms used third parties specialising in niche lending such as self-build or non-standard construction.
78. Management of large panels was sometimes outsourced to a panel manager who monitored providers' adherence to quality and compliance standards on behalf of the lender. The effectiveness of such arrangements should be subject to close scrutiny by the lender.

3.4.1. Solicitors

79. Many lenders identified solicitors as their largest single source of mortgage fraud risk.

One large lender considered solicitor fraud to be their greatest area of concern with approximately 50% of their mortgage fraud losses attributed to the actions of solicitors.

Some fraud involving solicitors occurs when the loan completes. Fraudsters can abscond with funds, dispersing them through the banking system to multiple client accounts or directing funds to accounts not directly associated with their firm. We consider it good practice for lenders to verify that funds are being dispersed in line with instructions held, particularly where changes to the Certificate of Title occur just before completion.

80. Many firms were reviewing the process for accepting conveyancers and solicitors on to their panels. They had enhanced the due diligence checks performed on prospective and existing panel members, and strengthened the terms and conditions of acceptance.

Lenders should be alert to the risks of ‘firm takeover’. This can occur, for example, where partners have retired and fraudsters buy into the business and are able to operate a seemingly legitimate firm. So it is good practice for lenders to have processes for monitoring the activities of firms not only at take-on but also while on panel.

81. In many firms, relationships with solicitors were managed by the in-house legal team, who may not work closely with the fraud function. We consider it good practice for firms to centralise responsibility for overseeing all third-party relationships.

Relationship management of the third-party panels in a medium-sized lender was fragmented. Although the chief surveyor managed the valuer panel, and brokers were overseen by divisional sales managers, there was no one assigned to control the solicitor panel.

82. Due diligence checks might include a documentation request (such as a letter on the solicitors’ headed paper or a practising certificate for one of the partners, and evidence that the solicitor holds valid professional indemnity insurance cover), supplemented by open source internet searches against the firm and its staff, including adverse information published by the Solicitors Regulation Authority or the Law Society. One firm was exploring the possibility of credit-checking solicitors. Checks were often performed regularly to identify issues of concern and remove dormant practices from their panels.

In a small lender, solicitors were required to sign the lender’s terms and conditions and provide information on their size, solvency, areas of expertise, management structure and business continuity plan, together with an explanation of why they should be accepted on to the panel. Quarterly meetings were held with solicitors to assess their performance.

A large lender had recently ‘cleaned up’ its solicitor panel and removed practices with low volumes and those that were classified as dormant. Others, including non-respondents, would have to re-register and submit their PI insurance certificate if they wished to remain on the panel. Criminal record checks were also being carried out.

In another large firm, when appointing a new solicitor panel member, a ‘Google’ search was carried out, the solicitor was telephoned and a senior partner spoken to in order to confirm that the solicitor’s practice was genuine. Contact numbers were independently verified as a further check.

83. Firms also monitored the quality of lending associated with each solicitor, seeking to identify where arrears levels or fraud trends might suggest a solicitor was complicit in malpractice.

84. Some lenders had decided to deal only with solicitor practices with more than two partners. In part, this reflected the difficulty of claiming for fraud losses against professional indemnity policies taken out by small solicitors' practices. Other lenders, however, were concerned that this had an adverse effect on customer choice.

One medium-sized lender did not know how many solicitor firms it had on its panel.

In a small lender, solicitors had to complete a new questionnaire if they had not acted for the firm in the past year. The firm maintained a list of solicitors with which they would not do business.

As part of their third-party controls, one small lender accepted only solicitor firms with at least two partners who had practised for a minimum of two years. All solicitor firms had to complete an application pack and provide evidence of adequate professional indemnity cover.

85. Many firms identified the time taken for solicitors to register charges over property with the Land Registry as a key mortgage fraud indicator. A delay or failure to register charges can indicate a) a fraudulent transaction taking place without the true owner's knowledge, or b) an effort to disguise back-to-back sales associated with some types of mortgage fraud. Early detection of this activity can help lenders identify customers and third parties involved in crime. We consider it good practice for firms to monitor the registration of charges and consider chasing solicitors where there are delays.

A large lender expected charges over property to be registered within six weeks. If this was not possible, the solicitor was asked to explain the position. Solicitors would be removed from the panel if the response was unsatisfactory. This initiative led to 98% of registrations being completed within six weeks.

A medium-sized lender removed 80 solicitors from its panel; eleven were dropped because of concerns over fraud or dishonesty.

