2008

Other People's Money: How a Time-Gap in Credit Reporting May Lead to Fraud

J. Alex Heroy

Follow this and additional works at: http://scholarship.law.unc.edu/ncbi

Part of the Banking and Finance Law Commons

Recommended Citation

Available at: http://scholarship.law.unc.edu/ncbi/vol12/iss1/14

This Notes is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Banking Institute by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.
Other People's Money: How a Time-Gap in Credit Reporting May Lead to Fraud

I. INTRODUCTION

While harp music played and leaves fell in the North Carolina Blue Ridge Mountains, real-estate developer Tony Porter promised investors big gains with no cash investment and little risk. The scene was set: a small mountain art community where baby boomers and retirees were “flocking . . . in droves” causing land values to rise dramatically. Investors’ confidences were bolstered by a $16 million loan from Sunset Financial Resources, Inc. made to get the new residential home project underway. So, investors like Henry Gerrits, an engineer, and Sherron Shields, a loan officer, obtained mortgages totaling $375,000 and $900,000, respectively, to invest in their future. In total, Mr. Porter convinced nearly 200 investors, who borrowed over $100 million, to invest in the Village of Penland. The dream of a picturesque community, however, vanished quickly and left raw an elaborate fraud. By early 2007, four major banks were claiming losses in the millions and investors were left with their credit in shambles and buried in debt with monthly payments in the thousands of dollars on land worth only a fraction of what they paid for it. The crux of the scheme, and what will be the major focus of this Note, is how the fraudsters were able to defraud their

2. Id.
5. Id.
6. Id.
7. Penland Real Estate Complaint, supra note 3, ¶ 34, ¶ 37.
"investors." 8

At its highest, the mortgage industry is a $2.37 trillion industry, 9 constituting almost one-fifth of the United States gross domestic product. 10 Mortgage fraud perpetrated in 2006 has been estimated to cost anywhere between almost one billion dollars and $4.2 billion, and the numbers are rising each year. 11 Moreover, mortgage fraud investigations conducted by the FBI have increased over 420% since 2002. 12 Victims include federally insured financial institutions, 13 government entities, 14 and investors. 15

Lenders rely heavily on the three national consumer reporting agencies (CRAs) 16 for information about credit scores and payment histories of prospective borrowers. 17 Under current law, all entities who furnish credit and debt information to CRAs have no obligation to submit information in a timely manner, in a certain format, with consistency, in full, or even to report at all. 18 The only duty imposed on those who report information about consumers is to not submit information known to be inaccurate or

8. Id. ¶ 19.
10. Id. The $2.37 trillion figure is based on a 2006 estimate of a US GDP of $13.06 trillion. Id.
12. Federal Bureau of Investigation, supra note 11. The FBI had 436 open files in September of 2002 and 1,036 in March 2007. Id.
13. Id. Fifty-seven percent. Id.
14. Id. Eight percent. Id.
15. Id. Thirty-five percent. Id.
16. E.g., Robert B. Avery et al., Credit Report Accuracy and Access to Credit, 90 FED. RES. BULL. 297, 298 (2004) [hereinafter Credit Report Accuracy]. The three national CRAs are TransUnion, Equifax, and Experian. Id.
17. Id. at 297.
CONSUMER FRAUD

for which there is "reasonable cause" to believe is inaccurate. Even when reported information is submitted in a timely, complete, and accurate manner, it still typically takes a minimum of thirty days to appear on a credit report. Perpetrators of mortgage fraud are thus given the opportunity to "work" undiscovered during the gap in time that occurs between when a loan is made and when it appears on a credit report. In this class of fraud, perpetrators take advantage of lenders, and borrowers, who are unaware that credit has already been issued on a piece of real property, or that numerous loans are simultaneously being issued to a borrower. The purpose of this Note is to illuminate loopholes in the mortgage lending system and current laws regulating credit reporting, showing that a change in the system itself is necessary to prevent mortgage fraud.

Part II of this Note will provide background information on lending practices and how the credit reporting system has been manipulated under three different mortgage fraud schemes. Part III will describe and analyze the current laws and agencies that govern credit reports and credit reporting, showing that a loophole for fraud remains. Finally, Part IV will consider whether more regulation is needed to close the gap, specifically considering recently proposed legislation and a change to the credit reporting system.

II. BACKGROUND

A. Credit Reporting

Credit reporting plays a central role in the mortgage

21. See infra Part II, Subheading C.
22. Id.
23. See infra Part II.
24. See infra Part III.
25. See infra Part IV.
industry. Credit reports contain a wide array of data concerning the credit history of individuals, and are heavily relied on by creditors in assessing the creditworthiness of potential borrowers. Credit reports are central to the decisions of creditors regarding whether to extend credit, and if so, at what rate. Good credit scores essentially correlate to lower interest rates. Without credit reporting agencies, consumers would have access to less credit, while paying more for credit that is extended. Furthermore, credit reporting has benefited from the use of technology over the past few decades to increase the accuracy and completeness of files. However, the system still has flaws and various aspects of it need improvement.

CRAs are only as effective as the information they receive. CRAs receive data from creditors, governmental entities, collection agencies, and third-party intermediaries, who are not bound by federal or state law to report data on credit users. In fact, one study found that eight percent of consumers surveyed reported that their credit file was “missing major credit, loan, mortgage, or other accounts.” The only requirement is that when information is furnished the creditor cannot know or have “reasonable cause” to believe it is “inaccurate.” Otherwise, the

27. Id.
28. Id. at 298.
29. Id.
30. Id. at 320. Documented benefits of credit reporting include: greater access to credit, especially for typically underserved populations; quicker reaction to market changes; dramatic changes in time elapsed to approve a loan (from “close to three weeks” prior to automated underwriting, to the majority only taking “two to three minutes” in 2002); and decreased cost of closing a loan, making homeownership rates rise. See Michael Turner, Information Policy Institute, The Fair Credit Reporting Act: Access, Efficiency & Opportunity: The Economic Importance of Fair Credit Reauthorization 37-39 (2003).
33. See e.g., Interview with Prof. Ed Van Wesep, supra note 20.
34. Credit Report Accuracy, supra note 16, at 298.
amount, the frequency, and the method of reporting is unregulated.  

B. Mortgage Loans

A "mortgage" is "[a] conveyance of title to property that is given as security for the payment of a debt or the performance of a duty and that will become void upon payment or performance according to the stipulated terms." In a home mortgage, real property is used as collateral for the loan. Aside from some states requiring the participation of attorneys, there are two essential parties to a mortgage loan transaction: the creditor or lender, who loans the money in return for a lien on the real property, and the debtor, who is obligated to repay or be subject to forfeiture.

