



Issue Date September 26, 2011
Audit Report Number 2011-KC-0004

TO: Deborah Holston, Acting Deputy Assistant Secretary for
Single Family Housing, HU

FROM: //signed//
Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: FHA Did Not Prevent Corporate Officers of Noncompliant Lenders From
Returning to the FHA Program

HIGHLIGHTS

What We Audited and Why

We selected the Federal Housing Administration (FHA) for review because we noted during previous Office of Inspector General (OIG) audit work that FHA might not have a system in place to track lenders who voluntarily left the FHA program with outstanding indemnification agreements. Our objective was to determine whether FHA prevented corporate officers from participating in FHA programs after those officers left other lenders that did not honor their FHA indemnification agreements.

What We Found

FHA did not prevent lenders' corporate officers from participating in FHA programs after those officers left other lenders that did not honor their FHA indemnification agreements. We found 12 different corporate officers who were participating in the FHA program after leaving 7 lenders that did not honor their indemnification agreements and had lost their FHA approval. However, FHA lacked the authority to prevent these corporate officers from reentering the FHA program.

What We Recommend

We recommend that FHA seek legislative and program rule changes to prevent lenders and their corporate officers with unsatisfied indemnification agreements from reentering the FHA program as the same or a new lender.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

FHA disagreed with our finding and our recommendation. We initially provided the draft report to FHA on May 17, 2011, and requested a response by June 16, 2011. FHA provided written comments on June 30, 2011. We later revised the report and provided a draft for comment to FHA on August 24, 2011, and requested a response by September 8, 2011. FHA provided signed written comments on September 23, 2011.

The complete text of the auditee's draft for comment response, along with our evaluation of that response, can be found in appendix A of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: FHA Did Not Prevent Corporate Officers of Noncompliant Lenders From Returning to the FHA Program	6
Scope and Methodology	12
Internal Controls	14
Appendixes	
A. Auditee Comments and OIG's Evaluation	15
B. Criteria	18

BACKGROUND AND OBJECTIVES

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by approved lenders throughout the United States and its territories. FHA insures mortgages on single-family and multifamily homes including hospitals and nursing homes. FHA mortgage insurance provides lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet established FHA requirements to qualify for insurance.

The Office of Single Family Housing is responsible for the overall management and administration of FHA single-family mortgage insurance programs. Activities include approving lenders for FHA participation; providing lenders instructions on how to originate, close, service, and foreclose on mortgages; providing loss mitigation assistance; and monitoring program participants. The three offices in the Office of Single Family Housing are the Offices of Single Family Program Development, Single Family Asset Management, and Lender Activities and Program Compliance.

The Office of Lender Activities and Program Compliance is responsible for administering various risk management activities related to FHA-approved lenders. There are three divisions within this office: the Lender Approval and Recertification Division, Quality Assurance Division, and Mortgagee Review Board Division.

The framework of the Office of Lender Activities and Program Compliance risk management strategy is

- Gatekeeping-Approving and recertifying only responsible loan correspondents and lenders to originate and/or service FHA-insured mortgages in FHA's Title I and II loan programs.
- Monitoring-Assessing lender performance, internal controls, and compliance with FHA origination and servicing requirements, largely through onsite reviews of lender practices, but also through onsite evaluations and analyses.
- Enforcement-Sanctioning those lenders and related parties that fail to comply with FHA requirements.

According to HUD Handbook 4155.2, Chapter 9, Section D.4.a thru D.4.d, mortgage lender violations that significantly increase FHA's risk and were caused by fraud or negligence on the part of the lender should result in an indemnification agreement. Indemnification is requested by either the Homeownership Center through the Quality Assurance Division, when appropriate, or Office of Lender Activities and Program Compliance, in lieu of referring the matter to the Mortgagee Review Board. Under an indemnification agreement, the originating mortgage lender agrees to either abstain from filing an insurance claim or reimburse FHA if a subsequent holder of the mortgage files an insurance claim and FHA suffers a financial loss in disposing of the property. The term or duration of an indemnification agreement varies according to the severity of the violation. Typically, the agreement is effective for 5 years from the date of the agreement but may extend for a longer period at FHA's discretion.

