How mortgage fraud is thriving in Canada's hot housing market

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In early 2013, Kelly Vandenham and her boyfriend were preparing to put an offer on a charming Craftsman-style house in West Kelowna, B.C. They had been preapproved for a mortgage with Canadian Imperial Bank of Commerce, but the couple’s realtor suggested they could get a lower interest rate at Toronto-Dominion Bank, where their realtor’s boyfriend, Kulwinder Dhaliwal, worked as a mobile mortgage specialist. What happened next is a problem that continues to plague the financial industry despite steady changes to mortgage lending rules, a dilemma that some warn threatens to undermine faith in the country’s robust housing market.

Shortly before the deal was set to close, according to court and regulatory tribunal documents, Mr. Dhaliwal e-mailed to say there was a problem with their application. Ms. Vandenham’s job letter from Interior Health Authority was missing some information, prompting the bank to take a closer look and potentially putting the deal at risk. In a statement she filed with a B.C. court later that year, Ms. Vandenham wrote that she offered to get a new letter the next day. Mr. Dhaliwal responded that he “would figure something out.”

Although TD was still reviewing the application, Mr. Dhaliwal instead cut out the Interior Health letterhead along with the signature of the agency’s human resources worker from the couple’s application and pasted them onto a fake new letter, which he submitted as part of a different application to Bank of Nova Scotia.

When Scotiabank called Interior Health to confirm some of the details of the letter, Ms. Vandenham was placed on unpaid leave and barred from setting foot on Interior Health property while it investigated her for fraud. “I was told my job was in jeopardy and I was worried I would lose my house I had just bought,” she wrote in a lawsuit against Mr. Dhaliwal that was eventually settled out of court. “I cried every day.”

According to court documents, Mr. Dhaliwal eventually admitted to what he had done and resigned from his job at the bank. TD ultimately approved Ms. Vandenham’s mortgage using her original – legitimate – employment letter. (Ms. Vandenham did not respond to requests for comment.)

Earlier this year, B.C.’s financial services regulator approved Mr. Dhaliwal’s application to become a mortgage sub-broker, someone who works as a broker but doesn’t own a brokerage.

In granting Mr. Dhaliwal a conditional licence, Carolyn Rogers, head of the provincial Financial Institutions Commission, put the blame on Mr. Dhaliwal’s former employer, TD Bank, for putting intense pressure on Mr. Dhaliwal, whom she described as poorly trained and financially naive.

What little coaching Mr. Dhaliwal received on how to properly conduct business, she wrote, “was overwhelmed by a focus on the volume of mortgage business Mr. Dhaliwal was bringing to the bank and relentless pressure to sell creditor protection insurance to as many borrowers as possible.”

Reached by phone last week, Mr. Dhaliwal said he needed to consult with his brokerage before making a comment. “I went through quite a bit of an ordeal with this whole situation,” he said. “I don’t want to get in any extra trouble for saying anything.” He did not respond to subsequent attempts to reach him.

Cases such as this represent what many in the mortgage industry say is the growing, yet under-reported, problem of mortgage fraud, perpetrated not by criminals looking to scam a bank, but by mortgage industry professionals looking to help their clients qualify to buy a home.

It's an issue that has been exacerbated in recent years by soaring home prices, stagnating incomes, fierce competition among brokers, lenders and real estate agents, and tighter federal mortgage lending rules that have made it harder than ever for many Canadians to afford home ownership.

"The people who are salaried and altering their income for the most part are probably just facing into some of the affordability pressures because of the level of house prices today and are trying to buy a home that's out of their reach," says Stuart Levings, chief executive officer of mortgage insurer Genworth MI Financial Inc. "You know how it is these days, folks just want that home. They could qualify if they looked at a lower-priced home."

Earlier this year, Home Capital Group Inc., the country's largest alternative mortgage lender, revealed it had cut ties with 45 mortgage brokers after an anonymous letter to the company's board of directors sparked an investigation into forged documents, such as fake employment letters and income statements. Collectively, the brokers who were fired generated nearly $1-billion worth of mortgages for the company last year.