A recent development in the mortgage lending industry has been the increased participation of mortgage brokers. Mortgage brokers act as intermediaries, matching loan applications, which are taken from banking and other mortgage lending institutions, with mortgage products. In the past, applying for a loan and the pricing of a loan were done primarily at a local bank, often selling only its own products. Mortgage brokers, on the other hand, often represent a large and wide array of lenders. The growth of mortgage brokers has been widespread: in 2001, around sixty-five percent of all mortgages, a number that has surely risen, were handled by a mortgage broker, each often dealing with five to ten

---

39. Id.
40. Email from Daniel Garner, Executive Legal Counsel to the N.C. Office of the Comm'r of Banks, and David Worth, Office of the N.C. Comm'r of Banks, to J. Alex Heroy, (Oct. 15, 2007) (on file with N.C.B.I journal) (noting that in some states, the presence or participation of an attorney is not required in real estate transactions); see also Joyce Palomar, The War Between Attorneys and Lay Conveyancers--Empirical Evidence Says "Cease Fire!", 31 CONN. L. REV. 423 (1999).
42. Robert B. Avery et al., The 2006 HMDA Data, 93 FED. RES. BULL. (forthcoming 2007) (draft at 9).
43. Id. (draft at 9-10).
44. Id. (draft at 10).
45. Mortgage Bankers Association, supra note 41, at Step 1.
lenders simultaneously.\textsuperscript{46}

Aside from some smaller local banks and credit unions, most institutions or brokers who receive loan applications today will “shop the loan around.”\textsuperscript{47} This means that the loan application will be offered to numerous lenders to determine who will give the borrower the best price.\textsuperscript{48} These potential lenders, as a normal procedure, request the credit report of the borrower and decide whether to extend a loan, and if so, at what rate.\textsuperscript{49} Credit report inquiries, unlike actual loans themselves, appear immediately on credit reports; therefore, it is typical for a lender to see numerous, recent inquiries into a report.\textsuperscript{50} Following an inquiry, a lender will decide, based partially on what is contained in the credit report, whether or not to extend credit.\textsuperscript{51} It is then the decision of the broker and the borrower whether or not to accept the loan.\textsuperscript{52} If the loan is accepted, the terms will be formalized and the loan will “close.”\textsuperscript{53} The closing is the final step in the loan process “whereby the conveyancing documents are concluded and the money and property transferred,” in a legal transaction between buyer and seller.\textsuperscript{54} It is common practice in the mortgage lending industry for

\textsuperscript{46} Turner, supra note 30, at 24. Cf. Ending Mortgage Abuse: Safeguarding Homebuyers: Before the S. Comm. on Banking, Housing, and Urban Affairs – Subcomm. on Housing, Transportation, and Community Development 9 (2007) (testimony of Michael D. Calhoun, Center for Responsible Lending) (stating that mortgage brokers account for the origination of forty-five percent of all mortgages), www.responsiblelending.org/pdfs/senate-testimony-m-calhoun-june-26-2007.pdf. It should also be noted that while brokers are beneficial to consumers, there is ample criticism of financial motivations and lack of regulation of broker-originated loans. See, e.g., id. at 8-9 (noting the limited liability of financially motivated mortgage brokers in the loans they broker).

\textsuperscript{47} Mortgage Bankers Association, supra note 41, at Step 5.

\textsuperscript{48} Id.

\textsuperscript{49} Id.

\textsuperscript{50} Robert B. Avery, et al., An Overview of Consumer Data and Credit Reporting, 89 FED. RES. BULL. 70 (2003) [hereinafter An Overview of Consumer Data and Credit Reporting]. This is especially so in the case of mortgages and auto loans. Interview with Prof. Ed Van Wesep, supra note 20. Inquiries appear immediately because CRAs have all the requisite information; when Lender X inquires into Borrower Y’s credit report, the CRA has the information from the point of inception, they must be asked for the report, and therefore the inquiry can be added immediately or almost immediately. Telephone Interview with Equifax representative, in Chapel Hill, N.C. (Sept. 20, 2007).

\textsuperscript{51} See Turner, supra note 30, at 24.

\textsuperscript{52} Id.

\textsuperscript{53} Mortgage Bankers Association, supra note 41, at Step 5.

\textsuperscript{54} BLACK’S LAW DICTIONARY 248 (8th ed. 2004).
the lender to report the issuance of the loan sometime during the month, or two, following the closing.\textsuperscript{55}

Entities that regularly furnish information to CRAs, including mortgage lenders, typically report all recent data once a month to CRAs, at which point it is processed and incorporated into the credit report within one to seven days.\textsuperscript{56} The effect of this is that the time period from the extension of credit to the appearance of the loan on a borrower's credit report ranges from just over a month to as long as ninety days.\textsuperscript{57} During this time-gap lenders are unaware of credit actions of consumers, and are vulnerable to fraud.\textsuperscript{58}

\section*{C. Mortgage Fraud}

The time-gap between when a borrower is issued a loan and when the loan appears on their credit report is a dangerous time because lenders and borrowers cannot accurately track loan transactions that may have transpired. Fraudsters can take advantage of this information gap, because lenders and other institutions do not have full access to information.\textsuperscript{59} Three examples of how the delay in reporting credit transactions to the credit reporting agencies may have facilitated mortgage fraud are discussed below.

The result of time-gap fraud is that banks and lenders suffer as they are left "hold[ing] a third, fourth, or fifth lien on a property."\textsuperscript{60} Each time, the properties are foreclosed and banks and lenders must write the loans off as a loss.\textsuperscript{61} The neighborhoods themselves are also victims of these schemes because overblown

\begin{itemize}
  \item \textsuperscript{55} Interview with Ed Van Wesep, \textit{supra} note 20.
  \item \textsuperscript{56} \textit{Credit Report Accuracy}, \textit{supra} note 16, at 298. Each agency may receive “more than 2 billion items of information each month.” \textit{An Overview of Consumer Data and Credit Reporting}, \textit{supra} note 50, at 49. Another study found that CRAs may receive more than 4.5 billion items each month. \textit{See Fed. Trade Comm’n}, \textit{supra} note 18, at 16.
  \item \textsuperscript{57} Telephone Interview with Equifax representative, \textit{supra} note 50; \textit{see} Electronic Privacy Information Center, \textit{supra} note 31.
  \item \textsuperscript{58} \textit{infra} Part II.C.
  \item \textsuperscript{59} \textit{See}, \textit{e.g.}, United States v. Nguyen, 493 F.3d 613, 617-18, 621 n.3 (5th Cir. 2007).
  \item \textsuperscript{60} \textit{2006 Mortgage Fraud Report}, \textit{supra} note 11.
  \item \textsuperscript{61} \textit{Id.}
\end{itemize}
appraisals push property taxes up, and foreclosures drive the property values down.62


On June 6, 2007, North Carolina Attorney General Roy Cooper filed a civil complaint on behalf of the State of North Carolina against a group of developers who allegedly defrauded around 200 investors and consumers out of hundreds of millions of dollars.63 Cooper alleged that one common scheme involved defendant developers selling ten, fifteen, or twenty lots of land to investors in exchange for various promises.64 To lure in investors, the defendants allegedly promised investors the receipt of eight percent of the loan proceeds at closing,65 no down payment,66 a free house in the community, and/or $100,000 for each house sold on an investor-owned lot.67 Defendants further agreed to make the loan payments for at least a year, and promised to buy back the lots within three years.68 The appraisal of each lot was "grossly inflated" at $125,000, when often the lots had tax values of lower than $20,000, could not support septic systems, did not have access to roads or utilities, or were as small as one-twelfth of an acre.69 In


63. See Penland Real Estate Complaint, supra note 3, ¶ 17-38; see, e.g., Carrns, supra note 1. Criminal prosecutions may be forthcoming, as FBI agents have raided Tony Porter's office; however the FBI has declined to comment on an investigation. Id.