Also, a July 28, 2006, Single Family Housing policy memorandum states indemnification agreements are negotiated primarily between the Quality Assurance Division and the lender. The indemnifications result from deficiencies discovered in loan reviews conducted by the Quality Assurance Division, the Processing and Underwriting Division, and/or the Office of Inspector General (OIG). Whether the deficiencies stem from Quality Assurance Division lender monitoring reviews, postendorsement technical reviews, or OIG audits, it is the materiality of the deficiency that is important, and the standard for requesting indemnification from the lender must be consistent.

Mortgagee Letter 2010-38 defines a corporate officer as a person with one of the following titles: owner, president, vice president, chief operating officer, chief financial officer, director, corporate secretary, chief executive officer, member (e.g., of a limited liability corporation) and chairman of the board.

Our audit objective was to determine whether FHA prevented corporate officers from participating in FHA programs after those officers left other lenders that did not honor their FHA indemnification agreements.

RESULTS OF AUDIT

Finding 1: FHA Did Not Prevent Corporate Officers of Noncompliant Lenders From Returning to the FHA Program

FHA did not prevent lenders' corporate officers from participating in FHA programs after those officers left other lenders that did not honor their FHA indemnification agreements. This condition occurred because FHA lacked the authority to prevent these corporate officers from reentering the FHA program.

Corporate Officers Participated in the FHA Program After Leaving Lenders That Did Not Honor Previous FHA Agreements

FHA did not prevent lenders' corporate officers from participating in FHA programs after those officers left other lenders that did not honor their FHA indemnification agreements. During our limited review, we found 12 different corporate officers who were participating in the FHA program after leaving 7 lenders that did not honor their indemnification agreements and had lost their FHA approval.

The seven lenders had 153 loans with unresolved indemnification agreements at the time their FHA business was terminated. Since the lenders left the FHA program, FHA was unable to collect on the more than \$7.3 million in net losses related to the unresolved indemnification agreements.

The following table lists the lender's name, the number of corporate officers participating in the FHA program after leaving the lender that did not honor its indemnification agreements, the date when the lender was terminated, either voluntary or involuntarily, from the FHA program, the total number of loans with unresolved indemnification agreements when the lender was terminated from the FHA program, and the loss amount incurred by FHA. The loss amount is the calculated amount of profit or loss resulting from the sale of a property.

The loans with unresolved indemnification agreements included loans that still had active indemnification agreements in effect when the lender left FHA or loans in which the lender had not already honored their indemnification agreements before they left FHA. The lender's FHA termination dates were obtained from

Neighborhood Watch and the number of loans with unresolved indemnification agreements came from the Single Family Enterprise Data Warehouse for loans endorsed from 1998 through 2008. The loss amount incurred came from the Single Family Enterprise Data Warehouse and Single Family Insurance System-Claims Subsystem for loans endorsed from 1998 through 2008 and having unresolved indemnification agreements.

Lender name	Number of corporate officers	Date when lender was terminated from FHA	Number of loans with unresolved indemnification agreements	Loss amount incurred by FHA
First Magnus Financial Corporation	4	June 1, 2009	111	\$5,892,831
Pinnacle Financial Corporation	2	March 24, 2008	15	\$607,086
Aegis Wholesale Corporation	1	June 13, 2008	11	\$347,440
Leader Mortgage Company	1	February 28, 2006	8	\$73,512
LoanCity	1	June 1, 2007	5	\$228,421
Community Mortgage Group, Inc.	2	August 2, 2006	2	\$133,255
MCM Holdings, Inc.	1	December 14, 2004	1	\$31,880
Totals	12		153	\$7,314,425

First Magnus Financial Corporation

First Magnus Financial Corporation, a former FHA-approved lender, was approved to begin FHA business on November 7, 1996, and later shut down its business in 2007 and went into bankruptcy. It was later involuntarily terminated by Mortgagee Review Board actions on June 1, 2009. At the time of its termination, First Magnus had 111 loans with unresolved indemnification agreements which incurred losses of more than \$5.8 million.

However, in May 2008, FHA approved a new lender which was led by a group of former First Magnus executives to originate insured home loans. Four corporate officers from First Magnus began work at the new FHA-approved lender. These included the chief financial officer who began working at First Magnus in August,

1997; the chief operating officer and chief technology officer who began working at First Magnus in October, 1996; and the general counsel who began working at First Magnus in December, 2002.

When these four officers began working at the new lender, one served as the president/chief executive officer, two were vice presidents, and one was the treasurer. Also, three of these individuals were listed on the new lender's board of directors.

