

## Federal Housing Finance Agency

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### Regulatory Policy Guidance

**Issuance Date:** March 2011

**RPG-2011-001**

**Subject:** Reporting of Fraudulent Financial Instruments

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**To: General Counsels of Freddie Mac and Fannie Mae  
Executives of the Federal Home Loan Banks**

This Regulatory Policy Guidance (Guidance) sets forth the Federal Housing Finance Agency (FHFA) guidance to the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (Bank or Banks) (collectively, regulated entities) under 12 CFR part 1233, *Reporting of Fraudulent Financial Instruments*.

Each regulated entity is directed to develop and implement or enhance existing reporting structures, policies, procedures, internal controls, and operational training programs to sufficiently discover and report fraud or possible fraud in accordance with the guidance provided below.

As there are significant differences in the product offerings and investments of the regulated entities, some sections of the guidance are directed towards these differences and not all the guidance is appropriate for all regulated entities. For example, given their business model, the volume of mortgage fraud reporting will likely be much greater at Fannie Mae and Freddie Mac. Therefore, in addition to a Financial Instrument Fraud Report (FIFR), Fannie Mae and Freddie Mac will submit monthly Fraud Reports (FRs) for all instances of fraud or possible fraud. The Banks will report situations only where there is: (1) an immediate notification; or (2) a pattern of fraud and therefore will only use the FIFR to report fraud.

In examining fraud reporting programs of the regulated entities, FHFA will evaluate the extent to which policies, procedures, internal controls, and training programs of the regulated entity minimize risks from fraud and the extent to which fraud or possible fraud is consistently reported to FHFA.

This Guidance is not intended to be in conflict with statutes, regulations, other guidance issuances, record-keeping requirements, etc. This guidance is not intended to relieve or minimize the decision making responsibilities or duties of a regulated entity's management or Board of Directors or any committees thereof. Fraud discovered at a regulated entity that is not covered under this Guidance may still be a reportable event under other regulations, guidance, procedures, etc.

This Guidance replaces the Office of Federal Housing Enterprise Oversight Policy Guidance PG-08-001 and is effective upon issuance.

## **I. DEFINITIONS AND EXAMPLES**

A number of definitions appear in 12 CFR part 1233 and additional terms are defined below. The examples of fraud are provided in this Guidance to elaborate the definition of fraud in 12 CFR part 1233.

**Discovery Date** means the date at which the central reporting point identifies or is notified about an activity that meets the definition of fraud or possible fraud.

**Examples of Fraud** include any suspicious transaction relevant to a possible violation of law or regulation such as a kind identified immediately below. On the other hand, absent other suspicious evidence, typographical errors or mistakes in data entry are not usually considered to be fraudulent.

Fraud might include, but is not limited to:

- False information contained in loan documents, such as identification, employment, income or appraisal documents;
- Theft of custodial funds or non-remitted payoff funds;
- Misrepresentations of collateral in loan or other documents;
- Theft or misrepresentation of Affordable Housing Program (AHP), Community Investment Cash Advance (CICA) and Community Investment Program (CIP) funds or advances; and
- Misrepresentation of the underwriting standards or servicing of mortgage loans, single or multi-family, sold to or guaranteed by the regulated entity or multiple deliveries of the same mortgage loan.

Fraud may be identified through internal or external sources. External sources include, but are not limited to, member institutions, third-party vendors, consumers, counterparties, and law enforcement or other government authorities.

**Insider Fraud** means a fraud or possible fraud involving a board member, officer, employee, contractor, or third-party vendor of a regulated entity.

**Pattern** means a fraud or possible fraud involving more than one transaction with characteristics of related conduct or behavior.

**Significant** used in the context of Immediate Notification, means that which may affect the integrity or public confidence in the regulated entity or U.S. Government.

## **II. REPORTING AND RECORDKEEPING**

The following section describes the types of reports regulated entities submit to the Director's designee when it discovers fraud or possible fraud. All reports are to be made to the Director's designee. The Director's notice of designee is sent via letter to the regulated entities.

