

April 4, 2005

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

**RE: RIN 2550-AA31
Mortgage Fraud Reporting Proposed Rule**

Dear Mr. Pollard:

The Mortgage Bankers Association (MBA)¹ welcomes the opportunity to comment on the Office of Federal Housing Enterprise Oversight's (OFHEO) *Mortgage Fraud Reporting* Proposed Rule (hereafter "the Rule"), published February 25, 2005. The Rule requires Fannie Mae and Freddie Mac (hereafter "the GSEs") to submit reports of mortgage fraud, or possible mortgage fraud, to OFHEO within four business days after the fraud has been identified. Mortgage fraud reports must be submitted before either GSE can require the repurchase of, or decline to purchase, a mortgage, mortgage-backed security, or similar financial instrument because of possible mortgage fraud.

MBA applauds OFHEO's effort to combat mortgage fraud against the real estate finance industry. Mortgage fraud is a growing part of the real estate finance system that costs the industry and consumers millions of dollars each year. Mortgage industry leaders are extremely concerned that mortgage fraud against the lending community has grown quite large in the past several years with devastating consequences to lenders, taxpayers, consumers and communities.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 480,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,900 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

I. WHAT MBA IS DOING TO COMBAT FRAUD

Due to the fact that the financial burden of mortgage fraud falls squarely upon mortgage lenders, MBA has undertaken a number of initiatives in support of efforts to prevent, detect and combat mortgage fraud. MBA facilitates an ongoing Fraud and Ethics Subcommittee that meets monthly to discuss the impact of mortgage fraud against the lending industry and initiatives that industry can undertake to alleviate this threat.

Recently, MBA hosted a National Fraud Summit that brought together a cross-section of the real estate finance industry, including lenders, brokers, title companies, appraisers, the GSEs, federal and state government, and law enforcement. The Summit provided an opportunity for attendees to discuss the impact of mortgage fraud against lenders, and develop potential action steps for combating mortgage fraud.

Finally, MBA has unveiled a new tool for lenders to use in the fight against fraud - the Mortgage Fraud Against Lenders Resource Center website (www.MBAFightsFraud.MortgageBankers.org). The website is the mortgage lending industry's one-stop web resource for detecting, investigating and preventing fraud against lenders.

II. INDUSTRY DEFINITION OF MORTGAGE FRAUD AGAINST LENDERS

The mortgage lending industry defines mortgage fraud as material misrepresentation - the giving of false information that is intended to deceive or mislead a lender into extending credit beyond the limits of what would normally be extended if the facts were known. Information or documentation is considered false if there is clear and convincing data that the information or documentation lacks truth or accuracy.

III. COMMENTS ON THE PROPOSED RULE

While supportive of OFHEO's intent in proposing the Rule, MBA believes that the Rule, as written, would add significant costs and administrative burdens upon the GSEs and those lenders who work with the GSEs, without a corresponding positive impact on the problem of mortgage fraud against lenders nor the safety and soundness of the GSEs. For this reason, MBA believes that OFHEO should reconsider whether such a reporting requirement is necessary and, if so, publish a new proposed rule for comment that addresses the concerns outlined below.

The Rule's definition of mortgage fraud is too broad making its application difficult.

Section 1731.2(c) of the Rule defines "mortgage fraud" as "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 of mortgage fraud is very broad and lacks differentiation between what is a result of human error and what is actual fraud. This is contrary to the industry's standard of what constitutes fraud – material misrepresentation that is deliberately intended to deceive a lender into extending a loan. The industry's definition of fraud excludes misstatements or omissions, due to an unintentional error that can often be resolved through communication between a lender and a GSE.

MBA believes that the word "omission" should not be included in a definition of mortgage fraud, unless the language is specific about an omission that is intended to deceive a lender or a GSE and does not include omissions resulting from an unintentional error.

The definition of "possible mortgage fraud" is too broad such that it may result in a huge reporting requirement.

Section 1731.2(e) of the Rule defines "possible mortgage fraud" as an "Enterprise having [has] cause to believe that mortgage fraud may be occurring or has occurred."