Pinnacle Financial Corporation

Pinnacle Financial Corporation began their FHA business on September 20, 1998 and voluntarily terminated on March 24, 2008. We found two corporate officers were listed as officers in the 1995 through 2009 annual reports filed with the Florida Secretary of State. Both of these individuals were also listed as the managing members for another lender during their time at Pinnacle Financial Corporation. This lender began their FHA business on December 16, 2002, and involuntarily terminated on April 6, 2010. According to documents filed with the Florida Secretary of State, one of the above corporate officers was listed as a managing member for the other lender from 2001 through 2005. The other corporate officer was also listed as a managing member for this lender from 2003 through 2007. Pinnacle Financial Corporation left FHA with 15 unresolved indemnification agreements and incurred losses of more than \$607,000.

Aegis Wholesale Corporation

Aegis Wholesale Corporation began their FHA business on May 23, 1951, and terminated voluntary their FHA status on June 13, 2008. One corporate officer worked for this lender as the vice president and chief financial officer from 2000-2005. This same corporate officer went to work for another FHA lender in 2005 and worked there until 2008. After leaving this lender, he went to work for another FHA lender as vice president. At the time of its termination, Aegis Wholesale Corporation had 11 loans with unresolved indemnification agreements which incurred losses of more than \$347,000.

Leader Mortgage Company

Leader Mortgage Company began its FHA business on April, 1, 1992, and voluntarily terminated its FHA business on February 28, 2006. On March 4, 2005, FHA approved another lender with a similar name and this lender is still active with FHA. Leader Mortgage's former president now serves as chief executive officer for this new lender. Leader Mortgage left the FHA program with 8 unresolved indemnification agreements and incurred losses of more than \$73,000.

LoanCity

LoanCity began their FHA business on September 13, 1990, and voluntarily terminated on June 1, 2007. Through the Washington Secretary of State and New Hampshire Banking Department Web sites, we learned one corporate officer served

as president from 1999 through 2007. The Approval Recertification and Review Tracking System data showed this corporate officer also began serving as president at another lender. This lender began their FHA business on June 2, 2009. Also, LoanCity left the FHA program with 5 unresolved indemnification agreements and incurred losses of more than \$228,000.

Community Mortgage Group Inc

Community Mortgage Group Inc began their FHA business on November 27, 1995, and involuntarily terminated for failure to submit its audited financial statements and recertification fees on August 2, 2006. On the Texas and Colorado Secretary of State Web sites, we found two corporate officers for Community Mortgage Group Inc. These corporate officers served from 1995-2004 as the president and the vice president. At the time of its termination, Community Mortgage Group Inc had 2 loans with unresolved indemnification agreements which incurred losses of more than \$133,000.

Another lender was formed on October 8, 2003 and dissolved on March 4, 2010. When the business began, it was a limited partnership with the general partner listed as Community Mortgage Group Inc. On January 9, 2004, the name was changed and it became a limited liability company. In the Articles of Organization for this limited liability company, it stated the initial state of managers was Community Mortgage Group Inc. This limited liability company began their FHA business on January 22, 2004 and involuntarily terminated for failure to submit its audited financial statements and recertification fees on February 5, 2009.

MCM Holdings Inc.

MCM Holdings Inc initially received its FHA status on September 1, 1998 and was terminated involuntarily because it didn't pay its recertification fee on December 14, 2004. It later reapplied to FHA and received approval to again begin FHA business on November 7, 2007. We reviewed the annual reports located on the Florida Department of State, Division of Corporations website and determined the president of MCM Holdings Inc continuously served from 2000 through 2010. Also, he was the only corporate officer listed in these annual reports. When MCM Holdings Inc initially left the FHA program, it had one unresolved indemnification agreement which incurred losses of more than \$31,000.

FHA Lacked Authority To Prevent Corporate Officers From Returning to the FHA Program

FHA lacked the authority to prevent these corporate officers from reentering the FHA program..

While FHA has the authority to prevent an FHA lender that does not make good on an indemnification agreement from conducting future FHA business, it does not have the authority to prevent its principals (e.g., individual officers) from reentering the FHA program with new or existing lenders unless those principals have been personally removed from or otherwise prevented from participating in the FHA program through such actions as debarments.