All regulated entities should submit:

- Immediate Notification, if appropriate;
- Financial Instrument Fraud Reports (FIFRs);
- FIFR Quarterly Status Submissions; and
- Annual Conformance Reports.

Regulated entities are required to provide Immediate Notification when a fraud or possible fraud involves a significant fiscal, financial or reputational impact or when a fraud or possible fraud involves insider fraud. For any Immediate Notification, a regulated entity will file a FIFR. In addition, FIFRs are also to be filed for patterns of fraud or possible fraud. FHFA will review and submit FIFRs, as appropriate, to the Financial Crimes Enforcement Network (FinCEN) to assist law enforcement in the prevention of fraud and prosecution of those perpetrating fraud. Quarterly Status Submissions will provide FHFA a broad overview of potential risk exposure due to fraud or possible fraud in the previous quarter. Annual Conformance Reports will ensure that the Boards of Directors of regulated entities are aware of the fraud programs within their organizations.

In addition, Fannie Mae and Freddie Mac must also file a monthly Fraud Report (FR) on **all** fraud or possible fraud. This additional reporting requirement is due to the business model of Fannie Mae and Freddie Mac as purchasers and guarantors of mortgage loans, as compared to that of the Banks which primarily use loans as collateral for advances, and reflects the large volume of isolated instances of fraud and possible fraud that Fannie Mae and Freddie Mac may experience.

Further, regulated entities should maintain a log of all communications sent to and received from law enforcement officials regarding FIFRs provided to FHFA.

### **A. IMMEDIATE NOTIFICATION.**

**1. General.** Within one calendar day of the Discovery Date, a regulated entity should notify the Director's designee and the FHFA's Office of Inspector General (FHFA-OIG) by telephone or electronic communication when a fraud or possible fraud may involve a significant fiscal, financial or reputational impact on the regulated entity or when a fraud or possible fraud involves insider fraud.

**2. Internal Procedures.** A regulated entity should have internal written policies and procedures that require the notification of senior risk management and the chairman of the relevant Board of Directors committee(s) of instances of fraud or possible fraud that require Immediate Notification. Every instance of fraud or possible fraud that warrants Immediate Notification also requires a regulated entity to submit a FIFR to the Director's designee and the FHFA-OIG in accordance with this Guidance.

**3. Format and Content.** FHFA shall provide each regulated entity with an Immediate Notification Fraud Reporting form. A regulated entity should make reasonable efforts to gather all information regarding the fraud or possible fraud that is known or available.

A reference to the date of the Immediate Notification should be included in all subsequent and related FIFRs.

## **B. FINANCIAL INSTRUMENTS FRAUD REPORT (FIFR).**

**1. General.** A regulated entity should submit a FIFR to the Director's designee and the FHFA-OIG for fraud or possible fraud that is part of a pattern or reported as an Immediate Notification. In addition, a regulated entity may also file a FIFR for any suspicious transaction that it believes is relevant to the possible violation of any law or regulation, but whose reporting is not otherwise required by this section.

**2. Timeframe.** Within thirty (30) calendar days of the Discovery Date, a regulated entity should submit a FIFR to the Director's designee and the FHFA-OIG.

**3. Format.** A regulated entity is to report fraud or possible fraud to FHFA on a FIFR template, which includes both a Microsoft® Excel spreadsheet and a .dat file. The .dat file complies with the technical specifications set forth by FinCEN for the Suspicious Activity Report for Depository Institutions.

**4. Content.** A regulated entity should make reasonable efforts to provide information related to the fraud or possible fraud, including a suspect's identity and financial instrument information, such as loan number, advance fund identifier, or CUSIP number. The narrative description field should always provide a complete chronological account of what is unusual, irregular or suspicious about the financial instrument and should include any other information necessary to understand the fraud or suspected fraud that is being reported. Specific data fields, such as suspect names, full addresses, identification numbers, estimated amount of the violation, etc., should be completed to the extent possible. The FIFR should include any details regarding the regulated entity's referral of the incident described in the FIFR to a licensing, regulatory, or other government entity.