64. Penland Real Estate Complaint, supra note 3, ¶ 18-23.

65. Tim Simmons, Banks aided fraud, investors say: A lawsuit accuses BB&T, First Charter of Charlotte and two other banks in a mountain-retreat fiasco that left investors owing at least $80 million, RALEIGH NEWS & OBSERVER, Nov. 21, 2007, at D1.

66. Carrns, supra note 1.

67. Penland Real Estate Complaint, supra note 3, ¶ 20.

68. Id. The defendants agreed to set up an escrow account sufficient to fund the primary bank loan payments for the first year. Id. Defendant Porter offered to back the loan repayments from his personal account if defendant Communities of Penland, L.L.C. did not pay off the second loan within the first year. Id. At the end of three years, defendants agreed to repurchase the property at the initial sales price. Id.

69. Id. ¶ 27.
a ten-plot scheme, for instance, consumers were asked to apply “for credit to purchase ten lots at the Village of Penland for a total of $1,250,000.” The defendants then arranged for each consumer a primary bank loan of $1,000,000 and a second loan for the balance of $250,000.

Once a consumer agreed to partake in the “investment opportunity,” an employee of one of the defendant companies, or a subsidiary thereof, “sent each consumer four or five loan applications for different lenders and told them to complete each loan application.” The defrauded consumers rarely dealt directly with the lenders because employees of the defendants handled all aspects of the transactions. Defendants then sent out “all of the loan applications to all of the lenders.” In this way, the defendants were able to take out multiple loans in the name of each borrower because the lenders were unaware of the contemporaneous or very recent credit extensions by other lenders. It is alleged that the defendants then mailed the closing documents to the borrowers with no explanation or direction except “where to sign.” As a result, the “investors” qualified for and received loans from multiple lenders simultaneously. However, had the lenders, or even possibly the investors, known that contemporaneous loans were being issued, it is unlikely that the lenders would have extended additional credit without, at

70. Id. ¶ 20. Interestingly, investors were not allowed to pay cash for lots, but could only do so through credit transactions. Id. ¶ 19.

71. Penland Real Estate Complaint, supra note 3, ¶ 20. There are also a host of other alleged violations in connection with this litigation, including fraudulent appraisals, violations of the Interstate Land Sales Full Disclosure Act, 15 U.S.C.A. § 1701, et seq. and a litany of unfair and deceptive trade practices. Id. ¶ 39-46.

72. Penland Real Estate Complaint, supra note 3, ¶ 24.

73. Id.

74. Id.

75. Id. However, recent allegations suggest that the banks might have been involved in the scheme, and were covering up obvious signs of fraud such as identical loan packages, the same picture being used for multiple loans, and the same appraiser and attorney used in all the loans. Tim Simmons, Suit Claims BB&T hid real estate scheme, RALEIGH NEWS & OBSERVER, Dec. 7, 2007, at D1; Tim Simmons, 2 N.C. Banks Accussed in Fraud Suit, THE CHARLOTTE OBSERVER, Nov. 21, 2007, at 1D. The banks have denied the allegations. Tim Simmons, BB&T denies coverup allegations, RALEIGH NEWS & OBSERVER, Dec. 8, 2007, at D1.

76. Penland Real Estate Complaint, supra note 3, ¶ 25.

77. Id. ¶ 24.
It is clear that the defendants, lawyers and savvy businessmen, knew that they could take advantage of a system where lenders did not know if credit had been extended within the last month, or even the last two or three months.

The perfect scene began to fall apart in the spring of 2007 when investors received an email from Tony Porter apologizing that the land values were not rising as quickly as predicted. Not long after the first email, investors received a letter stating that the defendants could no longer afford to make payments on their mortgages, leaving investors to make the hefty monthly payments. Furthermore, not only were hopes of repurchase by the defendants gone, but the defendants failed to get further than the preliminary phase of constructing a development, as promised. It is alleged that the defendants received "well over $100,000,000 in proceeds from loans extended to consumers who purchased lots at the Village of Penland." The defendants spent all or almost all of the proceeds, leaving the borrowers and lenders straddled with millions of dollars in debt and three North Carolina banks and one South Carolina bank reeling from the same.

2. "Mei Enterprises and the Straw Buyer Bank Fraud Scam"

In a similar scheme, which the United States "government claims [was] the largest mortgage-loan-fraud operation ever
prosecuted," at least twenty-three individuals were involved in a conspiracy that took advantage of the gap in time between when a loan is made and when it appears on a credit report. Under this scheme, defendants "would apply for a loan on [a] straw borrower's behalf to ostensibly finance the sham purchase of a home the [defendants] ‘owned’ according to their doctored title documents." The straw borrower could be an innocent or fictional person. Then, providing the lender "false inflated house appraisals, false title commitments, and false information on the straw borrower's loan application to boost the borrower's creditworthiness," the defendants obtained an artificially inflated loan amount; this part of the scheme was referred to as the "loan transaction." The defendants then used the loan proceeds to buy the house at its true value, and kept the difference between the mortgage loan amount and the lower purchase price, in what was deemed the "cash transaction." The defendants repeated this scheme no less than one hundred times, using numerous straw borrowers. As the transactions started to appear on credit reports the defendants switched straw borrowers. What made the scheme possible, testified one co-conspirator, was that the fraudsters could quickly complete up to five transactions per straw borrower before they began to appear on the straw borrower's credit report.

87. Id. at 926-35; see also, United States v. Nguyen, 493 F.3d 613 (5th Cir. 2007).
88. Nguyen, 493 F.3d at 617.
91. Id.
92. Id.
93. Id.
94. Nguyen, 493 F.3d at 617-18, 621 n.3; see also Willis, supra note 89 (noting that fraudsters simply switch straw borrowers when loans begin to appear on credit reports, allowing them to disappear before the fraud is discovered).
3. HELOC fraud scheme

According to the FBI, there is another emerging scheme that takes advantage of the gap in time between when a loan is issued and when it appears on a credit report. This newest exploitation uses the "home equity line of credit (HELOC) application process to conduct multiple-funding mortgage fraud schemes, check fraud schemes, and potentially money laundering-related activity." A HELOC borrower typically borrows for home repairs or bills by using a checkbook or credit card to borrow against the equity of the home over a period of time, usually on an as-needed basis. Full title searches and property appraisals are not often demanded on these types of loans, making the perpetration of fraud that much easier.

In this scheme, criminal groups apply for multiple HELOCs from different lenders simultaneously to maximize credit extension on a property to obtain credit well over the limit that could normally be acquired. Again, when lenders receive a borrower's credit report, they find nothing unusual and grant the loan. The problem is that four or five other lenders, all unknown to one another, have also granted loans.