This definition of possible mortgage fraud can cover a myriad of incidences that are not fraudulent, but may be considered a "red flag" indicating fraud may have occurred. For instance, the GSEs' automated underwriting systems typically will report "red flags" or warnings to lenders. Some, but by no means all, of these red flags are an indication of possible mortgage fraud. The Rule is unclear as to whether the GSEs would have to report these to OFHEO. If reporting all red flags were required, the reporting system would be congested with many non-fraud related reports that would make it difficult for OFHEO to identify actual threats of fraud.

Possible mortgage fraud under the Rule is similar to the definition of "suspicious" used in filing Suspicious Activity Reports (SARs)² under the Bank Secrecy Act. Due to the breadth of the definition of "suspicious" under SARs, MBA understands that many institutions who currently file SARs are over-reporting, out of fear of being found out of compliance with the Bank Secrecy Act. If the Rule's definition of possible mortgage fraud were equally as broad, there would be potential for OFHEO to have the same problem of over-reporting by the GSEs, which could lead to congestion of the reporting system and would unnecessarily burden the mortgage industry.

MBA believes that a more narrow definition of possible mortgage fraud which includes the requirement for evidence of actual fraud and identifies an investigative threshold is necessary to ensure that simple "red flags" do not fall under any definition of possible mortgage fraud.

² The Bank Secrecy Act (31 U.S.C. § 5311 – 5332) requires, among other things, that certain institutions report "any suspicious transaction relevant to a possible violation of law or regulation." The reports are called suspicious activity reports (SARs), and they are submitted to the Department of Treasury.

The nondisclosure provision could prohibit the GSEs from alerting lenders to fraud, thereby actually promoting the continuation of fraud.

Section 1731.4 (c) of the Rule states that “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.”

It is unclear whether this restriction would prohibit the GSEs from communicating with a lender when the GSE discovers fraud. If OFHEO’s intent is to prohibit the GSEs from notifying a lender about fraud or possible fraud with a loan or set of loans, then the Rule would have a dramatically disruptive effect on the GSEs’ and lenders’ processes for addressing fraud.

It is common industry practice for the GSEs and lenders to contact each other when they detect fraud, or suspected fraud, during their quality control processes. Such communication is important because, in many cases, the initial suspicion of mortgage fraud is a false alarm. Often, a question is due to error that can be resolved with additional information from the lender. This communication is sometimes the first indication a lender has about fraud within its pipeline. In order to avoid costly fraud schemes, it is important that the GSEs notify lenders as soon as possible of suspected fraud.

Additionally, the nondisclosure provision does not clarify the amount of time it would take between the submission of a mortgage fraud report to OFHEO and the granting of permission for the GSEs to disclose the reports to parties connected with the suspected fraud. Again, if OFHEO’s intent is to prohibit communication between a GSE and a lender prior to written approval by OFHEO, MBA is extremely concerned that the delays that would result could be costly, if it causes a lender to unknowingly continue originating or purchasing fraudulent loans. MBA does not want the GSEs to withhold information they have about fraud against a lender, as the lender continues to be defrauded.

Such a prohibition would also significantly impact multifamily lending. If the nondisclosure provision prohibits the GSEs from contacting multifamily lenders to share information about fraud that may or may not exist, such delays could result in significant costs for already complex multifamily transactions.

Furthermore, the nondisclosure provision would prohibit disclosure to “parties connected with mortgage fraud or possible mortgage fraud,” but does not define the scope of “parties.” Given MBA’s concern with the nondisclosure provisions, MBA believes the Rule should clarify whether a lender, who was a victim of fraud, be included in this definition.

MBA suggests that if OFHEO pursue rulemaking, that any final Rule either eliminates the nondisclosure clause or clarifies it such that it does not restrict communication between the GSEs and lenders concerning mortgage fraud or possible mortgage fraud.

The four day reporting requirement is too short, given the reality of how fraud is investigated by lenders.