Regulated entities should refer to the FinCEN publication "Preparation Guidelines for Suspicious Activity Report Form" issued July 2003 (revised 11/28/06). In addition, a

regulated entity is responsible for monitoring changes to FinCEN's forms and regulations on Suspicious Activity Reports for Depository Institutions on FinCEN's website.

**5. Electronic Submission.** The FIFR should be sent electronically through secure methods for each regulated entity or such other process as established by FHFA. For the Banks, FHFA's Secure Bank Portal shall be used. For Fannie Mae and Freddie Mac, the secure file transfer protocol shall be used. Users must be connected to the local area network (LAN) of the regulated entity in order to transmit files to FHFA.

**6. Submission to FinCEN.** Reports received under this Guidance will be reviewed by FHFA and the FHFA-OIG and transmitted to FinCEN, as appropriate, to assist law enforcement in the prevention, investigation, and prosecution of fraud.

**7. Supplemental FIFR.** A regulated entity should file a supplemental FIFR when either of the following two circumstances occur:

- a. Corrections.** When the regulated entity needs to correct errors or omissions identified in a previously filed FIFR. The corrected FIFR should highlight the reason for the correction.
- b. Change in Findings of Fraud.** When a material change, as defined by the regulated entity, has occurred in the information that the regulated entity initially reported on a FIFR. For instance, a supplemental FIFR should be submitted when the parameters of the situation reported on a FIFR have changed in terms of volume of financial instruments, the scope of the fraud or possible fraud, or the identity of parties involved, including identifying information (addresses, license numbers, etc.).

When a regulated entity files a supplemental FIFR all known information should be stated, including a repeat of all previously reported information. A supplemental FIFR should refer to the number of the initial FIFR and be filed within thirty (30) calendar days following the Discovery Date of additional information.

## **C. FRAUD REPORT (FRs) FOR FANNIE MAE AND FREDDIE MAC.**

**1. General.** On a monthly basis, Fannie Mae and Freddie Mac should submit a Fraud Report (FR) containing **all** instances of fraud or possible fraud discovered during the preceding month. At a minimum, the FR should include fraud or possible fraud that is reported on a FIFR, or supplemental FIFR, and fraud or possible fraud suspected for financial instruments that are not part of a pattern. For instance, fraudulent or possibly fraudulent financial instruments that were identified as a result of individual loan file reviews should be reported on a FR.

**2. Timeframe and Format.** An FR should be submitted each month within ten (10) calendar days after the end of the month of the Discovery Date. The FR shall be in a Microsoft® Excel spreadsheet or such other format as established by FHFA.

**3. Content.** The FR shall contain, **at a minimum**, the following information in the order listed below:

- Discovery Date;
- FIFR number, if applicable and known;
- Origination Date of the financial instrument;
- Financial Instrument Unique Identifier (e.g., loan number, CUSIP number);
- Brief description of the fraud or possible fraud;
- Borrower name;
- Co-borrower name;
- Property address;
- Acquisition UPB;
- Broker name;
- Broker address;
- Loan officer;
- Appraisal company name;
- Appraiser's name; and
- Property seller name.

**4. Electronic Submission.** The FR should be sent electronically through FHFA's secure file transfer protocol. Users must be connected to the LAN of Fannie Mae or Freddie Mac in order to transmit files to FHFA and the FHFA-OIG.

#### **D. FIFR QUARTERLY STATUS SUBMISSION.**

**1. General.** Quarterly Status Submissions will provide FHFA a broad overview of FIFR activity. Quarterly status submissions are not required for monthly fraud reports. A regulated entity, in its business judgment and taking into account the fraud or possible fraud involved, may anticipate uncovering additional financial instruments or suspects. Therefore, FHFA is requiring that a regulated entity report whether a filed FIFR is closed or whether the situation reported in the FIFR is under continued review. In a regulated entity's business judgment a situation may be closed upon submission of the first and only FIFR.

**2. Timeframe.** A FIFR Quarterly Status Submission should be submitted to the Director's designee within ten (10) calendar days after the end of each calendar quarter.