While scandals such as the one at Home Capital occasionally shed light on the dark side of Canada's $1.3-trillion mortgage industry, much of the problem of mortgage fraud remains hidden from public view.

In an online presentation on fraud and identity theft from 2012, mortgage insurer Canada Guaranty notes that "one in 10 mortgage applications will have some element of fraud." Credit bureau Equifax says it had been able to flag nearly $1-billion worth of attempted mortgage fraud among its lender clients since 2013.

"It's happening on such a level that the consumer is aware that this is something that can be done," says an Ontario mortgage broker who didn't want his name used and who once complained to federal and provincial regulators after being referred a deal that involved a family looking to buy three homes without any reportable income. "It's happening on such a level that some bank reps, mobile mortgage reps, have said: Call a mortgage broker, they can probably find a way to make your income higher."

'Soft fraud'

Those in the industry agree that much of what constitutes mortgage fraud in Canada is what's known as "soft fraud" or "fraud for shelter" and usually involves people who are genuinely looking to buy a home and pay their mortgage, but can't quite qualify for a conventional loan.

In some cases borrowers are simply trying to buy a home that is out of their reach financially. In others, the borrowers could qualify if they had a bigger down payment and paid a higher interest rate, but instead alter pay stubs and bank statements in order to qualify for the cheapest possible mortgage. Still, more involve people like Mr. Dhaliwal, who forge documents in order to save a deal that is up against a tight deadline.

One of the "red flags" that makes Toronto-area mortgage broker Mark Cashin suspect a deal may involve fraud is when a client comes in asking how much he charges. Brokers typically don't charge clients fees up front, instead collecting commissions from lenders when a deal closes. Some, however, charge fees into the thousands to create fake pay stubs, bank statements and tax documents and will often hit clients with steep charges when they go to renew a mortgage that was funded based on forged documents.

"When I first started in the business, I thought this is the greatest business ever, people are willing to pay you money up front," Mr. Cashin says. "And then my broker told me: 'They want you to create documents.' I figured that one out pretty quick."

Others come in clutching suspiciously perfect mortgage applications complete with all the required documents. Most legitimate clients have to be hounded for ages to submit all the necessary paperwork, Mr. Cashin says.

Montreal mortgage broker Walid Hammami once turned down a client because the copy of his Canada Revenue Agency notice of assessment looked too good. “The quality of the paper this thing was printed on was so classy,” he says. “It’s impossible the government would have the means to do that for every person.” In another instance, he called a client to verify documents given to him by a realtor that said the client worked as a butcher, only to find out he was actually a truck driver on disability.

Equifax has noticed the trend of people coming into its offices looking to upgrade their credit score with new employment details using fake job letters. “They’ll use the same template which has the same words spelled incorrectly,” says John Russo, Equifax’s legal counsel and chief privacy officer. Such attempts at “soft fraud” are up 15 to 20 per cent this year, he says. “We’ve seen many instances, in the thousands, come across our desks.”

In August, researchers at Veritas Investment Research visited 10 Toronto-area mortgage brokers, posing as buyers who were employed full-time and had a good credit rating, but were looking to take on more mortgage debt than they would qualify for under current rules. They offered to get fake employment letters from a relative who owned a business saying they also worked for him part-time.

Three brokers suggested they could get the deal approved through a “B lender,” or one specializing in subprime borrowers, including one broker who suggested the family member process a fake pay stub to include with the application. “This, of course, would only be acceptable for an upfront fee to the broker,” wrote investment analyst Mike Rizvanovic.

‘Project Cut and Paste’

While much of the focus on mortgage fraud is directed toward alternative mortgage lenders and independent mortgage brokers, a review of court files and provincial financial regulators’ disciplinary records paints a picture of a problem that is far more widespread. Major banks, private lenders, credit unions, monoline lenders – non-bank financial institutions that only deal in mortgages– have all been victims of both soft and hard fraud, perpetrated by mortgage brokers, lawyers, government workers and even the bank’s own employees.

