

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

12 CFR Part 1731

RIN 2550-AA31

Mortgage Fraud Reporting

AGENCY: Office of Federal Housing Enterprise Oversight, HUD.

ACTION: Final Rule

SUMMARY: The Office of Federal Housing Enterprise Oversight (OFHEO) is issuing a final regulation that sets forth safety and soundness requirements with respect to mortgage fraud reporting in furtherance of the supervisory responsibilities of OFHEO under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.

EFFECTIVE DATE: [Insert date 30 days after date of publication.].

FOR FURTHER INFORMATION CONTACT: Isabella W. Sammons, Deputy General Counsel, telephone (202) 414-3790 (not a toll-free number); Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION

Background

Title XIII of the Housing and Community Development Act of 1992, Pub. L. 102-550, titled the Federal Housing Enterprises Financial Safety and Soundness Act of 1992

(12 U.S.C. 4501 et seq.) established OFHEO as an independent office within the Department of Housing and Urban Development to ensure that the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises) are adequately capitalized and operate safely and soundly in compliance with applicable laws, rules, and regulations. To carry out its statutory responsibilities, OFHEO may, among other things, require an Enterprise to submit reports.¹

On February 25, 2005, OFHEO published for comment a proposed regulation, at 70 FR 9255, which set forth proposed safety and soundness requirements with respect to mortgage fraud reporting. The 30-day comment period was extended until April 4, 2005.² All comments received have been made available to the public in the OFHEO Public Reading Room and also posted on the OFHEO web site at www.OFHEO.gov.

Comments Received

Comments were received from the Inspector General for the Office of Housing and Urban Development; the Mortgage Asset Research Institute, a subsidiary of ChoicePoint Services Inc.; the Mortgage Bankers Association, a national association representing the real estate finance industry; the National Association of Mortgage Brokers; Freddie Mac; Fannie Mae; the Consumer Mortgage Coalition, a trade group of national residential mortgage lenders, servicers and service providers; AMCO, a valuation management firm; and various private citizens. All comments were taken into consideration. A discussion of the significant comments as they relate to the proposed sections of the regulation follows.

¹ 12 U.S.C. 4514.

² 70 FR 15018 (March 24, 2005).

Purpose and scope.

Several commenters questioned the necessity for a regulation expressly requiring reporting of mortgage fraud and possible mortgage fraud and the benefits of such reporting to the Enterprises and the mortgage industry. Two commenters recommended that OFHEO consider alternative approaches, such as reliance on private industry “ineligible” lists.

The purpose of the regulation is to set forth safety and soundness requirements and expectations with respect to the reporting of mortgage fraud in furtherance of the supervisory responsibilities of OFHEO, that is, ensuring the safe and sound operations of the Enterprises. OFHEO must gain timely information on actual or possible mortgage fraud to assure that adequate internal controls and systems exist to protect the Enterprises from risks associated with such fraud. The information provided will be the subject of review by the examination force of OFHEO, as well as other appropriate OFHEO offices. The information will assist OFHEO in assessing internal controls, security efforts, management of risks, including reputation risk, and other factors relevant to the safe and sound operation of the Enterprises. The oversight by OFHEO of programs to detect and avoid mortgage fraud will provide public understanding of the expectation that the Enterprises will remain vigilant in resisting fraudulent practices and should have a deterrent effect. OFHEO will develop a process for sharing of information it acquires with law enforcement authorities, while assuring that the Enterprises do not encounter liability issues.

The Federal Bureau of Investigation (FBI) indicated in *Financial Crimes Report to the Public* (May 2005) that combating significant mortgage fraud is an FBI priority

because mortgage lending and the housing market have a significant overall effect on the nation's economy.³ The FBI explained that:

A significant portion of the mortgage industry is void of any mandatory fraud reporting. In addition, mortgage fraud in the secondary market is often under reported. Therefore, the true level of mortgage fraud is largely unknown. The mortgage industry itself does not provide estimates on total industry fraud. Based on various industry reports and FBI analysis, mortgage fraud is pervasive and growing.

In combating mortgage fraud, the FBI noted that it works actively to investigate such fraud and has been fostering relationships and partnerships with the mortgage industry, including the Enterprises. While OFHEO has no authority to “police” the mortgage industry for fraud or to prosecute mortgage fraud, OFHEO has noted that the Enterprises, as part of the financial system, should operate in a manner to deter fraud and thereby assist in system-wide efforts to make mortgage fraud an unattractive avenue for corrupt individuals or institutions.

