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OFHEO Finalizes Regulation on Mortgage Fraud

Washington, D.C. — The Office of Federal Housing Enterprise Oversight (OFHEO) has finalized for publication in the *Federal Register* a regulation requiring Fannie Mae and Freddie Mac (the “Enterprises”) to report mortgage fraud or possible mortgage fraud in a timely fashion. The regulation, effective 30 days from publication, is the product of a notice and comment rulemaking.

In addition to requiring reporting of fraud to OFHEO, the regulation requires the Enterprises to maintain adequate internal controls, procedures, and training programs to assure an effective system to detect and report actual or possible mortgage fraud. OFHEO’s examination force will review information received, which will help in assessing internal controls, security efforts, management of risks, and other factors at the Enterprises. In addition, OFHEO is developing a process for sharing relevant mortgage fraud information with other federal agencies.

“The regulation makes transparent OFHEO’s oversight of Enterprise initiatives to detect mortgage fraud at the earliest possible time,” said OFHEO Acting Deputy Director Alfred Pollard. “This oversight coupled with Enterprise efforts will send a clear message that fraud will be actively resisted by the companies and their regulator. We believe the Enterprises are committed to this effort,” Pollard said.

“OFHEO appreciates the valuable assistance of the Federal Bureau of Investigation, the Department of the Treasury, and the Financial Crimes Enforcement Network (FinCEN) and the support of members of the President’s Corporate Fraud Task Force,” added Pollard.

In addition to the final regulation, OFHEO has finalized a Policy Guidance detailing procedures for implementing the regulation.

[Complete text of the final regulation follows.](#)

[Policy Guidance follows final regulation.](#)

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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: Proposed Rule

SUMMARY: The Office of Federal Housing Enterprise Oversight (OFHEO) is issuing a proposed regulation that would

DATES: Written comments on the proposed regulation must be received by [Insert date 30 days after date of publication.] For additional information, see **SUPPLEMENTARY**

INFORMATION.

ADDRESSES: You may submit your comments on the proposed regulation and collection of information, identified by regulatory information number (RIN) 2550-AA31, by any of the following methods:

- U.S. Mail, United Parcel Post, Federal Express, or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2550-AA31, Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

- Hand Delivered/Courier: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2550-AA31, Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- E-mail: RegComments@OFHEO.gov. Comments to Alfred M. Pollard, General Counsel, may be sent by e-mail at RegComments@OFHEO.gov. Please include RIN 2550-AA31 in the subject line of the message.

Instructions: OFHEO requests that comments to the proposed amendments include the reference RIN 2550-AA31. OFHEO further requests that comments submitted in hard copy also be accompanied by the electronic version in Microsoft® Word or in portable document format (PDF) on 3.5” disk. Please see the section, Supplementary Information, below, for additional information on the posting and viewing of comments.

FOR FURTHER INFORMATION CONTACT: Isabella W. Sammons, Associate 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 (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.

As a member of the President's Corporate Fraud Task Force that focuses on maximizing cooperation and joint regulatory and enforcement efforts, OFHEO is aware of the impact of mortgage fraud, not only with respect to the Enterprises, but with respect to the mortgage market as a whole. Losses resulting from mortgage fraud impact, among other things, profits, liquidity levels, and capitalization ratios.

For example, a recent investigation revealed a fraud scheme committed by insiders of First Beneficial Mortgage Corporation against Fannie Mae and the Government National Mortgage Association (Ginnie Mae). First Beneficial Mortgage Corporation sold fraudulent loans to Fannie Mae. When Fannie Mae discovered that the mortgages were fraudulent, it forced First Beneficial to repurchase the loans. To raise the money to repurchase the loans, First Beneficial sold fraudulent mortgages to Ginnie Mae.¹ Fannie Mae did not inform Ginnie Mae that First Beneficial had made fraudulent loans. Fannie Mae agreed to a consent order to forfeit approximately \$7.5 million to the Federal government, which represents the amount, plus interest, that the First Beneficial principals obtained through fraud.² This and other frauds in the mortgage industry reflect the need to deter and, if necessary, detect and remedy fraud.³

Analysis of Proposed Regulation

¹ See, e.g., Statement of Chris Swecker, Assistant Director, Criminal Investigative Division, FBI, Before the House Financial Services Subcommittee on Housing and Community Opportunity (Oct. 7, 2004).