3.4.2. Brokers

86. Rogue brokers can present risks to lenders. Some of the FSA's recent Enforcement actions against brokers were triggered by intelligence that brokers were involved in organised criminal mortgage fraud rings. In our Enforcement actions we also saw examples of brokers encouraging mortgage applicants to exaggerate their earnings to gain larger mortgage advances.

One medium-sized lender does not sell subprime or self-certified mortgages through brokers, and limits loan-to-value ratios to 80% for such sales.

87. Lenders used different approaches to vet brokers applying to join their panels, ranging from a simple check that the broker appeared on the FSA Register, to enhanced due diligence on individual brokers and networks. We do not regard it as adequate for a firm to rely solely on the FSA Register to vet mortgage brokers. The FSA Register entry alone does not contain enough data to allow such judgements. For example, details of any ongoing FSA investigations into a broker's conduct will show only once formal disciplinary action is taken. Lenders should perform supplementary checks such as open source Internet searches, and face-to-face meetings with brokers.

A small lender met new brokers face-to-face, performed an electronic credit check, and checked internal records to identify any previous dealings with that broker.

In another small firm, the compliance team did not monitor intermediaries and did not propose to do so; they kept no lists of prohibited brokers and relied solely on the FSA Register to satisfy themselves of a broker's status.

88. Some firms were reviewing the brokers on their panels. They were evaluating existing broker relationships and removing from their panel dormant brokers, or those submitting sub-standard applications. We regard it as poor practice for a firm to fail to keep their panel membership under review.

A medium-sized lender had reduced their introducers' panel by more than half, and split the remainder into primary and secondary panels relating to the amount and quality of business introduced by brokers. Arrears rates could damage a broker's quality score.

The panel of mortgage intermediaries in one small firm included some inactive brokers that nonetheless remained 'live' on the firm's panel management system.

89. Some firms rely on large intermediary networks to act as panel managers on their behalf. This can work well where the networks have an appropriate compliance function and where agreed terms and conditions are in place between the lender and the panel manager, which include the identification of suspicious activity and the mitigation of mortgage fraud. We also expect lenders working with intermediary networks to conduct appropriate checking of the compliance monitoring work carried out by the panel manager.

A small firm relied heavily on networks. The lender drew comfort from the belief that the large networks carried out good compliance checks, but the lender did not undertake quality assurance of broker submissions or monitor the networks' compliance checks.

In a medium-sized lender, the financial crime team worked closely with the compliance teams in the broker networks and were able to inform the network where they had an issue with a broker.

90. Some firms manage their broker relationships using regional sales managers. This can work well, but carries risks where the relationship manager is insufficiently trained in identifying potentially suspect behaviour or turns a blind eye to suspicious behaviour in order to secure sales. Some lenders periodically rotate relationship management staff to lessen the risk of collusion in wrongdoing. We regard this as good practice. We were, however, concerned that, in a number of firms, staff managing relationships with brokers were targeted and incentivised solely on the number of sales, with measures of sales quality, including fraud figures, not reflected in their remuneration.

In a small lender, brokers were visited regularly. The firm also rotated relationship managers and recorded telephone calls as ways of mitigating risk.

In a small firm there had been recent discussions about the sales staff having personal friendships with third parties (brokers, etc) and possible conflicts of interest. An example was given where a broker had struck up a friendship with the firm's senior underwriter. Any business contact was now dealt with by another member of staff.

91. Lenders use many tools to monitor the quality of mortgage applications submitted by brokers which enable the lender to identify suspicious activity. This will include checks to identify where applicants may be misrepresenting their circumstances. Some lenders subject a sample of a broker's applications to greater scrutiny. Another practice we support is the fresh review of a mortgage application if the borrower subsequently falls into arrears.
92. Brokers can become familiar with lenders' credit-scoring criteria, and may abuse this knowledge by, for example, repeatedly submitting the same application with certain details slightly altered in order to meet the lender's criteria. Some lenders had systems in place to detect such activity.
93. Where lenders develop concerns about a broker, we also expect them to contribute to cross-industry initiatives such as the Information From Lenders project, or CIFAS referrals. They may also lead to Suspicious Activity Reports.

One small lender received certified copies of the applicant's identity documents and bank statements via the broker, but asked the customer to provide originals in a third of all cases. The firm also monitored the quality of business introduced by each broker and would remove brokers where three or more of their cases had fallen into arrears. At the time of our visit there were six brokers from whom the firm would not accept business.

