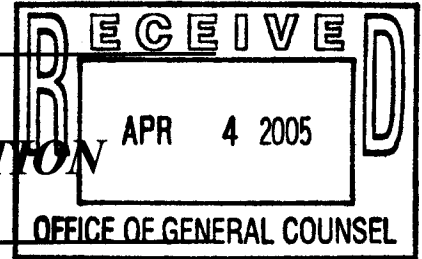


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**CONSUMER MORTGAGE COALITION**

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April 4, 2005

Alfred M. Pollard, Esq.  
General Counsel  
Attention: Comments/RIN 2550-AA31  
Office of Federal Housing Enterprise Oversight  
Fourth Floor  
1700 G Street, NW.  
Washington, DC 20552

**RE: Mortgage Fraud Reporting [RIN 2550-AA31; 70 Fed. Reg. 9225  
(Feb. 25, 2005)]**

Dear Mr. Pollard:

The Consumer Mortgage Coalition (the "CMC"), a trade group of national residential mortgage lenders, servicers, and service providers, appreciates the opportunity to submit its views concerning the proposal by the Office of Federal Housing Enterprise Oversight ("OFHEO") to impose "safety and soundness requirements with respect to mortgage fraud reporting" on the government-sponsored enterprises ("Enterprises").

The intent of the proposal is to address the significant, and growing, problem of fraud in connection with the origination and secondary-market sale of mortgages and mortgage-related financial instruments such as mortgage-backed securities. CMC's comments are directed at the portions of the proposal that would prohibit Fannie Mae from requiring the repurchase of, or declining to purchase, a mortgage because of suspected fraud, without promptly filing a notice of the suspected fraud with the Director of OFHEO.

The notice requirement responds to a recent incident in which, as described by OFHEO in the *Federal Register* notice, Fannie Mae discovered that First Beneficial Mortgage Corporation ("First Beneficial") had sold fraudulent loans to it and required the mortgage company to repurchase the loans. First Beneficial raised the money to repurchase the fraudulent loans from Fannie Mae by selling fraudulent loans to Ginnie Mae, but Fannie Mae did not notify Ginnie Mae of the apparent fraud. Fannie Mae asserts that it did not believe the loans were fraudulent but required the repurchase for other reasons.

Although the CMC commends OFHEO for its attention to the problem of mortgage fraud, we do not believe that the proposed reporting requirement will be an effective

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response. We are concerned that it could have unintended negative effects on lenders that sell loans to the Enterprises and on servicers of loans owned by them, who are likely to bear much of the burden of investigating instances of suspected fraud. We believe that vigorous enforcement of existing law and cooperative industry efforts to combat the problem are a better solution to the mortgage fraud problem.

### ***Background: Industry Cooperative Efforts***

Before discussing the specifics of the proposal, we want to emphasize that the mortgage industry takes the various forms of mortgage fraud very seriously and has committed both time and significant amounts of money to combating it.

As an example, Household Mortgage Services has created an “Ineligible List” of appraisers and other settlement service providers that it has found, through thorough investigations, to be ineligible for continued participation in its loan programs. Household Mortgage Services provides this list to its sellers, banking agencies, local law enforcement agencies and the Federal Bureau of Investigation, as well as other mortgage lenders. The list is also incorporated into third-party fraud-screening software used throughout the mortgage industry, and Household has provided an internally-developed screening system at no charge to others in the industry. The CMC believes that this type of approach is more effective, and less costly, than the new reporting requirements proposed by OFHEO.

### ***The Proposed Notice Requirement Might Not Have Prevented the First Beneficial Problem***

Under the proposal, the Enterprises would be required to report mortgage fraud or possible mortgage fraud within four business days of identifying it, or immediately in urgent situations. 70 Fed. Reg. at 9257. They would be prohibited from requiring the repurchase of a loan, or declining to purchase a loan, “because of mortgage fraud or possible mortgage fraud without promptly reporting to the Director” of OFHEO. “Possible mortgage fraud” would be defined to mean that “an Enterprise has cause to believe that mortgage fraud may be occurring or has occurred.” *Id.* “Mortgage fraud,” in turn, would 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.” *Id.*

