

Arms Length Transaction

By Lisa A. Tyler
National Escrow Administrator

Contrary to popular belief, the term "Arms Length Transaction" is not the distance the buyer and seller must stay away from each other at the signing ceremony! An arms length transaction is the term used when the parties to a transaction are independent and on an equal footing and the property is being sold at current market value. The payoff lenders on many short sale transactions are starting to require an arms length sale of the property securing their loan, specifically where familial ties exist between the buyer and seller. Find out why and how you can comply with this condition by reading two articles entitled "Arms Length Transaction" and "Arms Length Transaction – Part Deux."

"Mortgage Broker Siphons Proceeds" is a story about a cash-out refinance closed in Northern California where the mortgage broker convinced the borrowers to assign their proceeds to an unrelated third party. The borrowers authorized the payment with the understanding the monies would be funneled back to their lender to reduce the principal balance of their new loan. The monies were sent to the third party, who turned out to be the mortgage broker's wife, but the money was never forwarded to the lender to reduce the principal balance.

Although the stories contained in this edition of *Fraud Insights* won't bring you much joy, we wish you a tremendous holiday season. Remember, it's not too late to receive some extra holiday cash! If you have a heroic story to share, please submit the details to settlement@fnf.com. If your story is selected for a future edition of *Fraud Insights* the hero in the story will receive a \$1,000 reward from the Company as well as a letter of recognition.



Inside This Issue

Arms Length Transaction

There are a large number of homeowners realizing they owe more to the bank than their property is worth. They don't want to short sale their home and move out, but they do want to get out from under the tremendous debt. As a result, many homeowners have elected to fake a sale to a family member in order to obtain a lower mortgage payment.

Mortgage Broker Siphons Proceeds

Pay attention to all the red flags in this transaction involving unsuspecting borrowers in Northern California who were duped by their mortgage broker. The mortgage broker diverted the proceeds from a cash-out refinance to an unrelated third party – who later turned out to be his wife!

Arms Length Transaction – Part Deux

On a recent GMAC short sale transaction the chain of title reflected a Quit Claim Deed from the buyer to the seller just months prior to the contract date. The buyer was getting a new purchase money loan. Clearly this was not an arms length transaction.

Arms Length Transaction

There are a large number of homeowners realizing they owe more to the bank than their property is worth. They don't want to short sale their home and move out, but they do want to get out from under the tremendous debt. As a result, many homeowners have elected to fake a sale to a family member in order to obtain a lower mortgage payment.

Some property owners have figured out a clever way of reducing their debt while remaining in their home. The property owner enters into a purchase contract to short sale his/her property to a straw buyer, usually a family member. The property owner uses the purchase contract with the straw buyer to negotiate a short sale with the existing lender. In turn, the straw buyer uses the purchase contract to qualify for a new purchase money loan. Once the short sale approval letter and new purchase money loan are secured the transaction closes, but the owner never moves out of the property.

Instead, the original owner takes over the monthly payments from the straw buyer (relative) based on a lower principal amount, lower interest rate and much lower monthly payment. In these situations, the loan investor then suffers losses on both loans. The loan investor accepts a shortage on the existing loan and ends up purchasing the new loan with a borrower who doesn't actually live in the property and doesn't make the mortgage payments. Instead the investor receives payments from the same borrower who just shorted them thousands of dollars.

As a result, some short pay approval letters require the sale transaction be an arms length transaction with no relationship between the buyer and seller. Below is a sample of the requirement language:

Any relationships between seller, buyer, agents and escrow/title companies must be disclosed in writing and made known to lender upfront prior to a demand being issued. Failure to do so may result in the demand being declared null and void at any time.

In some cases the short pay lender will require the buyer, seller and their real estate agents to sign an Affidavit of Arms Length Transaction under penalty of perjury which states, in part, the following:

The purchase and sale reflected in the Agreement is an Arms Length Transaction meaning the transaction has been negotiated by unrelated parties, each of whom is acting in his or her own self-interest. And that the sale price is based on fair market value of the Property. With respect to those persons signing this affidavit as an agent for either Seller(s), Buyer(s), or both, those agents are acting in the best interests of their respective principal(s).