The Enterprises currently investigate and maintain information on mortgage fraud and possible mortgage fraud. A formal reporting requirement to OFHEO will focus Enterprise efforts on ensuring that internal policies, procedures, and training programs are in place to minimize the risks from mortgage fraud. No evidence exists that a formal reporting requirement will create or increase burdens on the Enterprises. The Enterprises currently investigate fraud or possible fraud, report fraud to law enforcement authorities, and provide reports to OFHEO as required; this regulation contemplates such routine

³ http://www.fbi.gov/publications/financial/fcs_report052005/fcs_report052005.htm#d1.

reporting to OFHEO. Additionally, no evidence exists that a formal reporting requirement will require the mortgage industry as a whole to take on additional burdens. The Enterprises currently, when fraud is suspected, inquire of seller-servicers and others about business transactions and practices. Furthermore, law enforcement authorities have reported that much of the fraud involving secondary market parties relates to institutional fraud, not individuals seeking to secure financing. Thus, Enterprise efforts to report on possible or actual mortgage fraud should have no regulatory burden for the mortgage finance industry as the Enterprises already conduct due diligence in dealing with seller-servicers and others in the mortgage finance system.

For the reasons set forth above and because of law enforcement reports of an increasing incidence of mortgage-related fraud — and the potential impact of such fraud on Enterprise profits, liquidity and reputation — OFHEO has determined to issue the mortgage fraud reporting regulation.

Definition of the terms “mortgage fraud” and “possible mortgage fraud.”

As proposed, the term “mortgage fraud” would be defined under § 1731.2 to mean a material misstatement, misrepresentation, or omission relied upon by an Enterprise to fund or purchase —or not to fund or purchase — a mortgage, mortgage backed security, or similar financial instrument. The term would include, but not be limited to, identification and employment documents, mortgagee or mortgagor identity, and appraisals that are fraudulent. The term “possible mortgage fraud” would be defined to mean that an Enterprise has cause to believe that that mortgage fraud is occurring or has occurred.

OFHEO received a few comments on the definition of the term “mortgage fraud.” One commenter noted that the definition treats all mortgage-backed securities (MBS) as equivalent to mortgages for purposes of mortgage fraud, whether issued or guaranteed by an Enterprise or whether issued or guaranteed by a third party. The commenter explained that MBS issued and guaranteed by a third party may present securities fraud issues, but not mortgage fraud issues, and requested that the definition make clear that it covers only MBS issued or guaranteed by an Enterprise. Two other commenters requested that the definition should include the concept that the material misstatement, misrepresentation, or omission be “knowingly made” or “intentionally made.”

OFHEO has revised the definition of the term “mortgage fraud” to clarify that it covers MBS issued or guaranteed by an Enterprise. OFHEO does not believe that it is necessary to include the concept that the material misstatement, misrepresentation, or omission be “knowingly made” or “intentionally made.” Such language goes to the definition of fraud that is well established, as opposed to the definition of a particular type, that is, fraud related to mortgages. In addition, benchmarks or “triggers” for providing information to OFHEO, as discussed below, will be developed as the reporting requirements are implemented.

The term “possible mortgage fraud” was proposed to be defined to mean that an Enterprise has cause to believe that mortgage fraud may be occurring or has occurred. Some commenters recommended that OFHEO should provide guidance, through regulation or through guidance documents, as to triggers and level of verification, otherwise the definition, they argued, is too broad. OFHEO agrees and will provide

guidance, as requested, as to these and related matters as part of the implementation of the reporting requirements.

One commenter recommended that the definition should include the element of good-faith judgment on the part of the Enterprise. Another commenter recommended that the definition should include the element of reasonable or justifiable cause to believe that mortgage fraud may be occurring or has occurred. OFHEO agrees that the definition should be modified to include “reasonable cause” and has clarified the definition of the term “possible mortgage fraud” accordingly.

Unsafe and unsound conduct.

Proposed § 1731.3 would provide that an Enterprise may not require the repurchase of or may not decline to purchase a mortgage, mortgage backed security, or similar financial instrument because of possible mortgage fraud without promptly reporting to the Director under § 1731.4. One commenter requested that this section should clearly state that it does not prohibit the Enterprises from declining purchases or requiring repurchases if the Enterprises are properly reporting mortgage fraud or possible mortgage fraud. OFHEO agrees, and has clarified the language of § 1731.3 accordingly.