Specifically in light of the N.C. v. Peerless Real Estate Services, Inc., Penland Real Estate, et al. case, affected banks have begun to implement their own internal safeguards to prevent mortgage fraud in lot-development schemes that cost the banks millions. Among the internal checks being implemented are "assigning fewer underwriters to handle consumer lot loans in one state or region, upgrading software to detect unusual spikes in

95. 2006 Mortgage Fraud Report, supra note 11, at 6.
96. Id.
97. Id. A HELOC is subordinated to any existing mortgage on the property, such as the mortgage used to finance the purchase of the home, making it riskier for lenders. E.g., Scott W. Carnahan, Home Equity Line of Credit Securitization: Issuer Issues, 11.3 J. STRUCTURED FIN. 30 (2005).
98. 2006 Mortgage Fraud Report, supra note 11, at 6.
99. Id.
100. Id.
101. Id.
loans in a branch or region, and requiring top executives to sign off on predevelopment lot loans."103 Although it is too early to know if the checks are working, bank analysts have stated that it should help to curb a "'weakness' in the banks' credit procedures, which let many people borrow through the retail system but 'escape the eyes of loan review because loan review is typically more focused on commercial real estate exposure.'"104

III. LEGISLATION AFFECTING LOANS AND CREDIT REPORTING

Credit reporting has been described by some as a "classic public good."105 This means that those parties that bear the costs of reporting in a timely and complete manner may benefit little from advancements in the system.106 That being the case, not all entities that benefit from the system contribute in turn.107 The end result is that consumers and lenders are hurt because access to a complete file is limited.108 Moreover, increased legislation and regulation may have a backlash effect as greater complexity and more demands may tempt furnishers of information to back out of the system altogether rather than meet increased demands.109

There is a federal statute, the Fair Credit Reporting Act (FCRA),110 amended by the Fair and Accurate Credit Transactions Act (FACTA),111 which addresses credit reporting, but which does not fix, nor directly address, the time-gap between when a loan is made and when it appears on a borrower's credit report.

103. Id.
104. Id.
106. Id.
107. Id.
Additionally, some states have enacted laws specifically regarding data breach and identity theft.112

A. **Fair Credit Reporting Act (FCRA)**

Enacted in 1970,113 the FCRA intended “to promote accuracy, fairness, and the privacy of personal information assembled by Credit Reporting Agencies (CRAs).”114 Congress found that “fair and accurate credit reporting” is the foundation of an efficient banking system, and that “[t]here is a need to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer’s right to privacy.”115 Enforcement of the FCRA was granted to the Federal Trade Commission and other appropriate federal financial agencies.116

112. See, e.g., Bob Ryan & Eric Rosenberg, Legislative Update, TRANSUNION (2007), available at http://www.transunion.com/corporate/business/clientSupport/resources/legislativeUpdate.page (pdf files available for each update on website); see also INFORMATION POLICY INSTITUTE, CREDIT FILE FREEZE: POSITION PAPER 3-6 (2005), http://www.infopolicy.org/publications/freeze_final.pdf (noting specific states that have enacted credit file freeze laws to guard against identity theft; and citing the problem that although the Federal Trade Commission is given primary oversight, it may not create binding regulations, and therefore, there is a need for a uniform federal standard, at least in regards to credit file freeze laws); TURNER, supra note 30; Kristan Cheng, Identity Theft and the Case for a National Credit Report Freeze Law, 12 N.C. BANKING INST. 239 (forthcoming March 2008).

113. Electronic Privacy Information Center, supra note 31. The FCRA came into effect on April 25, 1971. Id.

114. FCRA, 15 U.S.C.A. § 1681 (West 2000 & Supp. 2007). The Act was engineered by Representative Leonor Sullivan and Senator William Proxmire amid backlash against credit reporting agencies (CRAs) who were collecting “lifestyle” data on consumers—from sexual orientation to drinking habits—and denying those very consumers access to the files that were being used to deny them “services and opportunities.” Electronic Privacy Information Center, supra note 31.


116. 15 U.S.C.A. § 1681s. Any violation of the FCRA is deemed to be an “unfair and deceptive act or practice in violation of section 5(a) of the Federal Trade Commission Act.” Id. The Act also provides for enforcement by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the Administrator of the National Credit Union Administration, the Secretary of Transportation, the Secretary of Agriculture, the States, and the FBI. Id. In addition, the US PATRIOT Act added that “government agenc[ies] authorized to conduct investigations of, or intelligence or counterintelligence activities or analysis related to . . . terrorism” may obtain credit reports for investigations, and such inquiries shall not appear on CRA reports. 15 U.S.C.A. § 1681v. Legislating enforcement of the Act to such a wide variety of
The most important change brought about by the FCRA was the requirement that credit files and credit scores be disclosed to consumers. Disclosure has helped prevent and discover fraud and credit report errors. An equally important change was the regulation of the type of data that could be collated in credit files. Gone were the days of collecting "lifestyle" data on credit users; information now must be pertinent to a consumer’s financial history. Information that may be contained in consumer credit reports includes the identification of "end-users" that obtained reports for employment purposes over the past two years, or inquiries "for any purpose" during the one year period preceding the date on which the request is made. Other information was limited in the length of time it may appear on credit reports. The FCRA also imposed a duty on CRAs to follow "reasonable procedures" to provide "maximum possible accuracy." Moreover, the Act imposes a duty that a furnisher of information may not submit any information it "knows or consciously avoids knowing" is inaccurate, and shall, "promptly," correct and update any information on the credit report it determines is incorrect or incomplete. Consumers are given the right to dispute the agencies makes it difficult for researchers to find any conclusive information as one is constantly being directed to another agency. The effect this may have on the average consumer or enforcement and fraud prevention of the Act is outside the scope of this article.

117. 15 U.S.C.A. § 1681g; see also Electronic Privacy Information Center, supra note 31.
119. Electronic Privacy Information Center, supra note 31.
120. Id.
122. 15 U.S.C.A. § 1681c (stating that Bankruptcy actions may appear for ten years, while “[c]ivil suits, civil judgments, paid tax liens, accounts placed for collection, and records of arrest” may only appear for seven years). The Act also provides that criminal convictions may appear indefinitely. Id.
123. 15 U.S.C.A. § 1681e(b). During the 1970s, industry abuse was the norm, including self-imposed industry "quotas of negative information on data subjects" that forced investigators to fabricate information and leave files incomplete. Electronic Privacy Information Center, supra note 31.
“accuracy or completeness” of any information contained in their report.\textsuperscript{125}

Unfortunately, the Act only provides remedial measures for victims\textsuperscript{126} and does not, apart from listing permissible purposes to solicit a credit report,\textsuperscript{127} attempt to prevent fraud. The Act contains no mention of the timeliness of items appearing on a credit report, or when they must be reported to CRAs.\textsuperscript{128}

\section*{B. \textit{Fair and Accurate Credit Transactions Act of 2003}}

The Fair and Accurate Credit Transactions Act of 2003 (FACTA)\textsuperscript{129} amended the FCRA to “combat identity theft, increase the accuracy of consumer reports, restrict the use of medical information in credit eligibility determinations, and allow consumers to exercise greater control regarding the type and amount of solicitations they receive.”\textsuperscript{130} These goals primarily manifested into remedies available to victims of fraud, including extended fraud alert protections, provisions to opt-out of prescreening and affiliate sharing,\textsuperscript{131} and truncation of credit and debit card numbers on electronically printed receipts.\textsuperscript{132} FACTA also allows for consumers to receive their credit report annually at

\begin{itemize}
\item \textsuperscript{125} Electronic Privacy Information Center, \textit{supra} note 31. Under the FCRA, disputes must be made to CRAs rather than furnishers. \textit{Id.} This was changed under FACTA to allow consumers to make disputes directly against furnishers. 15 U.S.C.A. § 1681g.
\item \textsuperscript{126} 15 U.S.C.A. § 1681c-1, 2. Remedies for those who have fallen victim to fraud include placing fraud alerts in consumer files, access to free credit reports for victims, and blocking information that is a result of fraud. \textit{Id.}
\item \textsuperscript{127} 15 U.S.C.A. § 1681b.
\item \textsuperscript{128} \textit{See generally} FCRA, 15 U.S.C.A. §§ 1681–1681u (neglecting to discuss the timeliness of when things must be reported to CRAs).
\item \textsuperscript{130} Interagency Advance Notice of Proposed Rulemaking: Procedures to Enhance the Accuracy and Integrity of Information Furnished to Consumer Reporting Agencies Under Section 312 of the Fair and Accurate Credit Transactions Act, 71 Fed. Reg. 14422, 14422 (Mar. 22, 2006) (to be codified at 12 C.F.R. pts. 41, 222, 334, 571, 717, 660 and 661).
\item \textsuperscript{131} \textit{See} TURNER, \textit{supra} note 30, at 57–62. Used for third party credit offers. \textit{Id.} Controversy exists over how much this aids in fraud perpetration. \textit{Id.}
\item \textsuperscript{132} Electronic Privacy Information Center, \textit{supra} note 31.
\end{itemize}
no-charge from CRAs. Unfortunately, as important as these amendments have proven, they fail to provide preventative measures for combating fraud or close loopholes that allow for fraud.