In a medium-sized lender, where a broker was linked to an arrears case, a review would be conducted on the broker's previous applications. When a broker had been taken off the lender's panel, fraud indicators would be in place which would alert the firm if the broker were to reapply. The firm would notify the FSA through the IFL project.

A small lender used a system to match customer names, dates of birth, etc. that could identify where a broker submitted the same case more than once, with slightly altered details, to get it through their system.

3.4.3. Valuers

94. Properties can be deliberately overvalued to deceive the lender about the true nature of the collateral for the loan.

One large lender commented that it was often difficult to prove specific overvaluation fraud or just a high valuation where the valuer had been deceived themselves.

95. Many firms maintain a valuers' panel with agreed terms and conditions and service level agreements in place (such as a requirement to provide photographs of a property). When selecting a valuer or panel manager, firms may ask to see details of professional indemnity insurance and ensure that the valuers are RICS qualified. We saw examples of lenders terminating relationships with valuers and panel managers. The main reasons were valuers failing to include photographs with valuations or consistently overvaluing property.
96. Some firms felt able to contain the risks of overvaluation by limiting exposure to specific property developments, higher-risk postcodes or specific types of property (eg, newly built flats). Smaller regionally-based lenders believed local knowledge helped them assess valuations. A number of lenders performed their own checks to take a view on whether valuations were reasonable. Checks range from using 'automatic valuation models' (AVMs – commercially available models of property prices often drawn from public or private price databases) to seeking second opinions from other valuers.
97. Many firms used independent valuations performed by in-house staff or third parties, with the level of scrutiny ranging from a 'drive-by' valuation and the use of Google Streetview, to a full valuation. The sampling methods varied between firms; some checked a percentage of a valuer's work; others reviewed 'outlier' valuations or those flagged as presenting a higher fraud risk (e.g. loans on properties a long distance from the applicant's main address). When a mortgage application's loan-to-value ratio was low, some lenders dispensed with full valuations, and relied on AVMs or 'drive-by' valuations.

One small firm's business was concentrated in a particular geographical area. It felt able to monitor local solicitors and valuers and keep on top of current prices for local property.

Another small firm had no formal process for sharing adverse information about third parties within the firm. The branch network picked up intelligence on local brokers and the local market but this was not recorded or disseminated.

A small lender's agreement with a panel manager stated that the manager should only select valuers in multi-partner firms with adequate professional indemnity insurance and RICS qualifications. The lender also required the valuer's office to be within 20 miles of the property being valued.

In another small firm, the list of valuers was not fully controlled. To select a valuer on a case, the lender relied on the mortgage consultant and the customer to decide on the valuer, which exposed the lender to the possible risk of collusion. The firm is now reviewing its policy.

A medium-sized lender had a formal right of audit of the panel manager or the third parties in its agreement with the panel manager.

98. Many firms allocate work to valuers using automated systems. Valuation requests are passed either to a valuer on the lender's panel or to a third-party panel manager who allocates the work. Some lenders set parameters in the system to rotate work between valuers in a manner that allows identification of those that consistently under- or overvalue property.

In a small lender, valuers were required to submit two comparable valuations based on recently sold property data. To verify the valuations, the firm used popular property websites.

A large firm employed four surveyors who reviewed outlier valuations using property websites and Land Registry information. All outlier cases were suspended while being reviewed.

A medium-sized firm using a sub-panel manager carried out monthly checks on a random sample of valuation reports to assess the quality. Monitoring was increased where it was found that quality was sub-standard.

3.4.4 Managing relationships with solicitors, brokers and valuers; examples of good and poor practice

Good practice

- A firm has identified third parties they will not deal with, drawing on a range of internal and external information.
- A third party reinstated to a panel after termination is subject to fresh due diligence checks.

- A firm checks that solicitors register charges over property with the Land Registry in good time, and chases this up.
- Where a solicitor is changed during the processing of an application, lenders contact both the original and new solicitor to ensure the change is for a legitimate reason.
- A firm checks whether third parties maintain professional indemnity cover.
- A firm has a risk-sensitive process for subjecting property valuations to independent checks.
- A firm can detect brokers ‘gaming’ their systems, for example by submitting applications designed to discover the firm’s lending thresholds, or submitting multiple similar applications known to be within the firm’s lending policy.
- A firm verifies that funds are dispersed in line with instructions held, particularly where changes to the Certificate of Title occur just before completion.

