



FEDERAL HOME LOAN BANK OF INDIANAPOLIS

*Building Partnerships. Serving Communities.*

August 14, 2009

*via electronic mail to:*  
***RegComments@fhfa.gov***

Alfred M. Pollard, General Counsel  
Attention: Comments/RIN 2590-AA11  
Federal Housing Finance Agency  
Fourth Floor  
1700 G Street, N.W.  
Washington, DC 20552

**RE: Comments/RIN 2590-AA11  
Reporting of Fraudulent Financial Instruments**

Dear Mr. Pollard:

The Federal Housing Finance Agency (“FHFA”) has issued a proposed rulemaking with respect to the reporting of fraudulent financial instruments purchased or sold by a regulated entity (the “Proposed Rule”). This letter sets forth the comments of the Federal Home Loan Bank of Indianapolis (the “Bank”) with respect to the Proposed Rule. We thank you for the opportunity to be heard on this important matter.

The Bank has long shared FHFA’s views regarding the importance of combating mortgage fraud and agrees that a Federal Home Loan Bank (“FHLBank”) may be exposed to the risk of fraud, particularly when investing in whole mortgage loans. Given the importance of the topic, we believe it is especially critical that the requirements of the agency’s fraud reporting and detection regulation be clear to all regulated entities, to maximize the effectiveness of these anti-fraud efforts.

It is in light of the above -- what we believe to be our shared policy goals -- that we offer the following comments regarding the Proposed Rule.

**I. Scope of the Proposed Rule**

- **Background:** In 2008, the Office of Federal Housing Enterprise Oversight (“OFHEO”) issued policy guidance (the “OFHEO Guidance”) regarding the mortgage fraud programs of Fannie Mae and Freddie Mac (together with the FHLBanks, the “regulated entities”).<sup>1</sup>

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<sup>1</sup> Examination of Mortgage Fraud Programs, PG-08-001 (January 10, 2008).

The definition of “mortgage fraud” in the OFHEO Guidance covered material misstatements and omissions relied upon by an enterprise to fund or purchase -- or not to fund or purchase -- a single-family or multifamily mortgage, and then provided a nonexhaustive list of specific examples of in-scope mortgage fraud.<sup>2</sup> It is unclear whether the Proposed Rule<sup>3</sup> is intended to expand fraud detection and reporting requirements beyond whole loan mortgage investments as contemplated by the OFHEO Guidance, or whether it is intended merely to apply those requirements to the FHLBanks’ mortgage purchase programs.

- Comment: Please clarify Sections 1233.1 and 1233.3(a)(1) of the Proposed Rule by specifying whether the scope extends beyond whole loan mortgage investments of the type covered by the OFHEO Guidance. If FHFA does intend a scope broader than whole loan mortgage purchases, please specify which other purchase and sale activities of the FHLBanks would be subject to the fraud reporting requirements. In particular, FHFA should clarify that the Proposed Rule does *not* apply to mortgage loans held as collateral for FHLBank advances, even if the FHLBank were to later sell such collateral pursuant to an exercise of remedies under its advances agreement following a member failure or default. The Proposed Rule should not apply to mortgage loans held as collateral for three important reasons:
  - i. The FHLBank is not an investor in the mortgage loans it accepts as collateral.
  - ii. FHLBank managers of advances collateral should concentrate their focus on monitoring collateral quality in furtherance of the FHLBank’s goal and obligation to preserve safe and sound operations.
  - iii. The FHLBanks take whole loan collateral only from their regulated members, who maintain their own processes for detecting fraud. So long as the loans remain pledged as collateral (and beyond), the members retain their own financial incentives for guarding against, detecting and reporting possible fraud.<sup>4</sup>
  - iv. Member collateral is already subject to inspection and regulation by a member’s regulator, and an extensive fraud reporting regime is already in place for this purpose.

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<sup>2</sup> Including false information contained in identification and employment documents, false mortgagee or mortgagor identity, fraudulent appraisals, theft of custodial funds, non-remitted payoff funds, misrepresentations of borrower funds, and property “flipping” where designed to falsely inflate property value.