The definition of “mortgage fraud” is broad. According to the preamble to the proposal, it “would include, but not be limited to, identification and employment documents, mortgagee or mortgagor identity, and appraisals that are fraudulent.” *Id.* at 9256. Thus, the definition apparently encompasses fraud by an individual applicant that is detected after an Enterprise purchases a loan, as well as a broader pattern of fraud as alleged in the First Beneficial matter. In addition, the proposal does not include a standard of culpability; an Enterprise would apparently have to file report whenever it had “cause to believe” that fraud had occurred, regardless of whether that belief was reasonable. The difficulty with this broad definition and broad reporting requirement is that fraud is always a possibility when an Enterprise decides to require a repurchase or refuse to

purchase a loan for reasons such as inconsistencies in loan documentation or program ineligibility. In many cases, however, further investigation reveals that fraud is not the reason for the problem. Requiring the Enterprises to report whenever they can be said to have any “cause to believe” that fraud has occurred, without even limiting that belief to a reasonable one, could cause them to report a huge proportion of their required repurchases and purchase declinations. It would be impractical for the Enterprises to investigate each transaction and decide whether it represents fraud or possible fraud in time to report it within four business days or less, as required by the proposal. Therefore, they could decide to report any loan repurchase or declination where there is even a remote possibility of fraud. In that scenario, OFHEO could be overwhelmed with reports, defeating the purpose of the rule. In other instances, such as early payment defaults, fraud by the borrower is a significant possibility, but a default on one loan may not indicate a systemic fraud problem but simply reflect the fact that even the best lender controls are not perfect. A report of an isolated instance of apparent borrower fraud would seem to be of little value to OFHEO.

The prohibition against requiring a repurchase or declining to purchase a loan “because of” fraud or possible fraud could create perverse incentives not to identify fraud or possible fraud as the reason for the required repurchase or refusal to purchase. In Fannie Mae’s recent congressional testimony, the agency stated that it did not require First Beneficial to repurchase mortgage loans “because of” possible mortgage fraud, but rather because the loans were ineligible for purchase by Fannie Mae. *See* Testimony of Samuel M. Smith, III, before the Subcommittee on Oversight and Investigation of the House Financial Services Committee, 109th Cong., at 3 (March 10, 2005), *available at* <http://financialservices.house.gov/media/pdf/031005ss.pdf>. Moreover, Fannie Mae claims that it did not realize that the loans had been sold to Ginnie Mae to raise the funds for the repurchase, but believed First Beneficial’s claim that they had been sold to a subprime lender. *Id.* at 4. If Fannie Mae’s testimony is to be believed, then reporting would apparently not be triggered because Fannie Mae had not identified fraud or possible fraud.

The Inspector General of the Department of Housing and Urban Development (“HUD”), on the other hand, argued that Fannie Mae had enough information — including inconsistencies uncovered during inspections of the property and of land records — to be on notice of possible fraud. *See* Testimony of Kenneth M. Donohue, Sr., Inspector General, HUD, before the Subcommittee on Oversight and Investigation of the House Financial Services Committee, 109th Cong., at 4-5 (March 10, 2005), *available at* <http://financialservices.house.gov/media/pdf/031005kd.pdf>. If the Inspector General is correct, then Fannie Mae would apparently have had to report the loans if the rule had been in effect, but it would not have been a violation for Fannie Mae to require the repurchase without reporting fraud, because the repurchase was not required “because of” a fraud or possible fraud. Therefore, that aspect of the rule could create an incentive to find some other rationale for requiring a repurchase, even when the Enterprise suspects that fraud is the problem. In the common case where the seller of the loan was not the perpetrator of the fraud (because, for example, the seller acquired the loan through a broker or correspondent), this would defeat one of the goals of the rule — to ensure that

other innocent parties are warned of the fraud or possible fraud when they have time to limit their losses.

***A Reporting Requirement Would Have a Negative Impact on Both the Enterprises and the Mortgage Industry***

In contrast to the Bank Secrecy Act requirement to file Suspicious Activity Reports, which appears to be the model for the proposed rule, the proposed rule would not provide a safe harbor from liability to third parties for filing a report that turns out to be wrong. *See* 31 U.S.C. § 5318(g)(3). The proposal attempts to provide some protection by stating that an Enterprise does not waive any privilege by making a report, and, as OFHEO notes, its existing regulations prohibit disclosure of a report without the written approval of the Director. *See* 70 Fed. Reg. at 9257; *id.* at 9256 n. 5, *citing* 12 C.F.R. Part 1703. But these protections could be insufficient to protect an Enterprise from liability if it in good faith made a report, the Director of OFHEO, in turn, authorized OFHEO staff to inform the purchaser of the loan or a law enforcement agency, and the report turned out to be inaccurate.