3. **Contents.** Each Quarterly Status Submission will contain:
- a. **Quarterly Status Report.** For each FIFR, or Immediate Notification in which there is not yet a FIFR, the Quarterly Status Report should be submitted in a Microsoft® Excel spreadsheet, or other format as established by FHFA, and contain, at a minimum, in the order listed below:
- FIFR number;
  - Brief description of the fraud or possible fraud;
  - Estimated number of financial instruments involved;
  - Estimated total unpaid principal balance of the financial instrument at the date of acquisition or transaction execution, or other determined value of the transaction;
  - State(s) in which properties securing the financial instruments are located, if applicable;
  - Discovery Date;
  - Date the FIFR inquiry closed, if applicable;
  - Estimated number of AHP projects involved, if applicable, and state(s) in which AHP properties are located; and
  - The status of each FIFR indicating whether the situation is “under continued review” or “closed.” After a FIFR is reported as closed, it should be removed from subsequent Quarterly Status Reports. If the FIFR is closed, the results of the review should be indicated as one of the following:
    - Fraud or possible fraud found; or
    - Lack of evidence of fraud or possible fraud.
- b. **Quarterly Status Submission of Identifiers.** Each regulated entity should submit the unique identifiers for financial instruments that are involved in a situation reported in a FIFR, such as mortgage loan number, CUSIP, advance number, or AHP tracking numbers. The regulated entities should provide this information separately and simultaneously with the Quarterly Status Report in an American Standard Code for Information Interchange (ASCII) text file containing a FIFR number for each corresponding financial instrument identifier. These two data elements (FIFR number and financial instrument identifier) should be separated using the “pipe” character (“|”) and each unique combination should be placed in a separate row.
4. **Electronic Submission.** The Quarterly Status Submission should be sent electronically through secure methods for each regulated entity or such other process as established by FHFA. For the Banks, FHFA’s Secure Bank Portal shall be used. For Fannie Mae and Freddie Mac, the secure file transfer protocol shall be used. Users must be connected to the LAN of the regulated entity in order to transmit files to FHFA.

#### **E. ANNUAL REVIEW AND CONFORMANCE REPORT.**

At least annually, the Financial Instrument Fraud Officer should review the requirements of 12 CFR part 1233, *Reporting of Fraudulent Financial Instruments*, and whether the regulated entity's practices are consistent with this Guidance.

The Financial Instrument Fraud Officer should submit an Annual Conformance Report to the Board of Directors of the regulated entity describing the results of the review. At a minimum, the Annual Conformance Report should include a summary of the regulated entity's policies, procedures, internal controls, and training for financial instrument fraud risk that have been developed, modified, or enhanced; other actions taken by the regulated entity to comply with the provisions of this Guidance; and the status of the regulated entity's efforts to remediate findings identified as part of FHFA examinations as "matters requiring attention" related to the discovery and reporting of fraud or possible fraud.

Upon its approval and as documented in meeting minutes, the Board of Directors of the regulated entity should submit the Annual Conformance Report to the Director's designee on or before March 31<sup>st</sup> of the following year.

#### **F. LOG OF COMMUNICATIONS FROM LAW ENFORCEMENT BASED ON A FIFR SUBMITTED BY THE REGULATED ENTITY.**

A regulated entity should maintain a log of all communications sent to and received from law enforcement when the communication is based on a FIFR submitted by that regulated entity to FHFA and the FHFA-OIG. Information to be contained in the log include the date of the communication, name, department and location of the law enforcement official, the FIFR number being investigated, and the information sought by law enforcement. A regulated entity should produce the log for FHFA and the FHFA-OIG upon request.

#### **G. REJECTION OF REPORTS.**

FHFA may, upon its review, reject any report as required herein if FHFA determines the report is incomplete. In the event that an initial report (FIFR, FR, or Quarterly Status Submission) is rejected by FHFA, FHFA will provide the regulated entity with a written reason for the rejection. A revised report should be resubmitted with sufficient content to the Director's designee within ten (10) calendar days of the date of FHFA's rejection.