Although 12 U.S.C. (United States Code) 1708(c)(7) provides an expansive definition of “mortgagee,” which includes a “director, officer, employee, agent, or other person participating in the conduct of the affairs of the mortgagee, lender, or loan correspondent,” the definition only bars individual officers from reentering the FHA program with other FHA lenders if they have been found to be personally responsible for the actions of their former company or employer. In other words, it appears that the limited liability rules that protect officers of corporations from being personally liable for the bad acts of their corporate employers apply in this context as well. Thus, if a lender has been found to have engaged in conduct that renders it unfit to continue as an FHA lender, its officers are not imputed with the same bad behavior.

The law as it is currently drafted states only the lender can be withdrawn or suspended by the Mortgage Review Board under 12 U.S.C. 1708(c)(3)(E) or found to have been ineligible for approval as a mortgagee under section 203(D) of Public Law 111-22 (Helping Families Save Their Homes Act of 2009). Unless an officer is found to have been personally responsible for the lender’s failure to make good on its indemnification payments, there is no legal mechanism to prevent such officers from joining other lenders as corporate officers and transacting business in precisely the same manner as they did at the prior lender.

Appendix B contains the criteria outlined in the above paragraphs.

Conclusion

FHA did not prevent lenders' corporate officers from participating in FHA programs after those officers left other lenders that did not honor their FHA indemnification agreements. During our limited review, we found 12 different corporate officers who were participating in the FHA program after leaving 7 lenders that did not honor their indemnification agreements and had lost their FHA approval.

The seven lenders had 153 loans with unresolved indemnification agreements at the time their FHA business was terminated. Since the lenders left the FHA program, FHA was unable to collect on the more than \$7.3 million in net losses related to the unresolved indemnification agreements.

FHA lacked the authority to prevent these corporate officers from reentering the FHA program. Unless an officer is found to have been personally responsible for the lender's failure to make good on its indemnification payments, there is no legal mechanism to prevent such officers from joining other lenders as corporate officers and transacting business in precisely the same manner as they did at the prior lender.

Recommendations

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing

- 1A. Seek legislative and program rule changes to prevent lenders and their corporate officers with unsatisfied indemnification agreements from reentering the FHA program as the same or a new lender.

SCOPE AND METHODOLOGY

Our review covered the period July 1, 2008, through July 31, 2010, and was expanded as necessary. We conducted our fieldwork from September 2010 through April 2011 at HUD headquarters in Washington, DC.

To accomplish our objective, we

- Reviewed applicable laws and regulations;
- Evaluated policies and procedures from the Office of Single Family Housing's Office of Lender Activities and Program Compliance and Quality Assurance Division;
- Interviewed appropriate HUD staff;
- Reviewed HUD OIG audit reports;
- Analyzed lender data contained in the Single Family Housing Enterprise Data Warehouse, Single Family Insurance System – Claims Subsystem, Albany Indemnity Table, Neighborhood Watch, Institutional Master File, Approval Recertification and Review Tracking System, Lender Assessment Subsystem; and
- Reviewed data in LexisNexis and individual Secretary of State and social network Web sites concerning business corporations and individuals.

We were unable to perform broad nationwide testing due to limited access to FHA's Institutional Master File and the Approval Recertification and Review Tracking System databases. We initially requested a full download of the raw data from the systems. However, contractor related issues prevented FHA from providing us the requested data files. As a result, we could only review a small sample of FHA lenders.

To perform our limited testing, we initially prepared a listing of lenders who left the FHA program with existing indemnification agreements by reviewing HUD OIG single-family audit reports issued between 2004 and 2010. Also, we asked the HUD OIG regional inspectors general for audit and special agents in charge if they were aware of any lenders and their principals that may have left the FHA program with existing indemnification agreements and later returned to the FHA program as a new lender. In addition, we found terminated lenders with indemnifications that had tax identification numbers being used by other lenders. Overall, we identified 24 lenders that required additional review.

We later obtained and reviewed a listing of lenders that showed lenders (both active and terminated) with matching addresses. We later used Audit Command Language techniques to match indemnification data with these matching addresses. We identified 80 lenders with 36 matching addresses which required additional review. We identified 19 additional lenders as a result of our research efforts.