In addition, where the immediate seller of the loan to OFHEO is not suspected of fraud, the Enterprises may well decide to place the responsibility on the seller or current servicer to investigate whether a fraud report is warranted. Such an investigation would not only be an operational burden, but entities other than the Enterprises would not even have the limited protection from exposure to civil liability provided for the Enterprises in the proposal. The civil liability protections that the Bank Secrecy Act provides to suspicious activity report filers are absolutely crucial to the success of that program. *See* 31 U.S.C. § 5318(g)(3).

On the other hand, the proposal would prohibit disclosure of the report “to the party or parties connected with the mortgage fraud or possible mortgage fraud,” without written approval of the Director of OFHEO. The Enterprises might respond to this prohibition by avoiding disclosure of the fraud or possible fraud to anyone other than OFHEO and other law enforcement agencies. Although the intent seems to be to make sure that fraudulent lenders are not tipped off to the fact that their fraud has been detected, this restriction could be self-defeating if it prevented the Enterprises from disclosing fraud to other potential purchasers.

***Existing Laws Address the Problem and Should Be Enforced***

The CMC’s concerns about the reporting proposal should not be taken to mean that we view a failure by an Enterprise to detect and control fraud lightly. Under existing law, OFHEO has broad authority to ensure the safety and soundness of the Enterprises. *See* 12 U.S.C. § 4513(b)(5). If OFHEO concludes that an Enterprise’s procedures to address fraud are deficient, it should take appropriate action. The CMC believes that a case-by-case approach that focuses on specific problems in an Enterprise’s fraud-control procedures is preferable to a general reporting requirement.

In the First Beneficial matter, Fannie Mae also was required to pay \$7.5 million compensation to the federal government, representing Ginnie Mae, under forfeiture laws that require disgorgement of payments funded by the fruits of a crime. Therefore, at least in that case, Fannie Mae paid a significant price for not reporting the fraud and for accepting the proceeds of a fraudulent sale to Ginnie Mae. In other situations, the potential for civil or even criminal liability under laws of general application should provide a strong incentive for the Enterprises to institute appropriate procedures to detect and control mortgage fraud.

*An Alternative Approach — A National Ineligible List*

An alternative approach is for regulators to create and administer an “ineligible list” that would be made widely available to the industry. The CMC first approached HUD with a proposal to create a national registry of brokers who had been found to have engaged in fraudulent or questionable activities. Since HUD had different priorities, we recently began working with the Conference of State Bank Supervisors to create a web-based clearinghouse of information about brokers and other service providers that have been found to engage in fraudulent or dishonest activities. We believe that this type of process will be both much less expensive and more effective in stamping out mortgage fraud than the reporting structure that OFHEO has proposed. OFHEO could consider requiring the Enterprises to participate in the clearinghouse once it is implemented.

In addition, although Congressional action might be needed to ensure that new proposals had sufficient teeth, OFHEO could require the Enterprises to increase their requirements for appraisers. For example, when loans are originated with the involvement of an appraiser, the appraiser should be required to certify under penalty of perjury that he or she has performed the appraisal in accordance the appropriate standards and that the valuation is the appraiser’s best judgment of the value of the property. Moreover, the Enterprises could increase their standards for the levels of surety and errors and omission insurance carried by appraisers to ensure that the appraisers on loans sold to the Enterprises have sufficient wherewithal to back-up their appraisals.

We appreciate the opportunity to submit comments on the proposal.

Sincerely,



Anne C. Canfield  
Executive Director

## Turner, Jacqueline

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**From:** Erin Frederick [erin@canfieldassoc.com]  
**Sent:** Monday, April 04, 2005 4:09 PM  
**To:** regcomments@ofheo.gov  
**Subject:** RIN 2550-AA31 -- Consumer Mortgage Coalition Comments on Mtg. Fraud Reporting  
**Importance:** Low

Attached please find a comment letter from the Consumer Mortgage Coalition regarding RIN 2550-AA31, Mortgage Fraud Reporting [70 Fed. Reg. 9225 (Feb. 25, 2005)]

Please contact our offices at (202) 544-3550 with any additional questions. Thank you.

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