#### **H. REPORTING THE FINANCIAL IMPACT OF FRAUD.**

FHFA expects that, upon request, the regulated entities reasonably produce reports on the final disposition of the financial instrument (repurchase, sale, replacement, etc.) and



amount of financial loss associated with each fraudulent or possibly fraudulent financial instrument whether reported on a FIFR or FR.

### **III. INTERNAL CONTROLS, POLICIES, PROCEDURES AND OPERATIONAL TRAINING**

#### **A. GENERAL.**

A regulated entity should establish and maintain effective internal controls, policies, procedures, and operational training appropriate to the size, volume, and structure of a financial instrument to discover and report fraud or possible fraud. Internal controls, policies, procedures, and operational training should be more expansive when a financial instrument is owned or guaranteed versus when a financial instrument serves as collateral. Fraud or possible fraud may be discovered, for example, during routine sampling of loans and collateral or when a regulated entity is notified that a substitution of a loan or asset contained in an asset backed security or mortgage backed security was made because of fraud or possible fraud. Fraud or possible fraud may be discovered during the approval process or monitoring of the AHP or other programs. The regulated entity should determine the appropriate scope of review by applying its business judgment to the facts and circumstances based on all available information.

#### **B. INTERNAL CONTROLS.**

Effective internal controls provide the basis for good governance and the prevention and detection of fraud, particularly fraud associated with fraudulent financial instruments. A well designed and properly implemented system of operational and financial internal controls provides a regulated entity's Board of Directors and management the ability to safeguard resources, comply with laws and regulations, and produce reliable financial and regulatory reports.

At a minimum, a regulated entity's internal control system should include:

- A control environment;
- Risk assessment;
- Control activities;
- Accounting, information, and communication systems; and
- Self-assessment or monitoring.

All regulated entities are subject to supervisory review by FHFA examiners who will periodically assess and draw conclusions about the adequacy of the regulated entity's internal controls, policies, procedures, and operational training, including fraud discovery and reporting.

**1. Control Environment.** The Board of Directors is responsible for overseeing management's establishment and maintenance of effective controls that meet statutory

and regulatory requirements and respond to changes. Management should ensure that the control environment produces pertinent and timely information in a form that enables discovery and reporting of fraud or possible fraud. Senior management should also ensure that the responsibilities for managing business and investment activities are properly segregated to maintain operational integrity particularly associated with financial instruments. Back-office, settlement, and transaction reconciliation responsibilities should be conducted and managed by personnel who are independent of those initiating risk taking positions.

The control environment should include the following:

- *Financial Instrument Fraud Officer.* A designated management official with overall responsibility for the discovery, reporting, internal controls, policies, procedures and operational training in accordance with this Guidance. The Financial Instrument Fraud Officer should have primary responsibility for reporting to FHFA and to the Board of Directors, which should include reporting on the exposure and/or financial impact of fraud or possible fraud. The Financial Instrument Fraud Officer should have primary responsibility for developing and maintaining a training program that is designed to ensure that employees and contractors who identify fraud or possible fraud conduct their duties efficiently and effectively and in accordance with this Guidance. The Financial Instrument Fraud Officer may delegate responsibilities for discovery and review of fraud or possible fraud to other management officials of the regulated entity who have primary responsibility for the management of the business areas involved in financial instruments. These management officials with delegated responsibility shall be accountable for implementing their areas of responsibility. The Financial Instrument Fraud Officer is accountable for the effectiveness of efforts to discover and review fraud even if he/she delegates responsibilities to others;
- *Central Reporting Point.* An identified individual or office to whom or which employees and contractors are to report fraud or possible fraud as defined in this Guidance;
- *Central Repositories.* Aggregations of information related to fraud or possible fraud. The information in the central repositories should be readily accessible and available for dissemination to FHFA, the FHFA-OIG and to employees and contractors who need the information to carry out their respective official responsibilities;
- *Conditions for Continuing Business.* Board of Director-approved written policies and procedures specifying the conditions under which and the extent to which a regulated entity may continue to engage in business with an individual or entity suspected of fraud or possible fraud, and the designation of one or more senior management officer(s) to approve any continued business with such individual or entity;

- *Internal Publication.* Written policies that direct timely dissemination to all employees and relevant contractors of new or revised procedures and policies related to the discovery or reporting of fraud or possible fraud; and
- *External Publication.* Regular review and update of notices to external entities, employees, and contractors. These notices may include, for example, member product policies or seller servicers' guidelines with tips on avoiding certain fraudulent schemes.