Some short pay lenders require the Affidavit of Arms Length Transaction also be signed by the settlement agent acknowledging the parties are not related to one another to the best of the agent's knowledge. In most cases, the settlement agent wouldn't



know if the buyer and seller are related, so it is permissible to sign the affidavit and have the buyer and seller acknowledge the condition as placed on them by the short pay lender.

In spite of these measures, there are some instances where our exceptionally intelligent settlement agents detect a relationship between the parties. Carol May is one of those exceptional agents. She is an escrow officer for Chicago Title's Stockton, Calif. operation and recently handled a short sale where both parties had elected to sign outside our offices. Carol sent the documents out with two separate Company approved notaries, and the buyer and seller signed independently.

The short sale approval letter stated all parties needed to disclose any knowledge of a relationship between the parties. Both buyer and seller initialed the paragraph on the short pay approval letter, no relationship was disclosed. Carol received the signed documents back from the notaries and reviewed them. She noticed the buyer's and seller's drivers licenses indicated the same exact address!

Carol contacted the short pay lender with the facts. The short pay lender required the buyers and sellers provide a written and signed explanation of their relationship to one another. They simply stated in writing, "The buyers of the property are related to us through our in-laws." Much to our surprise the short pay lender returned the letter with a message signed by a vice president of the lending institution: "Ok to proceed with short sale."

As a token of appreciation from the Company for Carol's detection of the familial relationship and for notifying the payoff lender immediately of her findings she has been rewarded \$1,000 and a letter of recognition.

Moral of the Story

Had the settlement agent not made the payoff lender aware of the possible relationship between the buyer and seller, the payoff lender could have rejected the payoff amount and enforced their mortgage lien. The buyer in the transaction could have made a claim against the title insurer for a defective title. Our company would have had to expend whatever resources necessary to defend the Company and to unwind the transaction.

Mortgage Broker Siphons Proceeds

Pay attention to all the red flags in this transaction involving unsuspecting borrowers in Northern California who were duped by their mortgage broker. The mortgage broker diverted the proceeds from a cash-out refinance to an unrelated third party – who later turned out to be his wife!

The cash-out refinance was opened in a remote escrow branch in Northern California by Michael Bowman with Capital Direct Lending. He had never done business with our office before. Upon receipt of the loan documents the settlement agent arranged for an out-of-office signing with a BancServ notary. Just prior to the signing appointment the mortgage broker moved the signing location, causing the escrow officer to find another available BancServ notary. The mortgage broker offered to pick up the documents from the first notary and deliver them to the new signing location.

The mortgage broker inserted a document into the signing package that read as follows:

This shall serve as confirmation the additional proceeds available to you of \$6,132.68 or whatever is remaining that will be used to modify your existing principle [sic] balance and reducing it from \$98,500 down to \$92,368 thereby invalidating [sic] the existing amount of \$98.5k shown on the note and modifying it with a new amount of \$92.3K total amount due. Also, the interest rate has been returned to the original 4.875% from the current 5.00%. This is contingent upon the additional cash proceeds not being disbursed to you directly but only to a third party. These monies, the proceeds, will be transferred as a wire immediately at the close of escrow to a neutral third party who will then transfer these funds to the lender as a reduction in your principle [sic] balance.

Believe it or not the borrowers signed this nonsense! And, they signed an instruction authorizing the wire transfer to an account at Wells Fargo Bank belonging to an unrelated third party. The mortgage broker then delivered the documents back to the escrow branch office.

After the three-day right of rescission lapsed, the lender funded and the settlement agent began disbursing funds from the file, including the wire transfer of funds into the Wells account of an unrelated third party. Just as the settlement agent was about to send out the mortgage broker compensation her phone rang. The caller on the other end was a co-worker who claimed Michael Bowman was using their escrow branch's Federal Express account number to ship packages related to this and other transactions.

The settlement agent contacted the mortgage broker's main office location, asked for their overnight delivery account number and explained to Capital Direct Lending's owner that Michael Bowman had been using the Company account number for his own personal use. Capital Direct Lending's owner promised to reimburse the Company their expenses.