In a key change, FACTA required those that furnish credit information to CRAs to ensure the accuracy of files. FACTA amended § 1681s-2 of the FCRA to prohibit furnishers from providing any information to CRAs that is "know[n]" to be inaccurate or for which there is "reasonable cause to believe . . . is inaccurate." The credit reporting system is critically dependent on the credit information that furnishers of such information provide to CRAs. Therefore, this FACTA amendment is an important step in acknowledging that furnishers of credit information must be held accountable. Furthermore, furnishers have thirty days to investigate any claim by a consumer that information in the consumer's file is inaccurate or incomplete.

Under a new section of FACTA, lenders who use consumer credit scores in connection with closed- or open-ended loans that are "secured by [one to four] units of residential real property . . . shall provide [to the borrower] . . . a copy of the information . . . that was obtained from a [CRA] or was developed and used by the user of the information." Additionally, when a consumer requests a credit score, a CRA shall supply:

133. 15 U.S.C.A. § 1681j. The government has established/authorized a website where consumers can request their credit reports at www.annualcreditreport.com. Although, this provision aids in preventing fraud, it seems unlikely to make a substantial impact on the niche of fraud loophole examined in this article.
134. See Cheng, supra note 112.
135. See Electronic Privacy Information Center, supra note 31.
137. 15 U.S.C.A. § 1681s-2. In its original form, the FCRA stated that a furnisher of data shall not provide information that it "knows or consciously avoids knowing" is inaccurate. Id.
138. See TURNER, supra note 30, at 5-6.
139. 15 U.S.C.A. § 1681j. Upon receiving notice of dispute, furnishers typically have thirty days to investigate, review all pertinent information, report to the CRA and all others that received the information (if the dispute proves meritorious), and correct the information. Id. The time period is forty-five days in the event that the consumer provides new information during the original thirty-day period. Id.
140. 15 U.S.C.A. § 1681g.
(A) the current credit score of the consumer or the most recent credit score of the consumer that was previously calculated by the credit reporting agency for a purpose related to the extension of credit; (B) the range of possible credit scores under the model used; (C) all of the key factors that adversely affected the credit score of the consumer in the model used . . . ; (D) the date on which the credit score was created; and (E) the name of the person or entity that provided the credit score or credit file upon which the credit score was created.141

This provision allows a conscientious borrower to monitor what potential lenders see,142 but does not solve the problem of the integrity of the content and does little to prevent fraud that takes advantage of the time-gap between making a loan and the loan’s appearance on a credit report.143 A borrower is likely to see that numerous lenders made inquiries into their credit, a product of “shopping around” for lenders, but the report will not show for some time if any of those inquiries resulted in the extension and funding of credit.144 Of course, a borrower, or diligent lender, could request his credit report two or three months after closing145 and possibly discover if, in fact, fraud of this type had occurred, but by this time the damage has been done.146

Section 312 of the FACT Act requires that “[t]he Federal banking agencies, the National Credit Union Administration, and the [FTC] shall . . . (A) establish and maintain guidelines for use by” furnishers of information to CRAs, “regarding the accuracy and integrity of the information to consumers” that is furnished; and (B) require furnishers to “establish reasonable policies and

---

141. Id. (emphasis added).
142. An Overview of Consumer Data and Credit Reporting, supra note 50, at 72-73.
143. See supra Part II.C.
144. See supra notes 47-58 and accompanying text.
145. Id.
146. See An Overview of Consumer Data and Credit Reporting, supra note 50, at 72-73 (detailing how lenders may also be victimized).
procedures for implementing" the aforementioned guidelines.\textsuperscript{147} In
the first interim report presented to Congress on December 9, 2004, the FTC identified four areas to be studied: (1) "the effects of requiring the CRAs to match more points of information (e.g., name, social security numbers, address) to ensure" proper consumer identification; (2) the effect of requiring that consumers receive copies of the same credit report used whenever an "adverse action" is taken by creditors (based on the credit report); (3) "the effects of requiring consumers to be notified whenever negative information is added to their credit reports"; and (4) the effects on determining creditworthiness of greater reporting in areas typically not reported (e.g., utility payment history, rent payment history).\textsuperscript{148} Regrettably, it does not appear that further study into preventative measures is undertaken by this study.

The FTC's Report does concern itself with the challenges CRAs face in assuring accuracy and completeness of their files.\textsuperscript{149} Indeed, the report has found that "a creditor or other furnisher of data to the CRAs may provide information that is incorrect, may provide incomplete information, or may not provide information at all."\textsuperscript{150} The problem is compounded if incomplete consumer identifying information is provided, resulting in mixed files,\textsuperscript{151} fragmented files,\textsuperscript{152} and file segmentation.\textsuperscript{153} Lack of an obligation to report to all three of the major CRAs, or even to report at all, makes full accuracy and completeness all but impossible,\textsuperscript{154} and is

\textsuperscript{147} 15 U.S.C.A. § 1681g (West 2000 & Supp. 2007). Section 319 states that the study is to be completed over eleven years, with the final report due in 2014, and that the Commission shall give interim reports every two years in the meantime. \textit{Id.} § 319.
\textsuperscript{148} See \textit{FED. TRADE COMM'N}, supra note 18, at ii. Each section of analysis begins by discussing previous institutional studies, and then the report details a comprehensive study of its own to be undertaken over the coming years. \textit{Id.}
\textsuperscript{149} \textit{Id.} at i.
\textsuperscript{150} \textit{Id.} at ii.
\textsuperscript{151} \textit{FED. TRADE COMM'N}, supra note 18, at 13 (considering "mixed files" to be "files that contain[,] information pertaining to more than one consumer").
\textsuperscript{152} \textit{Id.} File fragmentation exists where one consumer has more than one file, resulting from instances when insufficient identifying information is provided to match with an existing consumer file and CRAs are forced to open new files. \textit{Id.} at 13-14.
\textsuperscript{153} \textit{Id.} File segmentation results when a consumer, wary of the negative implications of a poor credit report, seeks to manipulate the system by supplying information that will not be matched to them. \textit{Id.} at 51.
\textsuperscript{154} \textit{Id.} at 12, 43. Note the dilemma: CRAs pushing for greater accuracy and
further evidence that current legislation needs improvement.