Reporting time-period.

As proposed, § 1731.4 would set forth the procedures for reporting fraud and possible mortgage fraud to OFHEO. OFHEO would issue implementation instructions with respect to reporting such fraud. Section 1731.4 also would provide that if a situation requires the immediate attention of OFHEO, an Enterprise would report immediately by telephone or electronic communication.

A few commenters recommended that the proposed four-day notification period was too short and recommended either a 30-day period or that notification be “prompt.” OFHEO agrees that a requirement for “prompt reporting” would permit flexibility in addressing different situations and changing needs in the implementation of the reporting requirement and has modified the definition accordingly to remove the fixed time period and will address notification requirements as part of the implementation of the rule.

The requirement for immediate reporting, when appropriate, remains.

One commenter recommended that the reporting requirement should not be retroactive and apply only to mortgages purchased or not purchased six months after the effective date of the regulation. OFHEO did not propose and does not intend that the regulation have retroactive application; OFHEO will work with the Enterprises for an effective transition while the Enterprises develop and implement or enhance reporting systems.

Non-disclosure and safe harbor.

As proposed, the section would prohibit the disclosure of reporting mortgage fraud or possible mortgage fraud to the parties connected with such fraud without the prior written approval of the Director. The proposed section expressly stated that the requirement would not prevent an Enterprise from disclosing or reporting such fraud pursuant to legal requirements, including reporting to appropriate law enforcement authorities.

One commenter expressed a concern that the proposed section would discourage the Enterprises from reporting fraud; another argued that the Enterprises should be required to report fraud to law enforcement authorities. The Enterprises already have the

authority to report fraud to law enforcement; the major focus of concern of the proposed regulation is the need to make routine reporting of possible mortgage fraud to OFHEO and for OFHEO to take actions regarding such possible fraud. Another commenter recommended the addition of a clarification that the requirement of this section does not limit the Enterprise from reporting fraud to a third party or from taking any legal or business action it may deem appropriate, including an action involving the party or parties connected with the mortgage fraud or possible mortgage fraud. OFHEO agrees that this clarification is useful and has modified the section accordingly.

A few commenters addressed “safe harbor” concerns, in that the safe harbor provisions of the Bank Secrecy Act would not apply to the Enterprises reporting of mortgage fraud to OFHEO, and leave the Enterprises vulnerable to liability should OFHEO refer an Enterprise report to another government agency. OFHEO recognizes the liability concerns; nevertheless, OFHEO will continue to provide information on mortgage fraud to appropriate authorities while addressing concerns related to the absence of an explicit safe harbor.

Except with respect to the clarifications of the proposed language as noted above, OFHEO has determined to issue the regulation as proposed.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

The regulation is not classified as an economically significant rule under Executive Order 12866 because it would not result in an annual effect on the economy of \$100 million or more or a major increase in costs or prices for consumers, individual industries, Federal, state, or local government agencies, or geographic regions; or have

significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or foreign markets. Accordingly, no regulatory impact assessment is required. Nevertheless, the proposed regulation was submitted to the Office of Management and Budget for review under other provisions of Executive Order 12866 as a significant regulatory action.

Executive Order 13132, Federalism

Executive Order 13132 requires that Executive departments and agencies identify regulatory actions that have significant federalism implications. A regulation has federalism implications if it has substantial direct effects on the states, on the relationship or distribution of power between the Federal Government and the states, or on the distribution of power and responsibilities among various levels of government. The Enterprises are federally chartered corporations supervised by OFHEO. The regulation would require reporting of mortgage fraud to OFHEO. It would not affect in any manner the powers and authorities of any state with respect to the Enterprises or alter the distribution of power and responsibilities between Federal and state levels of government. It would in no way limit the authority of any state to take actions for violations of its laws. Therefore, OFHEO has determined that the regulation has no federalism implications that warrant the preparation of a Federalism Assessment in accordance with Executive Order 13132.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires that a regulation that has a significant economic impact on a substantial number of small entities, small

businesses, or small organizations include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). OFHEO has considered the impact of the proposed regulation under the Regulatory Flexibility Act. The General Counsel of OFHEO certifies that the regulation would not be likely to have a significant economic impact on a substantial number of small business entities because it would be applicable only to the Enterprises, which are not small entities for purposes of the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 1731

Administrative practice and procedure, Government sponsored enterprises.

For the reasons stated in the preamble, part 1731 is added to chapter XVII, title 12 of the Code of Federal Regulations to read as follows:

PART 1731 — MORTGAGE FRAUD REPORTING

Sec.