The Ontario Ministry of Community and Social Services uncovered an unauthorized mortgage brokerage operating out of the Family Responsibility Office, a provincial agency that enforces family court judgments for child and spousal support payments. It fired at least one employee after searching his computer and finding fake pay stubs for companies with names like Express Law Services and the Ontario Dental Institute.

One of the pay stubs was for an employee of the Family Responsibility Office who made $57,000 at her government job, but claimed to make $75,000 working for a company called Freedom Mortgage Financial Solutions, which was the name of a brokerage being run by one of the office’s managers. Investigators confirmed that a lender had given her a mortgage on a $320,000 townhouse based on the fake documents.

Last year, Frank Wong, a Scotiabank employee at a branch in Brampton, Ont., was convicted of fraud for altering details such as credit scores on more than 110 mortgage applications totalling $46-million. He was sentenced to a year in jail, as was his partner in the scheme, Praimraj Chansingh, an unlicensed, self-professed mortgage broker who paid Mr. Wong from $500 to $1,500 to process the fraudulent applications.

As part of the investigation, police also charged a Toronto police constable whom investigators alleged had received an inflated mortgage on a rental property he owned, an employee of a local law firm that did work on the mortgage applications, and a supervisor at CIBC who allegedly provided copies of her pay stubs to be used in at least five other mortgage applications as a favour for getting a large mortgage through Scotiabank. (Charges against everyone except Mr. Wong and Mr. Chansingh were eventually dropped.)

A Canada Post employee was fired after the postal service discovered he and his wife had been given a mortgage for nearly $800,000 on their Mississauga home as part of the Scotiabank scam using a forged job letter that claimed he was a supervisor making $90,000, when he was actually a letter carrier who made $48,000. (He was later reinstated by a labour arbitrator.)

While it went on for years, the Scotiabank fraud was not particularly sophisticated. Police dubbed their investigation "Project Cut and Paste" for the method Mr. Wong used to lift credit scores and other details from legitimate mortgage applications and paste them onto fraudulent ones. The broker, Mr. Chansingh, used Adobe software to alter other financial documents.

Many of the borrowers were struggling financially and eventually defaulted. By last year, according to court records, the bank had lost at least $12-million.

"This offence has the potential to seriously damage the value of all homes in the Brampton and Mississauga area," Crown prosecutors wrote in a court brief. "With a potential forecasted increase of 1 to 2 per cent on the mortgage interest rate, foreclosures will happen to some of these mortgage holders who can't even afford the current mortgage rates. Many of these homes could be foreclosed upon and whole communities will suffer from a fall in home values. This scenario occurred in the United States with the subprime mortgages."

Others play down the risks to the overall housing market from mortgage fraud, arguing that home buyers are merely responding to an overheated housing market that forces buyers to waive financing conditions to win a bidding war, meaning they'll lose hefty deposits if they can't get approved for a mortgage quickly.

An environment to cheat

Broker Mr. Cashin blames overly stringent federal rules governing insured mortgages, such as shorter amortization periods and higher mortgage insurance premiums, for making it harder for average Canadians to get a mortgage, especially in expensive markets like Toronto or Vancouver.

Such policies are aimed at ensuring the housing market didn't experience a catastrophic U.S.-style meltdown. Mr. Cashin argues that they have had the opposite effect, pushing otherwise creditworthy borrowers who would have qualified for a conventional mortgage in the past into riskier areas of the market, including to industry professionals willing to commit fraud to get a deal done at all costs.

"They're creating an environment for people to cheat because they want those low rates," he says. "A lot of times it's because they need it. House prices are going up. Everything is going up except people's wages, but policy is keeping the cheap money away from the people who need it the most."

Others say the driving force behind mortgage fraud is to help clients who have the means to afford the mortgage, but who work for cash or otherwise aren't declaring all their income. That might make them tax cheats, but it doesn't necessarily put them at higher risk of defaulting on a mortgage.