² See Fannie Mae Statement by Chuck Greener, Senior Vice President, Communications (Dec. 8, 2004), www.FannieMae.com/media/issues.

³ Other recent examples of mortgage fraud include lawsuits against Olympia Mortgage Corporation and United Homes L.L.C. involving alleged fraudulent appraisals. "Losing Your Dream Home," *The New York Times*, Oct. 17, 2004. The F.B.I. has reported that the number of complaints involving mortgage fraud increased from 5,623 in fiscal year 2001 to 12,134 in fiscal year 2003. *Id.*

In light of the impact of mortgage fraud on the safe and sound operations of the Enterprises, the proposed regulation sets forth safety and soundness requirements with respect to mortgage fraud reporting. OFHEO solicits comment on the purpose of the proposed regulation.

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.⁴ OFHEO would issue guidance and instructions with respect to format and content of mortgage fraud reports, including an elaboration of defined terms. OFHEO solicits comment on the definition of the terms “mortgage fraud” and “possible mortgage fraud” and on the other definitions set forth in the proposed regulation.

Under § 1731.3, an Enterprise would not be permitted to require the repurchase of or decline to purchase a mortgage, mortgage backed security, or similar instrument if it has notice of fraud or possible mortgage fraud until it promptly reports such fraud to the Director. OFHEO solicits comments on this proposed section.

Section 1731.4 would set forth the procedures for reporting fraud and possible mortgage fraud to OFHEO. As noted above, OFHEO would issue guidance and instructions with respect to format and content of mortgage fraud reports. Section 1731.4 also would provide that if the situation requires the immediate attention of OFHEO, an Enterprise would report immediately by telephone or electronic communication. The section further would provide for retention of

⁴ OFHEO recognizes that documentary evidence of fraud or possible mortgage fraud may also be the basis for financial institution reports to their regulators and federal agencies that investigate fraud.

records by the Enterprise and 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.⁵ This requirement would not prevent an Enterprise from disclosing or reporting such fraud pursuant to legal requirement, including to appropriate law enforcement authorities. Acceptance by OFHEO of other reporting formats promulgated by agencies with jurisdiction over mortgage fraud reporting would also be provided by § 1731.4. Finally, the section would state that an Enterprise does not waive any privilege it may claim under law by reporting mortgage fraud or possible mortgage fraud. OFHEO solicits comments on the proposed procedures for reporting mortgage fraud and possible mortgage fraud and the proposed requirements and provisions relating to use of other forms, nondisclosure, and no waiver of privilege.

Section 1731.5 of the proposed regulation would provide that an Enterprise must establish adequate and efficient internal controls and procedures and an operational training program to assure an effective system to detect and report mortgage fraud. OFHEO solicits comments on this proposed requirement.

Section 1731.6 expressly would state that failure to comply with the requirements of the regulation may subject the Enterprise or the board members, officers, or employees of the Enterprise to supervisory action by OFHEO under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, including but not limited to, cease-and-desist proceedings and civil money penalties. OFHEO solicits comments on this proposed section.

Request for Comments on the Proposed Regulation

⁵ OFHEO notes that staff of OFHEO would be prohibited from disclosing any report without the prior written approval of the Director pursuant to its Releasing Information regulation, 12 C.F.R. Part 1703.

OFHEO invites comments on all aspects of the proposed regulation and will take all comments into consideration before issuing the final regulation. The comment period has been set at 30 days because of the impact of mortgage fraud on safety and soundness, the size of the Enterprises, the volume of mortgage business, and the public interest in assuring deterrence and detection of such fraud.

All comments received will be posted without change to <http://www.ofheo.gov>, including any personal information provided. Copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street NW., Washington, DC 20552. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 414-6924.

Regulatory Impact

Executive Order 12866, Regulatory Planning and Review

The proposed 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 proposed 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 proposed 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 proposed 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, mortgage backed security, or similar financial instrument. Such mortgage fraud includes, but is not limited to, 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 cause to believe 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.