Because of the previous red flags, the settlement agent called the borrowers to tell them the refinance had closed and the funds were wired per their instructions to Wells Fargo. The borrowers were shocked to say the least. Evidently they didn't read any of the documents they signed including the instruction diverting the funds to an unrelated third party's account. They were under the impression they would receive proceeds in the amount of \$6,000. The settlement agent told them the name of the person who was to receive the wire transfer. The borrowers had no clue who that person was.

The settlement agent called for a reversal of the wire transfer. Wells Fargo insisted they needed the account holder's authorization to return the wire. They began calling the account holder, who did not answer her home phone, office phone and cell phone. The settlement agent contacted the owner of Capital Direct only to find out the account holder in question was Michael Bowman's wife!



Capital Direct then sent a fax notification indicating Michael Bowman would be wiring the funds directly to the lender to reduce the principal balance of their loan as promised. The settlement agent confirmed the wire was never received by the lender.

The settlement agent escalated the issue to FNF's National Escrow Administration and Treasury Departments. After further investigation it was discovered the mortgage broker, Michael Bowman, had his real estate license suspended indefinitely by the Department of Real Estate in 2002.

The borrower contacted the FBI Fraud Unit only to be told their case was too small. The FBI officer stated the Bureau will only investigate cases involving the theft of \$100,000 or more. The borrower was advised to contact the local authorities. This will be an ongoing story as the mortgage broker is reported to the Department of Real Estate and other regulators in the State of California. [Continued on pg4]

Arms Length Transaction – Part Deux

On a recent GMAC short sale transaction the chain of title reflected a Quit Claim Deed from the buyer to the seller just months prior to the contract date. The buyer was getting a new purchase money loan. Clearly this was not an arms length transaction.

Mayra Deeter, area manager for Chelsea Title in Clermont, was notified of a potential issue on a recent short sale transaction where the chain of title reflected the buyer had been a former co-owner of the property. Once notified, Mayra escalated the issue by notifying both the payoff lender and the buyer's new lender of the prior ownership interest of the buyer.



The short payoff lender on the transaction was GMAC and, much to Mayra's surprise, approved the closing knowing the buyer had been a former owner. Apparently GMAC held this loan in their portfolio and since it was in default wanted to get it off their books at any cost.

The purchase money lender felt differently. When they found out the buyer and seller had at some point jointly owned the property, they pulled their loan and shut down the transaction. As a result our file cancelled and all funds were returned to the buyer.

Mayra Deeter made the right decision to notify both lenders since their instructions required disclosure of any knowledge the settlement agent had of a relationship between the buyer and seller. For her efforts Mayra has been rewarded \$1,000 and a letter of recognition from the Company.

The moral of the story

"Better to shut it down, then to create a claim," were the words that accompanied this story when submitted by Susan West, the Eastern Florida operations manager. Truer words were never spoken. Had Mayra neglected to inform the payoff lender and the new lender of the previous ownership the buyer had in the property the transaction could have gone horribly awry. The result would have been the payoff lender rejecting our payment and the new lender having a claim against us since their loan would no longer be in first position.

[Mortgage Broker Siphons Proceeds — Continued from pg3]

Moral of the story

Payments to unrelated parties in a transaction are strictly prohibited! In a refinance transaction, loan proceeds may only be paid in strict compliance with the written closing instructions provided by the funding lender. Any request to pay additional parties must be listed in the 1300 section of the HUD-1 and approved in accordance with the lender's instructions. In most cases, approval of the HUD-1 or closing statement by the funder is not sufficient.

If a principal requests these types of disbursements, it is best to say it is against our Company policy. It is the settlement agent's fiduciary duty to remain neutral and safeguard the funds on deposit, ensuring all of the conditions are met. Lenders expect full disclosure of all receipts and disbursements in accordance with written mutual instructions. If a lender disapproves of any requested disbursement be sure to notify the party in writing.

Settlement agents may accept written instructions to deposit proceeds directly into a bank account on behalf of the principals. Settlement agents may also cut separate checks or send a wire in the name of each individual seller or borrower. Multiple disbursements to the same payee are not acceptable, especially when asked to disburse in increments of \$10,000 or less, as this might be perceived as participation in a money laundering scheme.

*For client distribution,
please attach business card.*