

## Identifying Fraudulent Lending within a BTL Portfolio

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While the economy may be stabilising and confidence slowly returning to the credit markets, the mortgage sector is facing fresh problems as the dust begins to settle. After one of the worse years for mortgage losses since the early 90's, recent months have seen a number of disclosures of fraud problems in the books of leading Buy-to-Let (BTL) lenders. Given the size of the BTL market in the UK, it can only be expected that further disclosures will be forthcoming from a number of other lenders. The current low interest rate environment may be conspiring to hide these problems, but if interest rates rise or economic hardships continue, through rising unemployment or depressed house values, then these will undoubtedly come to light.

In the large majority of cases, the fraud being experienced by the BTL lenders is resulting from fraudulent behaviour or professional negligence on the part of brokers, solicitors or valuers during the processing of the mortgage applications. Given the importance of these individuals in the application chain, lenders are discovering that losses resulting from this type of fraud are far greater than may be anticipated simply from falling house values, forced sales and associated costs.

If they haven't done so already, it is important that lenders start sizing the number of loans in their portfolio which may be fraudulent and to estimate the potential losses they are facing should this prove to be the case. Lenders need to move quickly to identify these loans, particularly if they plan to undertake professional negligence claims against third parties, to ensure they are at the top of the pile for any payouts that are made.

One key problem is that traditional fraud analysis and investigations have been reactive, such as investigating third parties after a tip-off has been received. In this article Euristix will provide insight on how lenders can start to approach the fraud problem pro-actively, identifying potentially fraudulent accounts which have yet to be uncovered and understanding the expected losses.

### Approach

The accurate identification of fraudulent lending gives lenders a high degree of certainty that any future losses in this area are already being provided for. As has been mentioned, the losses on fraudulent lending are typically higher than losses on credit lending so it is sensible to treat these separately.

The identification of the BTL fraud discussed here requires different techniques from other types of fraud analysis commonly undertaken in retail lending. Unlike account take-over or credit card transaction fraud, it is often the case with BTL fraud that the mortgage holder may not even be aware that fraud has occurred. Moreover BTL fraud is often the result of collusion between professionals in the processing of the application, with more than one fraudulent party. This makes the initial process relatively easy as known fraudulent third parties are identified but it becomes much more difficult when the remainder of the book is addressed.

## Investigations

Lenders need to begin by understanding the drivers and patterns of fraudulent activity within their portfolio. As with most types of fraud analysis in financial services, this typically starts with a manual investigations team.

These teams should begin by working all accounts linked to tip offs from industry sources such as the FSA. From this they can start building a qualitative picture of what fraud can look like and how it manifests. Other potentially fraudulent loans can be identified by linking known frauds to other accounts in the portfolio through basic matching of variables such as solicitor name.

This activity has obvious limitations however; it covers only the small part of the book which is linked to known fraud cases, potentially missing many more fraudulent loans which have yet to be uncovered. How do lenders tackle the problem of identifying these loans? The key is to combine a detailed analytical approach with the process output from the existing investigations work.

## Ground-Up Account Level Analytics

As with all fraud analytics activities, having a rich data source is ideal for identifying behaviours and patterns exhibited by previously identified fraud. Assuming that the lender has details of account investigations with a known fraud/non-fraud outcome, then this forms the natural foundation for the analytical work. However, even if existing fraud investigation information is limited, the analytics can start with an 'expert' approach to highlight likely cases and then refine into a more data-driven approach as the cases are worked. In either situation, a feedback loop should be established to incorporate the learning from the most recent investigations back into the analytical framework.

The data fields required for this type of analytics tend to go beyond those used in typical credit risk evaluation: the broker, solicitor and valuer used on the application, the landlord's correspondence address and bank details, type and location of property. When looking at a particular landlord's portfolio of loans, the size, location and speed of growth of that portfolio



can also be an indicator of potential issues. This is covered in a little more detail in the 'quick wins' section below.

Using these data fields and the output from the manual investigations allows an analytical approach to be taken which identifies the drivers of fraud in the portfolio. Carried out at an individual account level this gives an understanding of those characteristics most correlated to fraud. In addition to considering all variable types and variable combinations in this way, it is also important to analyse the linking of accounts to know frauds. There are numerous possibilities for the linking, from commonality of solicitor or valuer to having the same postcode. The relative importance of these links needs to be established to allow optimum use of the information.

Euristix have developed proprietary technologies to predict both of these likelihoods; the probability that an account is linked to an existing, identified fraud case, and the propensity for an unlinked account to still be the result of fraudulent activity. Applying these technologies to a BTL portfolio on an individual account level basis allows the derivation of these two probabilities in each case, which can then be used in combination to:

- Give indicative views of the total level of fraud within the portfolio, together with the expected monetary loss which may result.
- Prioritise the accounts for manual review to yield optimum efficiency of this process.
- Drive the initiation of timely and successful professional negligence claims.

Underpinning this concept is the necessity for both the feedback of learning and the implementation of an appropriate case management system. The first allows the experience and results from further investigations to improve the analytics and strengthen the fraud identification mechanisms. The latter ensures that status of all investigations is carefully tracked and the outcomes captured so that this learning can take place.

## **Example Quick Win from Fraud Analysis: Creating a Single Landlord View**

While the primary aim is of course the identification of fraud, some of the outputs from the fraud analysis can be incorporated into other areas of the business. For example, a quick win in both fraud and arrears analysis is to create a landlord view from the data.

Typically lenders' systems do not link same landlord accounts as a 'landlord id' is often simply not available as it is not generated as part of the application process. Therefore this linking needs to be carried out offline and this can be one of the beneficial by-products of the analysis



undertaken in the fraud analysis, where names, date of births, bank details and addresses are used to develop links of various strengths.

Once the landlord view is established and an associated 'landlord id' has been formulated, it is straight-forward to begin using this to drive additional insight and benefit. The landlord view can allow for more effective and targeted collections strategies which take account of the full customer picture. Loss forecasting and risk assessment can be improved which incorporates the view on landlord portfolio size and the associated dependency between accounts. And even at the most basic level, simply reporting at the aggregated landlord view can yield additional insight into the nature of the book.

## Conclusions

The issue of fraud will never be a simple one to address fully and the complete identification of all fraudulent activity remains impossible. But unlike the vagaries of the economic climate or the movements in the funding markets, this is one area that lenders do have control of. By building a robust analytical framework, which is equipped to both drive the manual review team and to learn from its findings, fraud can be captured and categorised. This leads firstly to a true sizing of potential losses and then to a mitigation of these losses through prioritised and timely actions. In a mortgage sector that is still facing difficult times this knowledge and loss reductions could be invaluable.

Euristix are experts in the area of retail financial services fraud, and have worked extensively within the mortgage sector to develop tools and technologies to understand fraud. If you would like to know more of our findings or wish to discuss the subject of BTL fraud in more detail then please contact Richard Pinch, [richard.pinch@euristix.com](mailto:richard.pinch@euristix.com).