Section 1731.4 (a) (ii) of the Rule states that the Enterprises are to submit, in writing, mortgage fraud reports to OFHEO's Director within four business days after identifying mortgage fraud or possible mortgage fraud.

A four day period is contrary to how fraud is investigated by the GSEs and lenders. It can often take several weeks to make a determination as to whether fraud has, or even has likely, occurred. Such a short timeframe would result in reports being filed unnecessarily. MBA is concerned that the Rule's four day reporting requirement would deter the GSEs from accurately detecting mortgage fraud and sending meaningful information to OFHEO.

Under the current SARs process, lenders are given a 30-day reporting window. Many institutions believe this requirement is also too short to adequately report a case of suspected fraud.

MBA suggests revising the proposed four day reporting requirement to a time period of 60 days, which would allow the GSEs and lenders minimal opportunity to investigate suspected cases of fraud. A longer time period would also reinforce a clearer definition of possible mortgage fraud by incorporating appropriate time for due diligence to differentiate fraud from unintentional errors or omissions. We believe a longer timeframe would also significantly curtail over-reporting such that the data OFHEO receives would be more meaningful.

The Rule gives no threshold of materiality for submitting mortgage fraud reports.

The Rule does not provide a material threshold for the GSEs to use in determining whether or not to submit mortgage fraud reports. The SARs process has a threshold that helps lenders prioritize loans that should be of concern. Although all levels of mortgage fraud are detrimental to the real estate finance industry, a lack of a reporting threshold could result in the reporting of a large number of cases with little significance. Such reporting could diminish OFHEO's ability to identify the larger schemes that may affect a GSE's safety and soundness.

MBA suggests the development of thresholds so that the GSEs will be able to prioritize loans that are of concern and should be reported, which will ultimately support the safety and soundness of each GSE.

The Rule gives no indication as to how OFHEO will use the information collected from the mortgage fraud reports.

The Rule does not state what OFHEO will do with the information that is collected from the mortgage fraud reports submitted by the GSEs. It also does not state whether OFHEO intends to share the collected data with the mortgage lending industry.

Many lending institutions who currently file SARs have expressed frustration that the information they report is not, in turn, reported back to them in a manner that could allow them to prevent their companies from being victimized by mortgage fraud.

At MBA's National Fraud Summit held on March 10, 2005, information sharing about mortgage fraud within the industry was identified as a key component in effectively combating mortgage fraud in the industry. Participants in the Summit's "Fraud Schemes and Information Sharing" Roundtable Discussion stated clearly that information must be received in a timely manner if it is to be most useful in combating mortgage fraud.

MBA believes that any Federal or state agency that mandates the collection of mortgage fraud information should not do so without developing a mechanism for sharing this information with industry in a timely manner. Such information sharing helps to give the burden of data collection a tangible benefit to the industry.

Likewise, MBA does not believe OFHEO should proceed with collecting such information if there are no plans to share the data it collects in such a way as to allow lenders to avoid being the victims of mortgage fraud.

The Rule is silent about retroactive application.

The Rule is silent on whether the reporting requirement would be applied retroactively. If OFHEO does implement the Rule, MBA strongly suggests that its application be applied only to mortgages purchased – or not purchased – six months after the Rule is finalized. Doing so will allow the GSEs time to build the required internal controls and prepare their systems for reporting. Further, OFHEO should be clear that the Rule would not require the GSEs to review every loan they have purchased or not purchased, before the Rule becomes final, to report every past case of potential fraud. A retroactive reporting requirement would be enormously burdensome, and would be grossly disproportionate to any possibility of fraud prevention.

IV. COSTS AND BENEFITS OF THE PROPOSAL

A. The Rule would burden the mortgage market.

Under the Rule, the GSEs would have substantial, continuous, reporting burdens. They would be required to report all instances of mortgage or possible mortgage fraud within four business days of discovery. In addition to that requirement, OFHEO could require

more information about any case of potential fraud that a GSE includes in an initial filing with OFHEO. OFHEO could further require continuing reporting, for an unlimited period of time, if it were to decide to monitor cases of potential fraud. Taken together, these reporting requirements would amount to a massive regulatory burden.

