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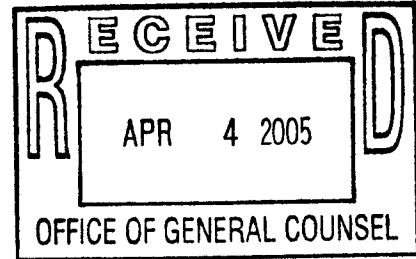
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April 4, 2005

Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
Washington, DC 20552



Re: Proposed Mortgage Fraud Reporting Regulation/RIN 2550-AA31

Dear Mr. Pollard:

Freddie Mac is pleased to provide these comments on the proposed mortgage fraud reporting regulations described in the Notice of Proposed Rulemaking issued by the Office of Federal Housing Enterprise Oversight (OFHEO) and published in the Federal Register on February 25, 2005.¹ Freddie Mac has long sought to be a leader in the fight against mortgage fraud and continues to look for new ways to enhance and strengthen its efforts to combat mortgage fraud. We welcome OFHEO's formalizing its role in the fight against mortgage fraud.

I. BACKGROUND

Freddie Mac shares OFHEO's commitment to fighting mortgage fraud. As a company whose mission is to expand homeownership opportunities, Freddie Mac is dedicated to promoting responsible credit underwriting and appraisal practices for all of America's families who seek to achieve the dream of homeownership. Mortgage fraud has an adverse impact on America's families and on the communities in which they live. We are committed to working with other participants in the mortgage finance system, and with OFHEO, to help prevent fraudulent activities and to help more families realize the full benefits of long-term homeownership.

Mortgage fraud is a serious problem in America, and Freddie Mac has taken steps to fight it. As we describe below, Freddie Mac has been working for some time to make proactive prevention, detection and resolution of mortgage fraud an integral part of Freddie Mac's business operations. Our risk management program includes rigorous evaluation of both the quality of the mortgage lenders and servicers with whom we do business and of the characteristics of the loans we have purchased. Where we suspect potential mortgage fraud, we investigate it, working closely with law enforcement agencies whenever appropriate. And we have reached out to others to raise awareness and to increase their effectiveness in fighting mortgage fraud. We also are continuously seeking additional means to combat mortgage fraud.

¹ 70 Fed. Reg. 9255.



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A. Focusing on Institutions

The first step in Freddie Mac's fight against mortgage fraud is our effort to make sure that the management and business practices of the mortgage loan sellers and servicers with whom we do business are sound and reputable. Therefore, before Freddie Mac will purchase mortgage loans from an institution, or allow an institution to service mortgage loans for Freddie Mac, the institution must meet our eligibility requirements. Our institutional eligibility requirements seek to ensure that the companies that sell or service mortgage loans for us have the organizational structure, financial resources, quality controls and personnel expertise to originate and service mortgages that are acceptable to Freddie Mac. We also perform background reviews of the institution's management by checking records of various regulatory, licensing and court authorities.

Our focus on institutions does not end upon an initial determination that an institution is eligible. Freddie Mac also periodically conducts on-site reviews of the operational processes and controls of our mortgage loan sellers and servicers in an effort to ensure that their management and business practices continue to meet our high standards. Our operational risk reviews include detailed testing of our mortgage loan sellers' broker and correspondent approval and monitoring processes, compliance with prudent underwriting practices, collateral evaluation processes (including appraiser approval and monitoring processes) and quality control programs. These tests and others are designed to ensure that mortgage loan sellers have the resources and processes necessary to originate acceptable quality mortgage loans that meet Freddie Mac's standards.

B. Focusing on Mortgage Characteristics

Freddie Mac leverages its contractual agreements to prevent and identify mortgage fraud. We require Freddie Mac mortgage loan sellers or servicers to originate and service mortgages in conformance with the requirements in Freddie Mac's Seller/Servicer Guides and other applicable contractual requirements. Under those agreements, Freddie Mac can require the seller to repurchase loans that do not meet contractual requirements, including instances of material misrepresentations or fraud.

To identify loans that fail to meet contractual requirements, we conduct sampling and evaluation of the mortgage loans we have purchased. This includes sampling of performing loans as well as loans that are in default due to nonpayment or that are considered "non-performing" because the borrower is not making timely payments.

In addition, our Guide requires our mortgage loan sellers to operate a quality control program to monitor and evaluate the integrity of their origination processes and to adjust and improve their production processes. We require our mortgage loan sellers to notify us in writing within 30 days anytime the seller determines that a quality control finding affects the investment quality requirements of applicable to mortgages loan sold to Freddie Mac.



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C. Investigations

In the event we suspect potential fraud or discover an irregularity regarding a performing or non-performing loan, Freddie Mac initiates a review to develop the underlying facts. We refer to our Institutional Investigations Unit all suspicious patterns or trends that might indicate the presence of fraudulent activity. Our Institutional Investigations Unit, which has been in place since 1989, is responsible for conducting intensive investigations of mortgage fraud, working closely with internal and external parties, including, at times, law enforcement agencies.