One instance of incomplete and inaccurate information exists when furnishers *intentionally* do not furnish or update information for strategic reasons.\(^{155}\) Some creditors and lenders intentionally fail to report so that the consumers who they charge the highest rates will not receive competing credit offers at lower rates.\(^{156}\) Intentionally failing to submit data of responsible borrowers likely had further affect on credit evaluations and credit ratings of such consumers.\(^{157}\) Hopefully, since this tactic has been exposed, Congress will be prompted to make new and more assertive changes.\(^{158}\)

Additionally, the report made various findings directly concerning mortgages.\(^{159}\) The report found that "[g]iven the importance of a mortgage transaction, both lenders (or brokers) and their customers are likely to take care in checking that an application is filled out properly and completely," and therefore, information in credit reports on mortgages is more likely to be reliable.\(^{160}\) This is inherent in a mortgage transaction,\(^{161}\) given that each party is carefully looking out for its own interests because of the significant amount of money involved. However, once a lender approves and funds a loan, there is no incentive to immediately report the loan to the CRAs; after all, the lender’s lien is already recorded and “in line.”\(^{162}\) Secondly, the report

---

\(^{155}\) *Id.* at 12; *Credit Report Accuracy*, supra note 16, at 305, 310.

\(^{156}\) *FED. TRADE COMM’N*, supra note 18, at 12. Subprime lenders may be the largest culprit of this type of gaming. *See id.* Encouragingly, one study found that instances of “missing credit limits on one or more . . . revolving accounts” dropped from seventy percent of files studied in 1999, to fourteen percent of files studied in 2003. *Id.* at 13 n.39 (citing Robert B. Avery et al., *An Overview of Consumer Data and Credit Reporting*, 89 *FED. RES. BULL.* 49 (2003)).

\(^{157}\) *Credit Report Accuracy*, supra note 16, at 305.

\(^{158}\) See Part III of this note for proposed changes in the Act. In addition, changes proposed by this Note may also have a beneficial impact on further proliferation of what has been deemed the “subprime mortgage crisis”; the extent to which it may prevent further abuses, however, is outside the scope of this note. *See also* Electronic Privacy Information Center, supra note 31.

\(^{159}\) *See, e.g.*, *FED. TRADE COMM’N*, supra note 18, at 43.

\(^{160}\) *See id.*

\(^{161}\) *But see infra* note 183 and accompanying text.

\(^{162}\) *See Chapter 41: Recording of Instruments, PURCHASE AND SALE OF REAL*
found that when a borrower has consistently and timely made mortgage payments "this typically will be reflected in his or her file in nationwide CRA databases."\(^{163}\) The reason for this is that mortgage brokers have substantial contacts with CRAs, technology is used to facilitate data transfer to CRAs, and mortgage lenders are extremely important to the business of CRAs.\(^{164}\) It therefore seems irrational that given the prevalence of fraud and the invaluable relationship between CRAs and mortgage lenders that there are no systems, rules, or regulations in place to enhance and precipitate the flow of data between these two entities. It appears that the FTC and Congress, in less than explicit terms, are hesitant to legislate and mandate, instead preferring to advise in the area of fraud prevention.\(^{165}\) This reluctance is likely due to an aversion to overreach into a private industry to change the voluntary nature of credit reporting.\(^{166}\) The prevalence of fraud and loopholes in the system, however, show that legislation regulating the credit reporting industry is flawed and needs improvement.

One more check on mortgage fraud involves examining the identity of the perpetrators. Generally, attorneys are required to perform title searches and issue "opinions" of title related to mortgage transactions.\(^{167}\) A title search of recorded documents researches the history of the property and the purchaser and includes checking for liens and previous deed transfers.\(^{168}\) The

---

\(^{163}\) Fed. Trade Comm’n, supra note 18, at 76.

\(^{164}\) The Accuracy of Credit Report Information and the Fair Credit Reporting Act, Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs, 108th Cong. (July 10, 2003) (statement of Stuart K. Pratt, Consumer Data Industry Association ("CDIA").

\(^{165}\) See id. at 9; see also 15 U.S.C.A. § 1681a-b (West 2000 & Supp. 2007) (Congressional findings and purpose of the FCRA).

\(^{166}\) See Credit Reports: Consumers’ Ability to Dispute and Change Inaccurate Information, supra note 18; but see An Overview of Consumer Data and Credit Reporting, supra note 50, at 73.


\(^{168}\) Email from Daniel Garner, supra note 167.
closing attorney issues an “opinion” of title based on this search, basically linking the attorney to the transaction, a title opinion “does not insure against undisclosed defects nor does it insure marketable title,” but may be necessary to obtain title insurance. In at least two of the fraud schemes discussed, where the time-gap has been exploited, there has been a flaw in the attorney’s, or equivalent closing agent’s, assurance that the transactions are legitimate. In Penland Real Estate the attorneys themselves were the fraud perpetrators or knowing participants in the fraud scheme. Theoretically, another type of potential flaw in an attorney’s title opinion could be that the attorney was somehow defrauded along with lenders in the perpetuation of fraud. In states where attorneys are required to “participate” in the mortgage loan closing, fraud, however, is generally, but not always, averted because attorneys “value their law license.” Not all states believe that “preparing necessary documents and then implementing them in a real estate title transfer transaction [i]s the practice of law, which ha[s] to be done only by licensed attorneys,” and allow for others, such as escrow companies, to finalize the transaction. In either case, whether it is an attorney, someone acting under the authority and guidance of an attorney, or a layman, the closing entity must act as a “gatekeeper” in keeping out this type of fraud, which can only be perpetrated when there is a failure at this level.

169. Id.


171. Email from Daniel Garner, supra note 167 (noting the difference between a title insurance and a closing defects policy).

172. Id.

173. See Complaint, supra note 3, ¶ 2-16.

174. Email from Daniel Garner, supra note 167.

175. Id.; see also Palomar, supra note 167. But see Penland Real Estate Complaint, supra note 3.

176. Email from Daniel Garner, supra note 167; see also United States v. Nguyen, 493 F.3d 613, 617 (5th Cir. 2007) (fraud perpetrators, employees of American Title Company, acted as notary, escrow, and closing agents).

177. Id.

178. See generally id. (discussing how notary, escrow, and closing agents were among the perpetrators of the fraud).
IV. CLOSING THE LOOPHOLE AND FIXING THE PROBLEM

A. STOP FRAUD Act

On April 25, 2007, Senator Barack Obama and Senator Dick Durbin introduced a federal bill entitled “Stopping Mortgage Transactions which Operate to Promote Fraud, Risk, Abuse, and Underdevelopment Act” or the “STOP FRAUD Act.” The Act proposes changes to numerous existing laws, including the Truth in Lending Act. It would explicitly address mortgage fraud by declaring it “unlawful for any mortgage professional to knowingly execute, or attempt to execute a scheme or artifice – (1) to defraud any natural person, financial institution,” or other borrower in connection with the extension of credit that is secured by either real property or personal property that is to be used as a primary dwelling, or “(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property, including without limitation in the form of fees or charges, from a natural person in connection with an extension of consumer credit . . . secured by” either of the same listed in part “(1).” The proposed statute includes criminal penalties of up to 35 years in prison and $5,000,000, and civil penalties measured by the sum of “all finance charges and fees paid or payable by the” victim of the fraud, and other damages, declaratory, injunctive and additional relief (court costs, investigative costs and reasonable attorneys’

179. See Credit Reports: Consumers’ Ability to Dispute and Change Inaccurate Information, supra note 18. In the past, CRAs attempted to assert their power over creditors by refusing to sell consumer reports to creditors who did not report. Id. CRAs have also advocated the implementation of a standard electronic format, called the “Metro” and “Metro 2” format, with success. Id. Their campaign was successful with ninety-five percent of those reporting in 1996 implementing the Metro format, and more than fifty percent using Metro 2, which was introduced in 1997, by 2003. Id. This shows that there was a correlation between the CRAs endorsement and the high rate of implementation, but it does not tell us that one was a result of the other – it could be just as likely that the new format was simply easier to use or more efficient. It is difficult, therefore, to predict how influential CRAs are in implementing policy changes.