In total, we identified 123 lenders for additional review (24 lenders from prior OIG sources or matching tax identification numbers, 80 lenders with matching addresses, and 19 lenders based on additional research efforts). For all 123 lenders, we compared the corporate officers' names listed in FHA's Institutional Master File and Approval Recertification and Review Tracking

System to find any instances where corporate officers worked for two separate lenders. For some of the lenders we used FHA's Lender Assessment Subsystem, Lexis-Nexis, and Secretary of State and social network Web sites to assist with our review.

In total, we identified 12 different corporate officers who participated in the FHA program after leaving 7 lenders that did not honor their indemnification agreements and had lost their FHA approval. Using data from FHA's Institutional Master File, Approval Recertification and Review Tracking System, and Lender Assessment Subsystem, in addition to data from LexisNexis and applicable Secretary of State and social network Websites, we verified the 12 corporate officers were registered officers of the 7 lenders at the time the lenders entered into the indemnification agreements. We then determined the seven lenders did not honor their indemnification agreements by comparing their FHA termination dates with the indemnification agreement expiration dates and HUD's Financial Operation Center's Albany Indemnity Table.

We assessed the reliability of data from FHA's Institutional Master File, Approval Recertification and Review Tracking System, and Lender Assessment Subsystem. We looked at the 12 corporate officers and the lenders for which they worked and determined that we could verify their Institutional Master File, Approval Recertification and Review Tracking System, and/or Lender Assessment Subsystem data with other sources. We verified the data by corroborating the information through such methods as reviewing prior HUD OIG audits, LexisNexis searches, and applicable Secretary of State business entity searches, which contained such archived documents as articles of incorporation, annual reports, etc. Overall, we determined the data used in our audit from the Institutional Master File, Approval Recertification and Review Tracking System, and Lender Assessment Subsystem supported our audit objectives and were reliable for the purposes of our review.

We assessed the reliability of data from the Single Family Enterprise Data Warehouse and Neighborhood Watch. In our limited testing of the data, we randomly selected 10 FHA loan indemnifications from a lender. Overall, we determined that the indemnification agreement number listed in the actual indemnification agreement and Neighborhood Watch matched in 9 of the 10 loans. Also, the indemnification agreement dates listed in Neighborhood Watch matched the indemnification agreement dates signed by either the lender or HUD's Quality Assurance Division. As a result, we determined the indemnification data supported our audit objectives and were reliable for the purposes of our review.

In addition, we obtained data from the Single Family Insurance System – Claims Subsystem to help compute the total debt owed to FHA. We did not assess the reliability of the data as the data were only used to demonstrate the potential impact of the finding.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Controls over tracking lenders and corporate officers with their indemnification agreements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

We evaluated internal controls related to the audit objective in accordance with generally accepted government audit standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of FHA's internal control.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

SEP 23 2011

MEMORANDUM FOR: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
FROM: *D. C. Holston*
Dorah C. Holston, Acting Deputy Assistant Secretary for Single Family Housing, HU
SUBJECT: Draft for Comment Audit Report – Lenders and their corporate officers who leave the FHA program with existing indemnification agreements

Background

The Office of Inspector General (OIG) audited the Federal Housing Administration (FHA) to determine whether FHA had a system in place to prevent corporate officers from participating in FHA programs after those officers left lenders that failed to honor indemnification agreements executed with the Department. The OIG determined that due to the absence of any legislative authority, FHA could not prevent individuals from participating in FHA programs on the grounds that they served as corporate officers for other FHA-approved entities that defaulted on indemnification agreements, unless the individuals had been debarred or determined to be personally liable for the noncompliant acts of their corporate employers.

The OIG recommended in its report that FHA “seek legislative and program rule changes to prevent lenders and their corporate officers with existing indemnification agreements from reentering the FHA program as the same or a new lender.”

FHA's Response

FHA disagrees with OIG's finding and recommendation. Neither the finding nor the recommendation is supported by the facts or the law. FHA could not prevent corporate officers from participating in FHA programs after those officers left lenders that failed to honor indemnification agreements, simply because FHA does not have that authority. A more accurate finding would be that FHA was not able to exercise such authority because FHA was not delegated such authority by the legislature in the first place.

FHA recognizes the premise underlying OIG's recommendation -- that corporate officers operating a mortgagee at the time it defaults on its contracts with the Department may demonstrate irresponsible behavior and/or a flagrant disregard for the Department that may be reflected in the future performance of other mortgagees operated by those same officers. It should be noted that the Department actively pursues corporate officers implicated in acts of fraud perpetrated in connection with FHA programs through referrals for debarment proceedings and proceedings pursuant to the Program Fraud Civil Remedies Act.