Freddie Mac may take a variety of steps to remedy or resolve a situation where fraud may have occurred, depending on the particular set of facts and circumstances. Among other steps, Freddie Mac may require the mortgage seller to repurchase a loan,² may terminate our business relationships with the individuals or companies involved, may refer the matter to state or local regulators, may refer the matter to federal, state or local authorities for appropriate civil and criminal action, or may enforce civil remedies.

In all cases, Freddie Mac is committed to working closely with criminal and civil authorities, including OFHEO, toward resolving the matter. Freddie Mac refers some of cases to the Federal Bureau of Investigation (FBI) and the United States Attorney's offices and also works with state and local law enforcement agencies. It is also our practice generally to inform OFHEO about any potentially significant matters.

To date, Freddie Mac's anti-mortgage-fraud activities have led to:

- The addition of 545 individuals and 303 companies to the Freddie Mac Exclusionary List (a list of individuals and companies that have been excluded from participating in transactions involving Freddie Mac loans, either directly or indirectly)³
- More than 100 indictments by federal and state prosecutors
- 76 convictions
- Nearly \$75 million in civil judgments, and \$20 million in criminal restitution orders
- Recovery of nearly 70 percent of all of our fraud losses

² In many cases, repurchases may occur prior to a determination of fraud, based on failures to meet our contractual delivery standards.

³ Freddie Mac's mortgage loan sellers and servicers must warrant to Freddie Mac that no individual or company on the Exclusionary List is involved in the origination or servicing of a loan sold to, or serviced for, Freddie Mac. The Exclusionary List is updated and distributed monthly to mortgage sellers and servicers who do business with Freddie Mac. In general, Freddie Mac prohibits further distribution of the Exclusionary List to third parties because it contains confidential information.



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D. Outreach

Freddie Mac promotes fraud awareness and works with others in the industry and in law enforcement on anti-fraud initiatives. Freddie Mac has established a toll-free Fraud Hotline for reporting suspected fraudulent activity. We actively participate in industry-wide training seminars and training sessions that focus on fraud detection and prevention. In addition, we actively participate in anti-fraud task forces in several cities across the country (currently Atlanta, Indianapolis, Kansas City, Chicago and Las Vegas). We are also regular participants in the training of new FBI agents at the FBI's headquarters in Quantico, Virginia.

And Freddie Mac is committed to helping other participants in the mortgage finance industry establish comprehensive quality control practices that safeguard against fraud and improper business practices. In this regard, Freddie Mac has developed and makes available to all of its mortgage sellers and servicers information about best practices for quality controls. Our publication entitled, "Discover Gold Through Quality," available online at www.freddiemac.com/dgtq/, helps mortgage loan sellers and servicers learn how to develop and maintain a comprehensive quality control program, effectively manage their wholesale operations, and prevent and mitigate fraud losses.

Freddie Mac also has expanded the Don't Borrow TroubleSM campaign, pioneered in Boston by Boston Mayor Thomas M. Menino and the Massachusetts Community & Banking Council, to reach more than 30 localities nationwide. Don't Borrow Trouble is the first comprehensive consumer awareness and foreclosure prevention campaign of its kind. Don't Borrow Trouble combines an extensive public education campaign with comprehensive counseling services to help homeowners avoid scams and resolve any financial difficulties they may be experiencing in an informed and prudent manner.

II. TECHNICAL COMMENTS

We support formalization of OFHEO's role in the fight against mortgage fraud, and we offer a limited number of suggestions with respect to the specific language of the regulations that it has proposed, or supporting regulatory guidance, based on our experience in investigating and addressing mortgage fraud.

A. Definition of "Possible Mortgage Fraud"

Proposed § 1731.2(e) defines "possible mortgage fraud" as follows:

Possible mortgage fraud means that an Enterprise has cause to believe that mortgage fraud may be occurring or has occurred.

We are concerned that § 1731.2(e), as presently framed, could be read to mean that an Enterprise's reporting obligation would be triggered whenever the Enterprise had any reason to believe that mortgage fraud may have occurred, however slight or uncertain that reason may be. The result could be voluminous over-reporting and unnecessary Enterprise exposure to liability that could result from after-the-fact second-guessing of what must necessarily be good-faith judgments by each Enterprise.



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As noted in OFHEO's March 10 Testimony⁴ one of the potential substantial costs of reporting is the possible exposure of a reporting Enterprise for libel in the absence of statutory protection.

Under these circumstances, we believe that it would be appropriate to clarify the definition of "possible mortgage fraud" by modifying § 1731.2(e) to read as follows:

Possible mortgage fraud means that an Enterprise *has determined, in its good-faith judgment, that mortgage fraud may be occurring or has occurred.*⁵

Alternatively, OFHEO could clarify the application of that definition in regulatory guidance.