182. S. 1222, sec. 2, § 1351(a)(1).

183. Id. at sec 2, § 1351(a)(2).
fees), for violators of the Act. An aggrieved person may bring a suit for recovery in any U.S. district court or state court having jurisdiction without regard to the amount in controversy, citizenship of the parties, or "exhaustion of any administrative remedies."

Another proposed change expands the range of reports and records that are required to be made available to the Secretary of the Treasury and Federal law enforcement which have a "high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence . . . to protect against international terrorism." Under this proposal, enforcement agencies would receive more reports involving "suspicious activity" in mortgage transactions. The desired effect would be twofold: first, more institutions would be put in the "gatekeeper" function, hopefully preventing more fraud; and, second, enforcement agencies would uncover more schemes and instances of mortgage fraud. As with current legislation, fraud that passes through the "gatekeeper" would only be stopped when it is eventually uncovered, meaning still that consumers are already greatly harmed before the scheme is discovered. The legislation, although a step in the right direction, does not strike at the heart of the fraud, the time-gap loophole in the mortgage system.

The Act directs the Attorney General, in combination with

184. Id. at sec. 2, § 1351(b)(1)-(2). Under current law, 18 U.S.C. § 1344 (2000), limitations on criminal convictions are limited at 30 years and $1,000,000. Under the current version of § 1344, the government must prove that the accused: (1) knowingly, (2) executed or attempted to execute, (3) a scheme or artifice to defraud or to obtain, "by means of false or fraudulent pretenses, representations or promises", anything of value "owned by, or under the custody or control of [(4)] a financial institution." United States v. Campbell, 64 F.3d 967, 975 (5th Cir. 1995). Section § 1344 has been used to prosecute those who have defrauded banks, including a case where a convicted person secured multiple loans on the same collateral – automobiles. See United States v. Sheahan, 31 F.3d 595, 596-99 (8th Cir. 1994).

185. S. 1222, sec. 2, § 1351(c)(1)(A)-(C).


187. S. 1222, § 3(b)(1).

188. See generally id. (stating that it is intended to stop fraud and abuse in mortgage transactions).

189. See generally Carrns, supra note 1 (describing harm that has befallen victims of the fraud perpetrators in Penland Real Estate).
CONSUMER FRAUD

the Secretary of the Treasury, to "establish a system" whereby interested parties "may register and receive updates from Federal law enforcement agencies on-- (1) suspicious activity trends in the mortgage industry; and (2) mortgage fraud-related convictions." The Act also calls for a "Debarred or Censured Mortgage Professional Database," "whistleblower protection" to protect those in the industry providing information; more authority in the Housing and Urban Development Act to allow the Secretary to assist "tenants, homeowners, and other consumers with respect-- (A) to mortgage fraud . . . and (B) to any other activities or practices . . . likely to increase the risk of foreclosure by such individuals;" more reporting to the Secretary of Housing and Development of uncovered fraud or deceptive practices by mortgage professionals in an effort to create federal fraud watch updates; crackdowns "to improve the monitoring and enforcement of housing appraisal regulation;" and more funding to state and local law enforcement to combat fraud. In its current form, the STOP FRAUD Act would devote a total of $80,000,000 to affected entities to prevent and remedy fraud, including the Department of Housing and Urban Development and federal, state, and local law enforcement agencies. More than any piece of legislation thus far, the STOP FRAUD Act makes proactive steps to combat mortgage fraud and gives specific direction to Secretaries and law enforcement.

B. North Carolina Legislation

Recently enacted legislation in North Carolina avoids making direct changes to the voluntary system of reporting credit

190. S. 1222, § 4(a).
191. Id. § 5(a).
192. Id. § 5(c).
193. Id. at sec. 6, § 106(g)(1).
194. See id. at sec. 6, § 106(g)(4)(A)-(B).
195. Id. § 7(a).
196. See S. 1222, § 8. The Act also grants additional rights to borrowers, but these initiatives are mostly directed at what has been termed the "subprime mortgage crisis." See id. § 10.
197. See Electronic Privacy Information Center, supra note 31 (listing authoritative entities under FCRA).
information to CRAs, but imposes direct responsibility on mortgage brokers to prevent fraud with multiple simultaneous loans. "Aside from more general provisions making it illegal for a mortgage broker to commit fraud, the North Carolina legislation requires mortgage brokers to, before closing, notify each lender of the specifics of all other loans issued contemporaneously and secured "by the same real property," if the broker knows of any such loans. The Act places liability on unscrupulous mortgage brokers, which is a "critical step" in lending practices and "[broker] compliance with fair lending laws." If the proposed legislation were fully complied with and full disclosure made, the schemes in N. C. v. Peerless Real Estate Services, Inc., Penland Real Estate, et al. or the HELOC scheme would not be possible because lenders would generally refuse to extend credit subordinated to numerous other loans, at least without further investigation. However, the usual case is that the unscrupulous violator will run off with the money or spend it, making relief for the borrower unrealistic. Again the legislation makes positive steps, but fails to address and answer how this particular type of mortgage fraud is perpetrated. It may be time that the system is changed so that it will foreclose the opportunity for this type of fraud, not merely make it illegal in the face of an obvious and gaping loophole.


201. See supra Part II.C (discussing fraud schemes where perpetrators were able to game the mortgage lending system precisely because they knew multiple loans were being extended and the lenders did not).


203. See Complaint, supra note 3, ¶ 34.

204. See generally H.B. 1817 (imposing liabilities on mortgage brokers for certain abusive tactics, but not specifically dealing with time-gap mortgage fraud).
C. Changing the System to Fix the Problem

In a mortgage industry that accounts for roughly one-fifth of the United States' total gross domestic product,\(^{205}\) the opportunity for fraud by exploiting loopholes in the FCRA regarding timeliness of reporting mortgage lending transactions to CRAs is apparent.\(^{206}\) Fearing regulatory overreaching, the mortgage industry is left largely unregulated because of capitalism and free market ideals.\(^{207}\) However, Congress has been willing to impose heavier regulation by government agencies in other areas, based on "intelligible principles"\(^{208}\) with the idea that the regulation's benefits outweigh its costs and interference with the free market.\(^{209}\)

Prior legislation has focused on remedying the effects of fraud and has failed to stop fraud from the point of inception.\(^{210}\) New amendments to the FCRA should focus on closing loopholes that allow fraud to occur. Placing a timeliness requirement on reporting certain extensions of credit should be considered. One option would be to impose the requirement on all loans over a certain amount, such as $100,000; a second option would impose the requirement on all mortgage loans.\(^{211}\) All creditors extending loans, at least if that extension was based on a credit report from the CRA, meeting the defined criteria would be required to submit loan reports on loans committed and on loans funded by the end

\(^{205}\) Central Intelligence Agency, supra note 9.