**2. Risk Assessment.** Risk assessment is the identification, measurement, and analysis of risks, internal and external, controllable and uncontrollable at individual business levels. Senior management should understand and assess the nature and level of various risks involved in normal business activities, including the risks associated with fraud or possible fraud. The risk assessment may take into account whether a transaction involves the purchase or guarantee of a financial instrument or the acceptance of a loan as collateral for an advance. There should be a written risk assessment policy in place to ensure objectives are met and business activities do not jeopardize operations. Written procedures should define the frequency of the risk assessment.

**3. Control Activities.** Control activities are the policies, procedures, and practices established to help ensure that personnel carry out Board of Directors and management directives related to the recognition and reporting of fraud and possible fraud at every business level. These activities help ensure that management acts to control risks associated with fraud or possible fraud and provide the basis for Board of Directors oversight.

Some activities that may assist in the discovery and reporting of fraud or possible fraud include:

- *Written Policies and Procedures.* (See section III.C. *Policies and Procedures* below);
- *Analysis.* In-house analyses, or where appropriate, independent third-party analyses of proposed purchases or sales of financial instruments. The analyses may be conducted at the instrument or portfolio level;
- *Verification.* Procedures should provide for independent verification and periodic internal and external reviews;
- *Personnel.* Operational personnel should have strong technical skills that enable them to completely understand the structures of financial instruments to enable them to discover and report fraud or possible fraud;

- *Documentation.* Documentation is required for all financial instrument transactions, including instructions for saving and safeguarding important records, as well as maintaining possession and control of financial instruments purchased; and
- *Conflicts of Interest.* Conflict of interest policies and procedures for employees who are directly involved in the purchase, sale and/or safekeeping of loans and financial instruments.

**4. Accounting, Information, and Communication Systems.** Accounting, information, and communication systems should capture and impart pertinent and timely information in forms and formats that enable the Board of Directors, management, and employees to carry out their responsibilities. Accounting systems are the methods and records that identify, assemble, analyze, classify, record, and report on transactions. Information and communication systems enable all personnel to understand their roles in the control system, how their roles relate to others, and their accountability. Information systems produce reports on operations, finance, and compliance that enable management and the Board of Directors to run the regulated entity. Communication systems impart information internally and externally.

**5. Self-Assessment or Monitoring.** Internal audit and external audit functions, as part of the monitoring system, may provide independent assessments of the quality and effectiveness of a control system's design and performance. Internal audit should regularly evaluate the effectiveness of the controls designed to discover and report fraud and possible fraud.

## **C. POLICIES AND PROCEDURES.**

A regulated entity should have written policies and procedures to discover and report fraud or possible fraud. Policies and procedures should specify objectives and means for discovering and reporting fraud or possible fraud at each stage in the lifecycle of a financial instrument, including the pre-purchase stage. Policies and procedures should address matters discussed above, in section III.B. *Internal Controls*, and specifically include a requirement that the regulated entity at least annually analyze incidents of fraud or possible fraud to identify and implement measures reasonably designed to prevent the regulated entity from being involved in such fraud or possible fraud in the future.

## **D. OPERATIONAL TRAINING.**

**1. General.** The operational training program of a regulated entity should be designed to ensure that employees and contractors with fraud detection and reporting responsibilities receive adequate training. Training should be commensurate with the regulated entity's business and the duties and responsibilities of employees and contractors.

2. **Content.** At a minimum, the training program should address:

- Types and levels of training;
- Criteria for selecting employees for the various types and levels of training;
- Frequency of training;
- Refresher training;
- Certification of training completion; and
- Such other matters as required by FHFA.