Describing the possible mortgage fraud in terms of a determination, in an Enterprise's good faith judgment, would establish a clearer and more appropriate threshold for triggering the reporting obligation under the regulations, setting that threshold at a level greater than a mere, unsubstantiated suspicion and recognizing that the Enterprise must make good faith judgments here. The proposed regulations provide OFHEO with the means to ensure that such determinations appropriately occur in support of the mortgage fraud reporting requirement by directing the Enterprises, in proposed § 1731.5, to "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."

B. Confidentiality

Confidentiality is a closely related point. As acknowledged in OFHEO's March 10 Testimony, the lack of statutory protection for an Enterprise reporting possible mortgage fraud poses a challenge to OFHEO in sharing information. Accordingly, we suggest that OFHEO clarify in commentary to the final regulations or in regulatory guidance that OFHEO would maintain the confidentiality of any reports submitted under the regulations until OFHEO is satisfied to a high degree of certainty that mortgage fraud has occurred, ideally with the concurrence of the reporting Enterprise.

C. Timing of Reports

The proposed regulations include two different timing requirements for reports: (1) an immediate requirement for situations requiring immediate attention by OFHEO⁶ and (2) a four-day requirement for other reports.⁷

⁴ Statement of Alfred M. Pollard, General Counsel, Office of Federal Housing Enterprise Oversight on Due Diligence in Mortgage Repurchases and Fannie Mae: The First Beneficial Case, before the Subcommittee on Oversight and Investigation, Financial Services Committee, U.S. House of Representatives (March 10, 2005) (hereinafter "March 10 Testimony").

⁵ New language in italics.

⁶ Proposed § 1731.4(a)(2).

⁷ Proposed § 1731.4(a)(1)(ii).



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1. Immediate Reports

We believe that it would be desirable for the final regulations or guidance to provide further instruction as to what situations would require "immediate attention by OFHEO" within the meaning of proposed § 1731.4(a)(2). At present, the situations that would fall into this category are entirely unclear, which would impair the Enterprises' ability to establish means of reasonably ensuring compliance with that reporting requirement.

We suggest that situations covered by proposed § 1731.4(a)(2) could be defined as those in which the Enterprise is aware that the failure to report mortgage fraud or possible mortgage fraud (as defined in the regulations) to OFHEO immediately upon its identification would be likely to substantially impair OFHEO's ability to investigate the circumstances surrounding, and to act upon, such mortgage fraud or possible mortgage fraud in the exercise of OFHEO's statutory supervisory and enforcement authority.

2. Other Reports

In addition, we would suggest that the four-day reporting requirement set forth in § 1731.4(a)(ii) is unnecessary (particularly given the separate reporting requirement for situations requiring immediate attention) and introduces undesirable rigidity into the reporting process. To permit more flexibility to address new and different reporting situations that cannot now be anticipated or effectively covered, especially with the separate immediate attention requirement for urgent matters, we suggest that the timing of reports on non-urgent matters be addressed by substituting "Promptly"⁸ for "Within four business days" in § 1731.4(a)(ii), to read that an Enterprise shall report mortgage fraud or possible mortgage fraud—

Promptly after identifying mortgage fraud or possible mortgage fraud.⁹

To the extent that OFHEO considers it desirable or necessary to establish outer limits as to what would constitute prompt reporting for particular situations – or in general – OFHEO could do so through regulatory guidance. Such an approach would enhance both the flexibility and effectiveness of OFHEO's mortgage fraud reporting regime.

D. Definition of "Mortgage Fraud"

Proposed § 1731.2(c) defines "mortgage fraud" as follows:

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.

This definition treats all mortgage-backed securities or similar financial instrument as equivalent to the mortgages associated with them for purposes of mortgage fraud. But they are not. Securities purchased by an Enterprise, such as mortgage-backed securities issued and guaranteed by an entity

⁸ See proposed § 1731.4(a), which similarly requires reporting to be done "promptly" under § 1731.4.

⁹ New language in italics.



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other than the Enterprise, can also present issues of fraud (e.g., securities fraud), but those issues are, of course, quite different than mortgage fraud issues.

We assume that OFHEO's intent is for the proposed regulations to cover all mortgages owned or controlled by the Enterprises, including those associated with mortgage-backed securities issued or guaranteed by the Enterprises. We suggest that OFHEO clarify the proposed regulations in this regard, for example, by revising § 1731.2(c) to read as follows:

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 instrument issued or guaranteed by the Enterprise.*¹⁰

* * *

Again, we fully share OFHEO's commitment to fighting mortgage fraud, and we support OFHEO's effort to formalize its role in that fight.

Sincerely,

A handwritten signature in black ink, appearing to read "Joan Donoghue".

Joan Donoghue
Senior Vice President
General Counsel and Corporate Secretary

¹⁰ New language in italics.