\(^{206}\) Electronic Privacy Information Center, supra note 31.

\(^{207}\) See Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information, supra note 18.

\(^{208}\) See, e.g., Whitman v. Am. Trucking Ass'ns, Inc., 531 U.S. 457, 472 (2001) (holding that when Congress grants authority to agencies, it must do so with "intelligible principles").

\(^{209}\) See CHRISTOPHER F. EDLEY, JR., ADMINISTRATIVE LAW: RETHINKING JUDICIAL CONTROL OF BUREAUCRACY 4-7 (Yale University Press 1990).

\(^{210}\) See supra Part III.

\(^{211}\) The requisite amount may be preferable as it would cut out many second loans, which could overburden CRAs. See FED. TRADE COMM’N, supra note 18, at 42 (discussing CRAs urging of furnishers of credit information to provide more information); See Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information, supra note 18 (noting that all payments/accounts cannot appear immediately due to contractually prescribed cycles, such as thirty day billing cycles).
Implementation of this solution would have three phases.

Phase I would require affected lenders to merely report that a loan was issued, with the specifics of the loan to come later. Requiring such a low burden should only minimally affect both lenders and CRAs. CRAs would be slightly more burdened as mortgage loans submissions would double on affected loans, with an initial, basic submission and then a more complete submission later filed. By striking directly at time-gap in mortgage reporting, fraud that takes advantage of the loophole is no longer possible because lenders are required to have all pertinent information immediately or almost immediately. Instead of being uncertain whether other large loans have been issued within the last thirty to ninety days, or even at all, evaluators of consumer credit would have a more complete and timely report to analyze. Furthermore, if fraud is still perpetrated, the time between the credit commitment and the discovery of the fraud would be dramatically reduced, increasing the opportunity to apprehend the wrongdoer, and giving victims a greater chance to remedy the fraud.

Phase II would require affected lenders to give a full report by the close of the business week. This phase increases the burden on lenders, but relieves the CRAs of double submissions. This should not be an unreasonable burden on lenders, since the specifics of the loan are known by the closing and the technology is available to easily transfer the information. Phase III would

\[\text{Page dimensions: 505.0x721.9} \]

---

212. With the creation of an inquiry tracking number, a unique number assigned to each inquiry into consumer credit reports, submissions from furnishers of data and CRAs could be streamlined. Furnishers would supply this number as a key identifying element linking the initial inquiry into a borrower's history and the final credit decision, thereby cutting down on file fragmentation and providing for greater efficiency. CRAs would first align the tracking number with the corresponding credit file, and then check the file with additional identifiers (name, address, social security number).

213. See FED. TRADE COMM’N, supra note 18, at 42 (discussing CRAs urging of furnishers of credit information to provide more information).

214. See supra notes 18-22, 33-37 and accompanying text.

215. Id. See also Kenneth G. Gunter, Note, Computerized Credit Scoring's Effect On the Lending Industry, 4 N.C. BANKING INST. 443, 444 (2000).

216. Although, if Phase I were to prove successful then the system may not need further change.

217. MATTHEW J. LEEDS, RESIDENTIAL REAL ESTATE CONTRACTS & CLOSINGS
require full submission to be made contemporaneously with the loan closing. Rapid transmission of data is technologically feasible;\textsuperscript{218} the difficulty would come in enforcing compliance with mandated reporting.\textsuperscript{219} However, just how much an additional pre-closing step (preparing the submission) and immediate post-closing submission would cost is unknown.

In a statement made by Stuart K. Pratt, on behalf of the Consumer Data Industry Association, he cautions that mandatory reporting requirements would be a "regulatory overreach, sending costs and liabilities too high . . . driving data furnishers to reconsider reporting any data at all to [] members' databases."\textsuperscript{220} This would certainly be true if all data reporting were made mandatory; but limiting mandatory data reporting to mortgage loans or loans of a very high-value should avoid risks of overburdening the system and driving furnishers away.

Any change to the credit reporting system needs to be considered carefully when the voluntary reporting system is fundamentally altered.\textsuperscript{221} Potential benefits of such an alteration of the system, which are not present under currently proposed legislation, include preventing mortgage fraud, increasing accuracy, reducing fragmentation, lessening duplication, increasing efficiency, improving accuracy in score reflections of risk, and lessening gaming by subprime lenders.\textsuperscript{222} These benefits need to be weighed against the potential adverse consequences, including: expense, efficiency concerns, backlash and outcry from furnishers, accuracy, feasibility, and potential effects harming competition and shopping loans.

\textsuperscript{486} (Practicing Law Institute 2004).

\textsuperscript{218} Credit Report Accuracy, supra note 16, at 298. Inquiries into credit reports already appear immediately. \textit{See, An Overview of Consumer Data and Credit Reporting, supra note 50.} As high as ninety percent of all data received by CRAs is submitted electronically. \textit{See Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information, supra note 18.}

\textsuperscript{219} \textit{See id.} It is beyond the scope of this Note whether implementation should be mandated by a federal amendment to FCRA or through self-regulation by CRAs.

\textsuperscript{220} Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information, supra note 18.

\textsuperscript{221} Credit Report Accuracy, supra note 16, at 322.

\textsuperscript{222} See supra notes 155–58 and accompanying text.
V. Conclusion

Current legislation and industry standards leave a loophole for fraud. The FCRA, as amended by FACTA, imposes upon lenders and other furnishers of credit information the requirement that they may not knowingly submit false information to CRAs.223 Left with no affirmative duty to report, and with no timeliness requirement, the mortgage lending and credit reporting industries have failed to adequately regulate and prevent fraud. A time-gap of between thirty and ninety days exposes unknowing lenders and the public to a fog where perpetrators of fraud prey. In one of the most recent fraud schemes, Penland Real Estate, fraud perpetrators swindled Americans nationwide and their banks out of over $100 million.224 Legislation must step up to the task of closing the time-gap, where con artists can conduct multiple, contemporaneous loan transactions and spend other people’s money before being caught.

Proposed and recent legislation is beginning to attack the edges of the time-gap. North Carolina has recently enacted legislation that explicitly imposes a duty on all real mortgage brokers to inform each lender of the specifics of all other loans issued contemporaneously and secured by the same property.225 Other federally proposed legislation, the STOP FRAUD Act, would allocate $80 million to fraud prevention and set up a nationwide fraud trend database.226 Furthermore, each law would explicitly make time-gap fraud illegal.227 However, no new or proposed legislation fixes the system.

New legislation should not take a stab at mortgage fraud with only remedial propositions, but should strike at the heart of a system that allows for it to be easily perpetrated. The burdens and costs of mortgage fraud are incalculable. No dollar figure can measure the costs of a family who loses everything to fraud, and the benefits should outweigh burdens placed on mortgage lenders.

224. Complaint, supra note 3.
225. See supra note 199 and accompanying text.
226. See supra note 197 and accompanying text.
227. See supra Part IV.A-B.
and CRAs to report immediately. If committed loans appear on borrower's credit reports simultaneous with their closing, no time-gap exists which fraud perpetrators can exploit. New legislation must change the credit reporting system to protect banks and the public, and stop time-gap fraud.

J. Alex Heroy