Poor practice

- A firm’s scrutiny of third parties is a one-off exercise; membership of a panel is not subject to ongoing review.
- A firm’s panels are too large to be manageable. No work is undertaken to identify dormant third parties.
- A firm solely relies on the FSA Register to check mortgage brokers, while scrutiny of solicitors only involves a check of public material from the Law Society or the Solicitors Regulation Authority.
- A firm that uses divisional sales managers to oversee brokers has not considered how to manage conflicts of interest that may arise.

3.5. Compliance and internal audit

99. Lenders’ compliance and internal audit (IA) teams have an important role in scrutinising efforts to contain mortgage fraud. During our review we assessed the adequacy of these arrangements.
100. Mortgage fraud is one of a wide range of issues that compliance and internal audit functions have to consider. We recognise their time must be allocated to a range of tasks, and firms’ judgements about where the risks lie will differ. Nevertheless, we were concerned that some lenders did not subject their mortgage fraud controls to sufficient scrutiny.

At a medium-sized lender, the head of IA said mortgage fraud was low down on the audit agenda and that the lender had higher priorities.

The compliance team at a small lender had no structured visit programme to branches and the compliance/audit programme had little or no focus on mortgage fraud or financial crime in general.

101. We were concerned to find some firms' internal audit and compliance functions marginalised in the anti-mortgage fraud governance process. Very few lenders' internal audit and compliance teams regularly monitored the adequacy of underlying customer take-on arrangements, the application process or third party relationships.
102. We saw few examples of mortgage fraud being treated in a 'holistic' fashion; instead it was touched on as part of wider compliance and audit monitoring. Most lenders reviewed parts of the mortgage process in isolation, but very few assessed anti-mortgage fraud systems and controls in the round.

At a large lender, the compliance and IA teams periodically reviewed areas such as valuations and solicitor management, panel composition, intermediary origination, selling practices, and fraud prevention and detection models.

While these areas had received a lot of ad hoc attention by the business in the period following the financial crisis, these reviews had not been in the context of a specific mortgage fraud review.

At a small lender, there was no compliance monitoring or quality assurance reviews of the mortgage process, although the firm was planning to institute an enhanced compliance programme in 2011/12. However, no details of the proposals were available for review and no resources had been allocated.

103. Compliance and internal audit usually completed only the standard financial crime training provided to all staff. While audit and compliance staff will often be generalists by nature, there are benefits to some degree of specialisation within teams, particularly when these staff are training others across the business.

At a large lender the IA team were unable to satisfy us that they understood the key risks to the business in relation to mortgage fraud or financial crime more generally.

3.5.1. Compliance and internal audit – examples of good and poor practice

Good practice

- A firm has subjected anti-fraud measures to 'end-to-end' scrutiny, to assess whether defences are coordinated, rather than solely reviewing adherence to specific procedures in isolation.

- There is a degree of specialist anti-fraud expertise within the compliance and internal audit functions.

Poor practice

- A firm's management of third party relationships is subject to only cursory oversight by compliance and internal audit.
- Compliance and internal audit staff demonstrate a weak understanding of mortgage fraud risks, because of inexperience or deficient training.

3.6. Staff recruitment and vetting

104. Controls over staff recruitment, including the enhanced vetting of those in higher-risk positions, can lessen the risk of staff being complicit in mortgage fraud. We assessed these controls during our review.
105. We examined recruitment and vetting standards in the financial services industry during two previous thematic reviews: our 2008 report, *Data Security in Financial Services*¹¹, and our 2010 report, *Anti-bribery and corruption in commercial insurance broking*.¹²
106. Many firms performed enhanced checks on employees in more sensitive positions. In relation to mortgage fraud, this tended to be:
- mortgage sales staff or those directly involved in obtaining mortgage business;
 - mortgage applications processing staff;
 - underwriters of mortgage business;
 - staff responsible for approving and releasing mortgage proceeds; and
 - those responsible for approving, reviewing or managing third-party relationships, such as brokers, solicitors and valuers.
107. During the recruitment process, lenders seek to identify information that might call into question a candidate's honesty and integrity. One large firm asked candidates to complete a declaration of their credit history; a small firm required candidates to declare any adverse information, such as missed payments or County Court Judgements, in their application form. Firms will make case-by-case judgements about what level of adverse data is acceptable. If adverse information was withheld by the candidate, and subsequently discovered, this was generally considered a serious matter.

11 See: www.fsa.gov.uk/pubs/other/data_security.pdf

12 See: www.fsa.gov.uk/pubs/anti_bribery.pdf

We have been told about instances when former brokers had worked for firms implicated in mortgage fraud and subsequently tried to join lender firms. Lenders should be alert to this in their recruitment and vetting processes.