§ 1731.4 Procedures for reporting.

(a) Procedures for reporting.

(1) General. An Enterprise shall report mortgage fraud or possible mortgage fraud –

(i) In writing to the Director in such format 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; and

(ii) Within four business days after identifying mortgage fraud or possible 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 limit an Enterprise from disclosing or reporting such fraud pursuant to legal requirement, including to appropriate law enforcement authorities.

(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.

[signed by Armando Falcon, Jr.] _____

Signature

Armando Falcon, Jr.

Director, Office of Federal Housing Enterprise Oversight

2/18/05 _____

Date

OFHEO

Director's Advisory

Policy Guidance

Issuance Date: February 22, 2005

Doc. #: PG-05-001

Subject: Safety and Soundness: Reportable Legal Proceedings

To: Chief Executive Officers of Fannie Mae and Freddie Mac
OFHEO Deputy Director and Associate Directors

Purpose:

This Advisory sets forth procedures for reporting by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises) of the occurrence of certain investigations or legal proceedings to the Office of Federal Housing Enterprise Oversight (OFHEO) consistent with the safety and soundness responsibilities of OFHEO under the Federal Housing Enterprise Safety and Soundness Act of 1992.

Reportable Events:

An Enterprise shall make a written report to OFHEO of the occurrence of the following events—

(a) Notice of the commencement of a legal investigation, legal proceeding, or civil or criminal action by Federal, state, or local governmental authority or by a private party or group of private parties in which the Enterprise or affiliate thereof, or an employee, officer, or board member of the Enterprise or affiliate thereof, in his or her official capacity, is a party to or the subject of the investigation or legal proceeding. A legal proceeding includes an administrative, civil, or criminal proceeding, including a discovery proceeding therein, before a court of law, administrative board or commission, hearing officer, or other judicial or quasi-judicial body, including arbitration.

(b) Notice of the commencement of an investigation, proceeding, or action by a national securities exchange or national securities association or a facility thereof with respect to the Enterprise or affiliate thereof.

(c) Notice of a formal investigation of the Enterprise or affiliate thereof by Congress or committees or subcommittees thereof.

How to Report:

(a) An Enterprise shall report the occurrence or event(s) listed above to the Director, OFHEO, or his or her designee, in writing, in such form and in such manner as OFHEO may prescribe.

(b) In any situation involving the occurrence of a reportable event requiring immediate attention, the Enterprise shall immediately report, by telephone, the occurrence of the event to the Director, OFHEO, or his or her designee.

Compliance:

Filing of a knowingly false or misleading report or failure to report the occurrence of an event in accordance with this advisory may subject the Enterprise and its board members and any responsible officer to supervisory action.

Preservation of Existing Authority:

Nothing in this Advisory in any way limits the authority of OFHEO to otherwise address unsafe or unsound conditions or practices or violations of applicable law, regulation or supervisory order. Action referencing the Advisory may be taken separate from, in conjunction with or in addition to any other enforcement action available to OFHEO. Compliance with the Advisory in general would not preclude a finding by the agency that an Enterprise is otherwise engaged in a specific unsafe or unsound practice or is in an unsafe or unsound condition, or requiring corrective or remedial action with regard to such practice or condition. That is, supervisory action is not precluded against an Enterprise that has not been cited for a deficiency under the Advisory. Conversely, an Enterprise's failure to comply with one of the supervisory requirements set forth in the Advisory may not warrant a formal supervisory response from OFHEO, if OFHEO determines the matter may be otherwise addressed in a satisfactory manner. For example, OFHEO may require the submission of a plan to achieve compliance with the particular requirement or standard.

Events Reportable on Form 8-K or Other Mandated Reports:

Reports made pursuant to this Advisory do not in any way limit, waive, or excuse any obligation of the Enterprise to report the event on Form 8-K of the U.S. Securities and Exchange Commission or to provide a copy of the Form 8-K to OFHEO under 12 CFR Part 1730 or to meet any other mandated report or disclosure of the Commission as required of a registered company, or of any other regulatory body.