Because the GSEs are not allowed to originate loans directly, everything they learn about loans comes to the GSEs from lenders. This means that the GSEs would need to obtain from mortgage lenders the information the GSEs would need to report to OFHEO. To comply with the proposed reporting requirement, which is extraordinarily broad, the GSEs may need to require more information from lenders than is customary today. And, in cases where OFHEO wants information in addition to an initial report, the GSEs could well require the lenders to provide new information to the GSEs for filing with OFHEO. In cases where OFHEO decides to follow a case for an indefinite period of time, lenders may face a continuous process of providing an extraordinary amount of information to the GSEs.

Many lenders already file SARs in case of suspicious activities. SARs must be filed within 30 days of an initial suspicion. But under OFHEO's Rule, the lenders would need to get information about possible mortgage fraud to OFHEO in time for a four day reporting requirement. To the extent that the SAR also requires the same information as OFHEO, the institution will have a double reporting burden. And the OFHEO Rule would, in effect, shorten the SAR reporting time from 30 days to a mere four days.

In addition to the reporting burden this Rule would place on the mortgage lending industry, the GSEs may pass their costs of complying with this reporting requirement through to mortgage lenders, through fee increases and other pricing mechanisms.

OFHEO may rightly assume that the GSEs will be able to bear the costs of complying with the Rule. But, the majority of MBA's members are small businesses that do not enjoy the massive assets of the GSEs. These lenders may have no choice but to pass through to consumers the costs of OFHEO's reporting requirement.

MBA understands that some may believe that the GSEs will absorb, rather than pass on to lenders and consumers, the costs of complying with the Rule because of competitive pressures. This argument is that the GSEs can reasonably be expected to refrain from passing on the costs and burden to lenders because lenders would, in reaction, take their business to other secondary market outlets.

This argument is not consistent with the realities of the secondary mortgage market. Fannie Mae and Freddie Mac together purchase about 80% of the market for fixed rate, conforming loans.³

³ Conforming loans are those that are under the maximum loan size that Fannie Mae and Freddie Mac may permissibly acquire.

B. Possible benefits from the Rule are lacking.

OFHEO does not specify in the Rule the benefits it expects to derive from this mandated reporting. OFHEO has not described how the Rule will actually reduce either the incidence or the severity of fraud, nor how it will be used in monitoring the safety and soundness of the GSEs.

OFHEO does cite an article from a Sunday newspaper about mortgage fraud, but the article makes no mention of either GSE, and it is not at all clear that the GSEs were involved in the transactions the article describes. If the GSEs are not involved in a transaction, they would not be able to report it to regulators.

MBA does not believe a regulation, with enormous compliance burdens, is a necessary reaction to that single case.

Moreover, OFHEO has not proposed any particular uses for the massive information it proposes to collect. OFHEO is not a criminal investigatory agency and does not have authority to conduct criminal investigations. OFHEO does not regulate the entire mortgage industry, and it, appropriately, does not claim to be on the lookout for fraud that hurts lenders but against which the GSEs are able to protect themselves. Rather, OFHEO bases its reporting proposal on its role as the safety and soundness regulator for the GSEs. For this reason, MBA believes that any rule should be limited to that purpose. OFHEO does not have authority to require a massive reporting requirement, that would fall on the lending industry, and that would not significantly alter the safety and soundness of the two GSEs.

OFHEO has not identified any use for the massive volume of information it would collect, and has not connected any possible use to the GSEs' safety and soundness.

C. The full rulemaking process should be followed.

MBA does not see that OFHEO has weighed the benefits of its Rule against the costs of compliance. Certainly a cost-benefit analysis is an important part of any administrative rulemaking that would impose an enormous, new, and permanent reporting burden on an industry. Weighing costs and benefits is all the more important when the new regulatory burden could be passed on to consumers, as in this proposal.