<sup>3</sup> The Proposed Rule requires reporting of fraud or potential fraud occurring in connection with “a loan, a series of loans or other financial instruments that [a] regulated entity has purchased or sold.” Proposed Section 1233.3(a)(1).

<sup>4</sup> Similarly, FHFA should clarify that the final rule does not apply to the FHLBanks’ Affordable Housing Programs, because the statutory authorization under 12 U.S.C. § 4642 is expressly limited to loans or financial instruments purchased or sold.

## II. Intent as an Element of Fraud

- Background: Under the Proposed Rule, “fraud” is defined to mean “a material misstatement, misrepresentation, or omission relied upon by a regulated entity,” and “possible fraud” is defined to mean “that a regulated entity has a reasonable belief, based upon a review of information available to the regulated entity, that fraud may be occurring or has occurred.”<sup>5</sup> However, tort and criminal law generally require intent to deceive as an element of fraud. For example, the principal federal criminal statute applicable to a fraud upon an FHLBank, 18 U.S.C. § 1014, makes it a crime to “knowingly [make] any false statement or report, or willfully [overvalue] any land, property or security, for the purpose of influencing in any way the action of...any Federal home loan bank.” The definition of “fraud” in the Proposed Rule does not state explicitly whether intent is an element of the definition or if instead inadvertent misrepresentations or omissions are also to be characterized as “fraud,” notwithstanding the idiosyncratic nature of such a characterization in the broader context of tort and criminal law.
- Comment: Please clarify whether a regulated entity is required to report to FHFA misstatements or omissions which the regulated entity, after due diligence, has concluded were likely unintentional, rather than knowingly fraudulent.<sup>6</sup>

## III. Reporting Procedures

- Background: Section 1233.3(a) of the Proposed Rule requires that reportable fraud be communicated in writing promptly to the Director of the FHFA, and in certain cases immediately by telephone or electronic communication.
- Comment: This section should be revised to permit a regulated entity to make fraud reports to its Examiner-in-Charge rather than directly to the Director. In addition, detailed guidance concerning specific FHFA processes and procedures for communicating reportable fraud would greatly assist the FHLBanks as they establish and maintain their internal controls and procedures in compliance with this new rule.<sup>7</sup>

## IV. Reliance on Third Parties

- Background: Certain FHLBanks (including our Bank) currently utilize, by contract, third parties in connection with the quality control process (including mortgage fraud

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<sup>5</sup> Section 1233.1 of the Proposed Rule.

<sup>6</sup> We recognize that Section 1379E of the Safety and Soundness Act (12 U.S.C. § 4642(a)) does not expressly indicate whether this reporting requirement is triggered when the regulated entity reasonably concludes a misstatement or omission was merely unintentional. Nevertheless, this issue will be critical when FHLBanks establish or refine their internal controls, procedures and training programs to conform to the final rule.

<sup>7</sup> *E.g.*, reporting forms, acceptable methods of electronic reporting, and other documentation issues. We read Section 1233.3(b) of the Proposed Rule to mean that the Director or his designee intends to provide such additional guidance following (or perhaps in conjunction with) the issuance of the final rule.

Alfred M. Pollard, General Counsel

August 14, 2009

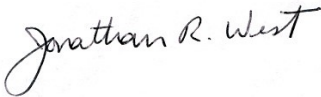
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detection) for their mortgage purchase programs, in accordance with the delegation provisions of the Acquired Member Assets regulation.<sup>8</sup>

- Comment: Please confirm that adequate and appropriate third-party reviews may constitute fraud detection controls sufficient to satisfy a regulated entity's obligations under Section 1233.4 of the Proposed Rule.

Thank you for your consideration of our comments.

Sincerely,



Jonathan R. West  
Senior Vice President - General Counsel

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<sup>8</sup> 12 C.F.R. § 955.5(a). Also, in the Mortgage Partnership Finance ("MPF") program, the Federal Home Loan Bank of Chicago performs quality control on behalf of other FHLBanks participating in the MPF program.