108. All firms visited required new recruits to provide references and standard identification documents such as passports, utility bills or driving licences. Some firms said they checked prospective employees' eligibility to work in the UK. Many firms supplemented their documentation requests with credit, criminal records bureau (CRB) or CIFAS checks on staff. Some limited this to senior or Approved Person roles. Others subjected all staff involved in mortgage business to CRB checks.
109. Six of our 20 firms carried on screening staff after they are employed. Examples included periodically checking credit histories, or the CIFAS staff fraud database. Other firms asked staff to declare whether their circumstances have changed since joining the firm. One purpose of these checks is to determine if staff might be under greater financial pressure, and hence be more vulnerable to coercive pressure from criminals.

One firm said that, if credit checks showed an individual's financial commitments were five or six times their annual salary, this might result in a discussion with Human Resources.

One large firm said a new employee could start work without a Criminal Records Bureau check being complete, but where adverse information was identified that had not previously been declared, the employment offer might be affected. A Red-Amber-Green rating system specified what type of information fell into which category. Red criteria included five or more County Court Judgements (or two or more undeclared ones); amber criteria included a declared criminal record, repeat loan or credit card defaults; green criteria included criminal records for motoring offences, single loan or credit card default.

One large firm said vetting and referencing were completed during the 16 week induction training period for mortgage processing staff. New staff had no access to customer data during this period.

In two large firms, vetting checks were repeated only if someone was promoted to a role that required additional screening.

One lender introduced annual credit checks after a branch manager with a deteriorating financial position began to steal from dormant customer accounts.

110. We found few lenders employed temporary or contract staff in positions that were sensitive to mortgage fraud. However, where firms use employment agencies to recruit staff it is good practice to understand the checks carried out by the agency. Firms should also consider taking steps to satisfy themselves that agencies are complying with their agreed recruitment and vetting terms. It is also good

practice to subject temporary staff to the same checks as permanent staff in similar roles.

*One small firm required recruitment agencies to collect candidates' identification documents but would still verify the information independently.
A small firm said vetting of temporary staff consisted only of taking references.
A small firm said temporary staff underwent the same checks as permanent staff.*

3.6.1. Staff recruitment and vetting – examples of good and poor practice.

Good practice

- A firm requires staff to disclose conflicts of interest stemming from their relationships with third parties such as brokers or solicitors.
- A firm has considered what enhanced vetting methods should be applied to different roles (e.g. credit checks, criminal record checks, CIFAS staff fraud database, etc.).
- A firm adopts a risk-sensitive approach to managing adverse information about an employee or new candidate.
- A firm seeks to identify when a deterioration in employees' financial circumstances may indicate increased vulnerability to becoming involved in fraud.

Poor practice

- A firm uses recruitment agencies without understanding the checks they perform on candidates, and without checking whether they continue to meet agreed recruitment standards.
- Staff vetting is a one-off exercise.
- Enhanced vetting techniques are applied only to staff in Approved Persons positions.
- A firm's vetting of temporary or contract staff is less thorough than checks on permanent staff in similar roles.

3.7. Remuneration structures

111. Inappropriate remuneration structures can undermine lenders' controls against mortgage fraud. For example, without strong controls elsewhere, incentive schemes may encourage staff to achieve sales targets in a manner that exposes the firm to fraudulent applicants. This formed one aspect of our review.

112. We found most remuneration structures did not appear to encourage staff to take unnecessary risks to achieve sales. Performance bonuses tended to range between 6% and 20% of base salary. However, few lenders' remuneration structures successfully measured or rewarded staff members' efforts to prevent fraud.
113. There was a handful of cases where we judged the element of remuneration composed of sales commission was excessive. One large firm used variable 'accelerators' to incentivise multiple sales that could greatly increase the size of bonus payments. This was not balanced by a 'clawback' or deferred payment arrangements that might penalise sales staff if loans turned sour. Unless there were strong controls elsewhere in the firm, this approach could expose a firm to a high risk of mortgage fraud.
114. Most firms offered staff relatively straightforward remuneration packages. These generally included a bonus scheme. Bonuses were sometimes driven solely by the achievement of sales targets (whether by the individual or by a wider team). In other firms, a proportion of the bonus was dependent on more qualitative measures of competency or behaviour; one small firm excluded such underperformers from the bonus scheme completely. Bonuses were often capped to contain their potential for incentivising the wrong behaviours.
115. We saw few examples of mortgage fraud performance being explicitly reflected in remuneration or in the staff appraisal process. Few staff outside dedicated anti-fraud teams had mortgage fraud measures as part of their Key Performance Indicators. We did, however, see examples of other quality measures affecting rewards. One medium-sized firm lowered a salesperson's bonuses if mortgages went into arrears or the quality of advice given to the customer later proved to be substandard. One small firm reviewed a sample of mortgage applications to identify instances of non-adherence to lending criteria. Bonuses were reduced if they found corners had been cut. These approaches demonstrate a more balanced approach to remuneration. Some lenders made discretionary awards to staff who identified mortgage fraud (for example 'fraud buster' vouchers).