This report suggests that FHA's jurisdictional purview over corporate officers of approved mortgagees should be extended beyond acts of fraud in order to impose liability on corporate

Comment 1

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

officers for acts of negligence under a strict liability standard when their corporate employers fail to fulfill contractual indemnification obligations to the Department. While FHA agrees that such expanded authority may prove beneficial in some instances, the Department is unsure of the legality of such an extension of its authority.

FHA's Plan of Action

In response to this report, FHA plans to take the following action:

FHA will seek a legal opinion from the Office of General Counsel (OGC) on whether, as a matter of law, legislation can be enacted that confers upon the Department the authority to prohibit an individual from participating in FHA Programs under the following circumstance:

The individual served as a corporate officer within an FHA-approved mortgagee at a time when that FHA-approved mortgagee was determined to have committed a knowing and material violation of FHA requirements.

Since this would not require the Department to prove any knowledge or culpability on the part of the individual being excluded from FHA participation, such a standard would impose strict liability on corporate officers for the acts of the corporation.

OIG Evaluation of Auditee Comments

Comment 1 We recognize in the report that FHA does not currently have the authority to prevent individual officers from participating in the FHA program solely based on the fact that their previous lending institution did not honor its indemnification agreements with HUD. Further, we understand FHA's concern about proving the knowledge or culpability of the individual being excluded from FHA participation. However, our concern remains that individual principals of some lending institutions are able to disregard the indemnification agreements with HUD and are allowed to continue FHA participation by hiding behind corporate law and forming a new corporation.

Appendix B

CRITERIA

12 U.S.C. 1708(c)(7) defines the term “mortgagee” as

- (A) A mortgage approved under this chapter;
- (B) A lender or loan correspondent approved under subchapter I of this chapter;
- (C) A branch office or subsidiary of the mortgagee, lender, or loan correspondent; or
- (D) A director, officer, employee, agent, or other person participating in the conduct of the affairs of the mortgagee, lender, or loan correspondent.

12 U.S.C. 1708(c)(3)(e) states that the Mortgagee Review Board may at any time enter into a settlement agreement with a mortgagee to resolve any outstanding grounds for an action.

Agreements may include provisions such as

- (A) Cessation of any violation;
- (B) Correction or mitigation of the effects of any violation;
- (C) Repayment of any sums of money wrongfully or incorrectly paid to the mortgagee by a mortgagor, by a seller, or by FHA;
- (D) Actions to collect sums of money wrongfully or incorrectly paid by the mortgagee to a third party;
- (E) Indemnification of FHA for mortgage insurance claims on mortgages originated in violation of FHA requirements;
- (F) Modification of the length of the penalty imposed; or
- (G) Implementation of other corrective measures acceptable to the HUD Secretary.

Material failure to comply with the provisions of a settlement agreement shall be sufficient cause for suspension or withdrawal.

Public Law 111-22 (Helping Families Save Their Home Act of 2009), section 203(d)(2), and Mortgagee Letter 2009-31 state that to be approved, an applicant lender shall not be and shall not have an officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator of the applicant lender who is (1) currently suspended, debarred, or under a limited denial of participation; (2) under indictment for or has been convicted of an offense that reflects adversely upon the applicant’s integrity, competence, or fitness; (3) subject to unresolved findings contained in a HUD or other governmental audit, investigation, or review; (4) engaged in business practices that do not conform to generally accepted practices of prudent lenders or that demonstrate irresponsibility; (5) convicted of or who has pled guilty or nolo contendere to a felony related to participation in the real estate or mortgage industry.

Mortgagee Letter 2010-38 clarified the term “unresolved finding” by stating that all principal owners and corporate officers of FHA-approved lenders must confirm that the above-mentioned

individuals are not be subject to any unresolved findings or Federal lawsuits resulting from an investigation, audit, or review by HUD or other Federal, State, or local governmental agency. The lawsuits and findings may include but are not limited to open issues in any HUD OIG audit, investigation, or review; any action by HUD's Mortgagee Review Board; the suspension, surrender, or revocation of a license of any kind by a State or local jurisdiction; the imposition of fines, settlement agreements, or other monetary sanctions by a State or local entity; or any other action taken by a government agency.