MBA urges OFHEO to weigh these costs, and the harm they could do to mortgage lenders, against any benefits of the new reporting requirement. Only if the benefits of preventing mortgage fraud through increased reporting to OFHEO outweigh the costs to all affected parties, not just the GSEs, should OFHEO finalize this proposal.

There are laws that require federal agencies to consider the burdens of proposed regulations as a mandatory part of the rulemaking process. These include Executive Order 12866, the Paperwork Reduction Act, and the Regulatory Flexibility Act. MBA realizes that OFHEO may be able to find technical legal reasons why these laws may

not apply in this case. However, the policy behind these laws is sound, and there is no reason OFHEO should ignore this sound policy in such a burdensome rulemaking.

1. Executive Order 12866

OFHEO had submitted the Rule to the Office of Management and Budget (OMB) because it is a significant regulatory action within the meaning of Executive Order 12866 (the Order).

MBA understands that OFHEO believes the Rule will not have an economic impact of \$100 million or more per year, and that OFHEO therefore has not prepared a written economic analysis of the proposal, as the Order requires for regulations that would have that quantity of impact.

There are aspects of the Order that apply to all rulemakings, even when a formal economic analysis is not required. These are sound, reasonable aspects of any good rulemaking. MBA cannot see whether OFHEO has addressed them.

For example, § 1 of the Executive Order states “In deciding whether and how to regulate, agencies should **assess all costs and benefits** of available regulatory alternatives, including the alternative of not regulating.” (Emphasis added.) MBA is not aware of any alternatives OFHEO identified or considered, and MBA is aware of no cost-benefit analysis of any possible approach.

MBA suggests that OFHEO consider the following alternatives, and weigh their costs and benefits:

- Obtain from FinCEN information OFHEO needs to supervise the GSEs’ safety and soundness. FinCEN already collects and maintains a large amount of information from financial institutions about “suspicious activities,” including mortgage fraud. FinCEN and OFHEO may share information without danger of waiving privileges. MBA can imagine no benefit to requiring institutions to report information to OFHEO that OFHEO may already obtain merely by asking FinCEN for the information.
- Obtain from the GSEs only information that FinCEN cannot collect. OFHEO’s proposal would create a duplicate reporting burden. First, lenders would give information to the GSEs so the GSEs can report that information to OFHEO, under the proposed regulation. Then lenders subject to SAR requirements would need to report suspicious fraud to FinCEN, which in many cases would be the very same information already submitted to OFHEO. MBA can see no benefit to this double reporting burden, and we strongly urge OFHEO not to create this duplicative burden.

Executive Order 12866 also contains many other requirements, and MBA notes only a few here. The Order directs agencies, in promulgating rules as follows:

[To] design its regulations in the most cost-effective manner to achieve the regulatory objective. In doing so, each agency shall consider . . . the costs of enforcement and compliance (to the government, regulated entities, and the public), flexibility, distributive impacts, and equity.

Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs. . . .

Each agency shall tailor its regulations to impose the least burden on society, including individuals, businesses of differing sizes, and other entities . . . ⁴

MBA does not see that OFHEO has considered the costs to the mortgage lending industry of the GSEs' compliance with this proposed regulation. MBA is not aware, for example, that OFHEO surveyed mortgage bankers or lenders about the impact a rule of this nature could have on them, or about the extent to which consumers would ultimately bear the costs. MBA urges OFHEO, in considering this rulemaking, to avoid compliance costs, whether borne by the GSEs or passed through to lenders and consumers, which exceed any identified benefit of this regulation.

2. Paperwork Reduction Act

The Paperwork Reduction Act is a law designed, among other things, to “minimize the paperwork burden” when the federal government collects information.⁵ Before a federal regulation may require a “collection of information,” the Paperwork Reduction Act requires consideration of, and public comment on, the burden the regulation would impose.⁶

In implementing this statute, OMB has promulgated a definition of “collection of information” to which the Paperwork Reduction Act applies.