"If I feel a client can afford it, I'll help them and guide them," says one Toronto mortgage broker who spoke on condition of anonymity because he admits he helps clients fake job letters, income documents and employer phone references.

"Yes it's fraud. But we are looking out for the bank. We are looking out for the economy in that we're not giving the mortgages we know are going to screw up," he says. "I will stop clients and deals that I know are headed for trouble because it's not healthy for anybody."

Home Trust CEO Gerald Soloway told an analyst conference call earlier this year that the mortgages it had flagged for fraud were actually performing better than the company-wide average.

Genworth's Mr. Levings says the mortgage industry has gotten better at spotting fraud attempts through collaboration and new technology that makes it easier to identify suspicious applications, such as those that use job letters from the same non-existent employer, or applications that are being shopped around to several lenders with slightly different documentation each time.

Lenders don't usually send Genworth the paper documents, but the insurer gets a set of about 160 data fields from each application that it feeds into a software system that scores every deal based on details such as the borrower's age, income, the industry they work in, the type of home they're buying and where they live. Applications that score high often get approved with little follow-up, while those that score low are sent for a more detailed review. Since the 2008 global financial crisis, the rate of mortgages that Genworth sees defaulting within the first year – a sign of fraud or borrowers in over their heads – has dropped by half, he says.

The industry also improved after the Office of the Superintendent of Financial Institutions, the federal regulator, brought in new underwriting standards requiring both lenders and insurers to make reasonable attempts to verify employment letters and other financial documents. Mr. Levings says the "gold standard" for underwriting in the industry today, which most lenders are meeting, is to ask for two pieces of documentation and then back it up with independent research, such as checking a borrower's credit score or looking up an employer on Google to see if it exists.

"You don't need to go beyond that," he says. "There's a diminishing return. The more you get doesn't necessarily mean you're going to catch more."

Yet just as technology has given the financial industry new tools to spot fraud, it has also given fraudsters better tools to avoid detection. Almost any document can be forged these days, the Toronto broker says. The only step that will guarantee that a deal will fail is if a lender asks for permission to call the Canada Revenue Agency to independently verify income details. "If you ever get to that point, you've got to drop the deal," he says.

Vetting every application with a call to the CRA is not a realistic solution, Mr. Levings contends. "Frankly, I very much doubt that the CRA would ever be willing to give that up," he says. "The privacy risk is so huge with that."

However, many say more thorough due diligence by lenders will only go so far in solving the problem and that the mortgage industry has to do more to curb the incentives for home buyers and mortgage professionals to want to commit fraud in the first place.

Regulators need to threaten stiff penalties for even minor fraudulent activity, mortgage broker Mr. Hammami says. Banks and mortgage brokerages, many of which have been aggressively hiring, have to do a better job of checking into the backgrounds of new employees. "Some of these mortgage reps working for the banks move from one bank to another because they got caught," he says. "And after doing it to a few banks, they move to the brokerage industry."

Mr. Hammami is among those pushing for national industry standards and a Canada-wide regulatory body for brokers, who are now regulated at the provincial level. New brokers need help coming up with a business and marketing plan, he says. Unless they have a steady pipeline of new clients, brokers can go months without closing a deal and getting paid, so he thinks brokerages may need to rethink the commission-only business and start paying new employees a salary for the first several months until they get a feel for the industry.

"We need to speak up about these things," he says. "People are treating the mortgage industry like a free ride."

With a new Liberal federal government professing to tackle the country's affordable housing crisis, Mr. Cashin believes Ottawa may need to take a second look at all of the regulations put in place in recent years to safeguard the housing market if it really wants to curb the demand for fraud.

"The mortgage business has become more complicated than it needs to be, all in the optics of protecting and stabilizing the economy," he says. "People in general are just trying to provide the best place they can for their family to be raised. They're trying to get to that cheap money like everyone else. If you create a situation that would motivate behaviour like that, well then shame on the government, shame on us."