

SafeAlert



A loss control advisory from the ABA-sponsored insurance program underwritten by Progressive

Using Third-Party Originators

Third-party originators can be a valuable means of expanding your business, but can increase exposure to fraud. Progressive has seen a growing number of losses arising from the use of mortgage brokers and leasing companies.

The mortgage subsidiary of a \$400MM community bank accepted loans originated by an out-of-state broker. Within the initial weeks of the relationship, the bank approved two loans in excess of \$400,000 each. The broker completed the paperwork and purportedly obtained the required signatures for the loans to be funded by the bank and sold to the secondary market. The bank was later forced to repurchase the loans and incur a loss of almost \$1,000,000 when it was found that the properties were virtually worthless and all the documents submitted by the brokers—applications, appraisals and title information—were fraudulent.

A \$300MM bank purchased equipment leases from a local leasing company. When a contractor defaulted on his equipment lease, the bank attempted to collect from his business partner, who had guaranteed the lease. The partner's signature was determined to have been forged. As the bank had not obtained warranties from the leasing company, they were forced to write off the balance of the lease.

Strong internal controls in the lending area are critical to protect your institution against fraud. Purchasing or funding loans originated by third parties exposes the bank to fraud on the part of both the originator and the borrower. If third-party originations are integral to your strategy, take the following important precautions:

- ☑ Perform extensive due diligence on any third-party originator, including (1) several reliable references, confirming that they are legitimate parties; (2) financials on both the company and individuals; (3) background checks that are more than perfunctory; (4) confirmation of Bond/E&O insurance and (5) an on-site visit to the operation. Follow up on anything that doesn't "feel" right.
- ☑ Understand the originator's policies and procedures, particularly in the area of internal controls that protect against loan fraud.
- ☑ When using a broker, ensure that the closing is handled by the bank, not the broker. Obtain all signatures in front of a bank officer, closing agent, escrow agent or attorney and verify the identity of all parties.
- ☑ When purchasing loans, make sure that there are appropriate warranties in your contract to make the originator liable for loss due to fraud.
- ☑ Understand the risks of relying upon a notarized signature on a loan document, even on loans originated by the bank. Fraudulently-executed documents are often notarized after the fact. This is the easiest means of a perpetrator defrauding the bank and the source of continuous claims over time in our program.

Selling fraudulent loans to the secondary market may not only cause loss but may jeopardize your ability to continue selling to the secondary market.

For more information, contact Tom Hruby, Loss Control Manager, at 800-274-5222.