‘Collection of information’ means . . . the obtaining, causing to be obtained, soliciting, or requiring the disclosure to an agency, third parties or the public of information by or for an agency by means of identical questions posed to, or identical reporting, recordkeeping, or disclosure requirements imposed on, ten or more persons⁷

The Rule would certainly require the GSEs to obtain and report to OFHEO an abundance of information. This brings up the question whether the reporting requirement would fall on “ten or more persons” within the regulatory definition of “collection of information.” OMB has also defined this term:

⁴ Executive Order 12866, § 1(b)(5), (6), and (11).

⁵ 44 U.S.C. § 3501(1).

⁶ See generally, 44 U.S.C. §§ 3506 – 3507.

⁷ 5 C.F.R. § 1320.3(c).

'[t]en or more persons' refers to the persons to whom a collection of information is addressed by the agency within any 12-month period, and to any independent entities to which the initial addressee may reasonably be expected to transmit the collection of information⁸

OFHEO's proposed rule would, at first, require Fannie Mae and Freddie Mac to report to OFHEO. But the ramifications of this proposed regulation would most certainly not stop with the GSEs. The GSEs would request information from lenders, then submit that information to OFHEO. That is, lenders are "independent entities" to whom the GSEs can "reasonably be expected" to transmit OFHEO's requests for information. There are thousands of mortgage lenders, far in excess of OMB's threshold of ten persons. As we discussed above, it is not realistic to believe that the GSEs will refrain from requesting information from ten or more lenders to comply with the Rule. The GSEs get all their loan information from lenders.

MBA is concerned that OFHEO may have assumed the Rule would have no significant burden on mortgage lenders. MBA strongly believes that the burden will be very significant.

It appears to MBA that the Paperwork Reduction Act applies to OFHEO's proposed rule. For this reason, MBA requests that OFHEO address the requirements of this law.

3. Regulatory Flexibility Act

The Regulatory Flexibility Act requires agencies, in their rulemakings, to consider the impact of the rules on small businesses. Congress passed the Regulatory Flexibility Act because:

uniform Federal regulatory and reporting requirements have in numerous instances imposed unnecessary and disproportionately burdensome demands including legal, accounting, and consulting costs upon small businesses, small organizations, and small governmental jurisdictions with limited resources; [] the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity;

unnecessary regulations create entry barriers in many industries and discourage potential entrepreneurs from introducing beneficial products and processes; [and] alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes may be available which minimize the significant economic impact of rules on small businesses⁹

⁸ 5 C.F.R. § 1320.3(c)(4).

⁹ Regulatory Flexibility Act, Pub. L. No. 96-354, § 2, 96 Stat. 1164 (1980).

Under this act, when a proposed rule would have a significant impact on a substantial number of small entities, the agency must consider alternatives that would lessen the regulatory burden on small entities.

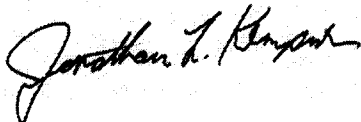
MBA realizes that courts construe this requirement to cover only the regulatory impact on small entities that are directly subject to the agency's rule, and that only the two large GSEs are directly subject to OFHEO regulations. But the GSEs are in a position to pass their costs of compliance with the Rule on to mortgage lenders, many of whom are small businesses in no position to handle the burden. For these reasons, MBA believes that OFHEO should not promulgate this Rule without voluntarily complying with the sound requirements of the Regulatory Flexibility Act.

V. CONCLUSION

Thank you for the opportunity to comment on the *Mortgage Fraud Reporting*, RIN 2550-AA31 proposed Rule. MBA is supportive of strong efforts to detect, prevent and combat mortgage fraud, but believes that the costs of the Rule, as currently proposed, far outweigh the benefits it could have for consumers and the real estate finance industry.

MBA is very interested in working with OFHEO to develop a proposal that addresses the safety and soundness requirements with regard to the GSEs and mortgage fraud, and does so in a manner that is not burdensome to the industry.

Most sincerely,



Jonathan L. Kempner
President and Chief Executive Officer