1731.1 Purpose and scope.

1731.2 Definitions.

1731.3 Unsafe and unsound conduct.

1731.4 Procedures for reporting.

1731.5 Internal controls, procedures, and training.

1731.6 Supervisory action.

Authority: 12 U.S.C. 4513(a) and 4513(b)(1), (2), and (7).

Part 1731—Mortgage Fraud Reporting

§ 1731.1 Purpose and scope.

The purpose of this section is to set forth safety and soundness requirements with respect to the reporting of mortgage fraud in furtherance of the supervisory responsibilities of OFHEO under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 et seq.).

§ 1731.2 Definitions.

For purposes of this part —

(a) Director means the Director of OFHEO, or his or her designee.

(b) Enterprise means the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

(c) Mortgage fraud means a material misstatement, misrepresentation, or omission relied upon by an Enterprise to fund or purchase -- or not to fund or purchase -- a mortgage, including a mortgage associated with a mortgage-backed security or similar financial instrument issued or guaranteed by an Enterprise. Such mortgage fraud includes, but is not limited to, a material misstatement, misrepresentation, or omission in identification and employment documents, mortgagee or mortgagor identity, and appraisals that are fraudulent.

(d) OFHEO means the Office of Federal Housing Enterprise Oversight.

(e) Possible mortgage fraud means that an Enterprise has a reasonable belief, based upon a review of information available to the Enterprise, that mortgage fraud may be occurring or has occurred.

§ 1731.3 Unsafe and unsound conduct.

An Enterprise may not require the repurchase of or may not decline to purchase a mortgage, mortgage backed security, or similar financial instrument because of possible mortgage fraud without promptly reporting to the Director under § 1731.4. An Enterprise may decline such purchase or require such repurchase if it is reporting mortgage fraud or possible mortgage fraud in accordance with § 1731.4.

§ 1731.4 Procedures for reporting.

(a) Procedures for reporting.

(1) Prompt report. An Enterprise shall report promptly mortgage fraud or possible mortgage fraud in writing to the Director in such format and under such notification procedures as prescribed by OFHEO. The report shall describe the mortgage fraud or possible mortgage fraud in detail sufficient under OFHEO guidance. The Enterprise, at the sole discretion of the Director, may be required to provide additional or continuing information in connection with such mortgage fraud.

(2) Immediate report. In addition to reporting in writing under paragraph (a)(1) of this section, in any situation requiring immediate attention by OFHEO, an Enterprise shall report the mortgage fraud or possible mortgage fraud to the Director by telephone or electronic communication.

(b) Retention of records. An Enterprise shall maintain a copy of any report submitted to the Director and the original or business record equivalent of any supporting documentation for a period of five years from the date of submission.

(c) Nondisclosure. An Enterprise may not disclose, without the prior written approval of the Director, to the party or parties connected with the mortgage fraud or

possible mortgage fraud that it has reported such fraud under this part. This restriction does not prohibit an Enterprise from –

(i) Disclosing or reporting such fraud pursuant to legal requirements, including reporting to appropriate law enforcement or other governmental authorities; or

(ii) Taking any legal or business action it may deem appropriate, including any action involving the party or parties connected with the mortgage fraud or possible mortgage fraud.

(d) Acceptance of other forms. The Director may, upon written notice to each Enterprise, accept reports of mortgage fraud or possible mortgage fraud in formats promulgated by any Federal agency that has jurisdiction over the reporting of mortgage fraud or possible mortgage fraud by the Enterprises.

(e) No waiver of privilege. An Enterprise does not waive any privilege it may claim under law by reporting mortgage fraud or possible mortgage fraud under this part.

§ 1731.5 Internal controls, procedures, and training.

An Enterprise shall establish adequate and efficient internal controls and procedures and an operational training program to assure an effective system to detect and report mortgage fraud or possible mortgage fraud under this part.

§ 1731.6 Supervisory action.

Failure by an Enterprise to comply with §§ 1731.3, 1731.4, and 1731.5 may subject the Enterprise or the board members, officers, or employees thereof to supervisory action by OFHEO under the Federal Housing Enterprises Safety and Soundness Act of 1992 (12 U.S.C.

4501 et seq.), including but not limited to, cease-and-desist proceedings and civil money penalties.

Stephen A. Blumenthal
Acting Director
Office of Federal Housing Enterprise Oversight

Date