One small firm rewarded collection staff according to their success in chasing and recovering arrears. Productivity measures were the main driver for bonuses, but a monitoring scheme ensured high performers were not gaming the system (by, for example, cutting phone calls short to give an impression of higher productivity, a practice the firm considered to be gross misconduct).

One small firm did not reward staff who identified mortgage fraud because it should be considered 'business as usual'.

3.7.1. Remuneration structures – examples of good and poor practice

Good practice

- A firm has considered whether remuneration structures could incentivise behaviour that may increase the risk of mortgage fraud.
- A firm's bonuses related to mortgage sales will take account of subsequent fraud losses, whether through an element of deferral or by 'clawback' arrangements.

Poor practice

- The variable element of a firm's remuneration of mortgage salespeople is solely driven by the volume of sales they achieve, with no adjustment for sales quality or other qualitative factors related to compliance.
- The variable element of salespeople's remuneration is excessive.
- Staff members' objectives fail to reflect any consideration of mortgage fraud prevention.

3.8. Staff training and awareness

116. We reviewed lenders' staff training arrangements during our visits. This included formal training programmes, and other initiatives to foster knowledge and awareness among staff.
117. We were concerned that firms' training programmes often lacked material focused on mortgage fraud. We recognise that training should be tailored to staff members' roles. But often basic material was lacking on, for example, the methods by which staff can report their concerns.
118. Mortgage fraud was sometimes touched on in the financial crime training provided to all staff, but seldom explored in depth. One small firm required all staff to undertake computer-based mortgage fraud training, and a large firm had recently introduced more material on the topic into its training programme. Another small firm carried out a one-off training session to all staff following a significant mortgage fraud. But these were the exceptions.
119. In addition to computer-based training, some firms adopted other methods such as 'on-the job' or 'face-to-face' training. We were told this would tend to have greater focus on mortgage fraud in those parts of the business best able to tackle the risks. Some firms suggested briefings from specialist trainers and speakers from, for example, CIFAS or the police were valuable.
120. Some firms relied on staff furthering their financial crime and mortgage fraud awareness by reading in-house newsletters or the trade press, and publications

from specialist organisations, such as the Council of Mortgage Lenders or the City of London Police. While these resources can be valuable, they are not a substitute for more formalised training.

121. We were told by several firms that senior staff attended fraud prevention seminars or were involved with fraud prevention organisations, but it was not clear whether insights from these experiences fed through to the front line.

A medium-sized firm said all new advisers received mortgage fraud training; however little, if any, material related to this topic featured in their financial crime course.

A medium-sized firm identified that specific mortgage fraud training was lacking and steps were being taken to introduce annual mortgage fraud training.

A small firm said that, once a month, line managers covered two ‘on the job’ training modules with each member of staff on one core topic. Topics included the role of the FSA, business conduct, health and safety, and general fraud.

One large firm held a quarterly fraud forum to disseminate information to staff.

A medium-sized firm said underwriters did not undertake specific mortgage fraud training but did attend some industry courses.

One small firm said presentations on fraud had been given to all its branches for the past two years. Training included scenarios and case studies.

One medium-sized firm’s induction programme included a session on financial crime which included a test. During the assessment, staff could refer to the firm’s fraud awareness manual which included a definition of mortgage fraud, examples of suspicious mortgage transactions, and a description of internal escalation procedures.

3.8.1. Staff training & awareness – examples of good and poor practice

Good practice

- A firm’s financial crime training delivers clear messages about mortgage fraud across the organisation, with tailored training for staff closest to the issues.
- A firm verifies that staff understand training materials, perhaps with a test.
- Training is updated to reflect new mortgage fraud trends and types.
- Mortgage fraud ‘champions’ offer guidance or mentoring to staff.

Poor practice

- A firm fails to provide adequate training on mortgage fraud, particularly to staff in higher-risk business areas.
- A firm relies on staff reading up on the topic of mortgage fraud on their own initiative, without providing formal training support.
- A firm fails to ensure mortgage lending policies and procedures are readily accessible to staff.
- A firm fails to define mortgage fraud in training documents or policies and procedures.
- Training fails to ensure all staff are aware of their responsibilities to report suspicions, and the channels they should use.

4. Consolidated examples of good and poor practice – proposed guidance

| Mortgage fraud against lenders – consolidated examples of good and poor practice | |
|--|--|
| Examples of good practice | |
| Examples of poor practice | |
| Governance, culture and information sharing | |
| <ul style="list-style-type: none"> A firm's efforts to counter mortgage fraud are coordinated, and based on consideration of where anti-fraud resources can be allocated to best effect. Senior management engage with mortgage fraud risks and receive sufficient management information about incidents and trends. A firm engages in cross-industry efforts to exchange information about fraud risks. A firm engages front-line business areas in anti-mortgage fraud initiatives. | <ul style="list-style-type: none"> A firm fails to engage with the FSA's Information From Lenders project. A firm fails to define mortgage fraud clearly, undermining efforts to compile statistics related to mortgage fraud trends. A firm does not allocate responsibility for countering mortgage fraud clearly within the management hierarchy. |
| Applications processing and underwriting | |
| <ul style="list-style-type: none"> A firm's underwriting process can identify applications that may, based on a thorough assessment of risk flags relevant to the firm, present a higher risk of mortgage fraud. Underwriters can contact all parties to the application process (customers, brokers, valuers etc.) to clarify aspects of the application. The firm verifies that deposit monies for a mortgage transaction are from a legitimate source. New or inexperienced underwriters receive training about mortgage fraud risks, potential risk indicators, and the firm's approach to tackling the issue. | <ul style="list-style-type: none"> A firm's underwriters have a poor understanding of potential fraud indicators, whether through inexperience or poor training. Underwriters' demanding work targets undermine efforts to contain mortgage fraud. Communication between the fraud team and mortgage processing staff is weak. A firm relying on manual underwriting has no checklists to ensure the application process is complete. A firm requires underwriters to justify all declined applications to brokers. |

Mortgage fraud against lenders – consolidated examples of good and poor practice

Examples of good practice

| Examples of good practice | | Examples of poor practice | |
|---|---|--|---|
| Mortgage fraud prevention, investigations, and recoveries | | | |
| <ul style="list-style-type: none"> A firm routinely assesses fraud risks during the development of new mortgage products, with particular focus on fraud when it enters new areas of the mortgage market (such as sub-prime or buy-to-let). A firm reviews existing mortgage books to identify fraud indicators. Applications that are declined for fraudulent reasons result in a review of pipeline and back book cases where associated fraudulent parties are identified. A firm has planned how counter-fraud resources could be increased in response to future growth in lending volumes, including consideration of the implications for training, recruitment and information technology. A firm documents the criteria for initiating a fraud investigation. Seeking consent from the Serious Organised Crime Agency (SOCA) to accept mortgage payments wherever fraud is identified. | <ul style="list-style-type: none"> A firm's anti-fraud efforts are uncoordinated and under-resourced. Fraud investigators lack relevant experience or knowledge of mortgage fraud issues, and have received insufficient training. A firm's internal escalation procedures are unclear and leave staff confused about when and how to report their concerns about mortgage fraud. | <p>Mortgage fraud prevention, investigations, and recoveries</p> | <ul style="list-style-type: none"> A firm's anti-fraud efforts are uncoordinated and under-resourced. Fraud investigators lack relevant experience or knowledge of mortgage fraud issues, and have received insufficient training. A firm's internal escalation procedures are unclear and leave staff confused about when and how to report their concerns about mortgage fraud. |
| Managing relationships with solicitors, brokers and valuers | | | |
| <ul style="list-style-type: none"> A firm has identified third parties they will not deal with, drawing on a range of internal and external information. A third party reinstated to a panel after termination is subject to fresh due diligence checks. A firm checks that solicitors register charges over property with the Land Registry in good time, and chases this up. Where a solicitor is changed during the processing of an application, lenders contact both the original and new solicitor to ensure the change is for a legitimate reason. | <ul style="list-style-type: none"> A firm's scrutiny of third parties is a one-off exercise; membership of a panel is not subject to ongoing review. A firm's panels are too large to be manageable. No work is undertaken to identify dormant third parties. A firm solely relies on the FSA Register to check mortgage brokers, while scrutiny of solicitors only involves a check of public material from the Law Society or Solicitors Regulation Authority. A firm that uses divisional sales managers to oversee brokers has not considered how to manage conflicts of interest that may arise. | <p>Managing relationships with solicitors, brokers and valuers</p> | <ul style="list-style-type: none"> A firm's scrutiny of third parties is a one-off exercise; membership of a panel is not subject to ongoing review. A firm's panels are too large to be manageable. No work is undertaken to identify dormant third parties. A firm solely relies on the FSA Register to check mortgage brokers, while scrutiny of solicitors only involves a check of public material from the Law Society or Solicitors Regulation Authority. A firm that uses divisional sales managers to oversee brokers has not considered how to manage conflicts of interest that may arise. |

| Mortgage fraud against lenders – consolidated examples of good and poor practice | |
|--|--|
| Examples of good practice | Examples of poor practice |
| <ul style="list-style-type: none"> • A firm checks whether third parties maintain professional indemnity cover. • A firm has a risk-sensitive process for subjecting property valuations to independent checks. • A firm can detect brokers ‘gaming’ their systems, for example by submitting applications designed to discover the firm’s lending thresholds, or submitting multiple similar applications known to be within the firm’s lending policy. • A firm verifies that funds are dispersed in line with instructions held, particularly where changes to the Certificate of Title occur just before completion. | |
| Compliance and internal audit | |
| <ul style="list-style-type: none"> • A firm has subjected anti-fraud measures to ‘end-to-end’ scrutiny, to assess whether defences are coordinated, rather than solely reviewing adherence to specific procedures in isolation. • There is a degree of specialist anti-fraud expertise within the compliance and internal audit functions. | <p>A firm’s management of third party relationships is subject to only cursory oversight by compliance and internal audit.</p> <p>Compliance and internal audit staff demonstrate a weak understanding of mortgage fraud risks, because of inexperience or deficient training.</p> |
| Staff recruitment and vetting | |
| <ul style="list-style-type: none"> • A firm requires staff to disclose conflicts of interest stemming from their relationships with third parties such as brokers or solicitors. • A firm has considered what enhanced vetting methods should be applied to different roles (e.g. credit checks, criminal record checks, CIFAS staff fraud database, etc.). • A firm adopts a risk-sensitive approach to managing adverse information about an employee or new candidate. | <ul style="list-style-type: none"> • A firm uses recruitment agencies without understanding the checks they perform on candidates, and without checking whether they continue to meet agreed recruitment standards. • Staff vetting is a one-off exercise. • Enhanced vetting techniques are applied only to staff in Approved Persons positions. |

Mortgage fraud against lenders – consolidated examples of good and poor practice

Examples of good practice

- A firm seeks to identify when a deterioration in employees' financial circumstances may indicate increased vulnerability to becoming involved in fraud.

Remuneration structures

- A firm has considered whether remuneration structures could incentivise behaviour that may increase the risk of mortgage fraud.
- A firm's bonuses related to mortgage sales will take account of subsequent fraud losses, whether through an element of deferral or by 'clawback' arrangements.

- Staff members' objectives fail to reflect any consideration of mortgage fraud prevention.

Staff training and awareness

- A firm's financial crime training delivers clear messages about mortgage fraud across the organisation, with tailored training for staff closest to the issues.
- A firm verifies that staff understand training materials, perhaps with a test.
- Training is updated to reflect new mortgage fraud trends and types.
- Mortgage fraud 'champions' offer guidance or mentoring to staff.

Examples of poor practice

- A firm's vetting of temporary or contract staff is less thorough than checks on permanent staff in similar roles.

- The variable element of a firm's remuneration of mortgage salespeople is solely driven by the volume of sales they achieve, with no adjustment for sales quality or other qualitative factors related to compliance.

- The variable element of salespeople's remuneration is excessive.

- Staff members' objectives fail to reflect any consideration of mortgage fraud prevention.

- A firm fails to provide adequate training on mortgage fraud, particularly to staff in higher-risk business areas.

- A firm relies on staff reading up on the topic of mortgage fraud on their own initiative, without providing formal training support.

- A firm fails to ensure mortgage lending policies and procedures are readily accessible to staff.

- A firm fails to define mortgage fraud in training documents or policies and procedures.

- Training fails to ensure all staff are aware of their responsibilities to report suspicions, and the channels they should use.

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