

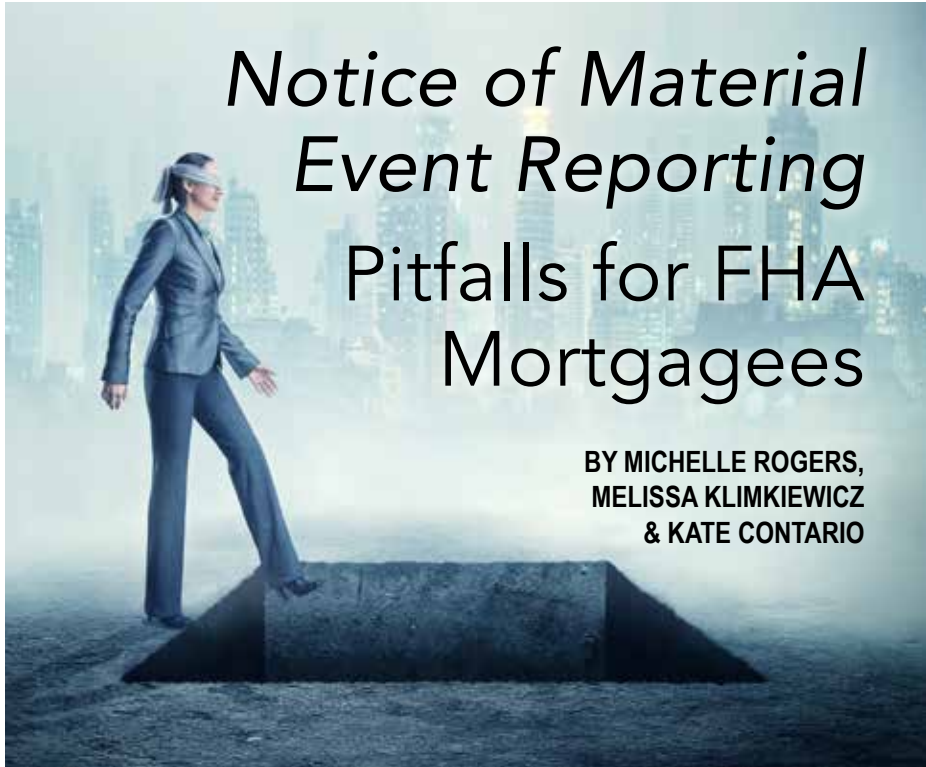


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Notice of Material Event Reporting – Pitfalls for FHA Mortgagees

**Michelle Rogers,
Melissa Klimkiewicz
& Kate Contario**

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Notice of Material Event Reporting Pitfalls for FHA Mortgagees

BY MICHELLE ROGERS,
MELISSA KLIMKIEWICZ
& KATE CONTARIO

by inconsistent language resulting from the various changes made by HUD, including the updated definition of “Unresolved Finding” that became effective in September 2015. Although it may not be possible to cure past shortcomings, mortgagees subject to MRB referrals can consider whether arguments may be available that events they did not report were not actually subject to a reporting obligation. Furthermore, all mortgagees can assess their compliance efforts with the NME requirement to reduce their risks going forward. Nevertheless, compliance challenges will remain to the extent it is unclear whether an event is reportable or a mortgagee’s ability to report the event is restricted by other regulators’ confidential supervisory information (CSI) protections.

FHA NOTIFICATION REQUIREMENTS

There are three types of notifications that mortgagees may be required to submit to FHA:

- 1. Information Updates**, through which mortgagees use the Lender Electronic Assessment Portal (LEAP) to communicate to FHA changes to their corporate or branch information that do not require HUD approval—such as administrative contact changes and principal/authorized agent relationship updates;
- 2. Change Requests**, through which mortgagees request approval to change certain information in LEAP—such as adding Title I or Title II insurance authority; and ▶



Michelle Rogers



Melissa Klimkiewicz



Kate Contario

With sighs of relief, the vast majority of Federal Housing Administration (FHA) mortgage insurance program participants completed the fiscal year 2015 annual recertification process. The process requires attesting to 10 broad and somewhat ambiguous statements regarding the mortgagee’s compliance with FHA approval and program requirements, or explaining to FHA’s

Lender Approval and Recertification Division (the Division) why such certifications cannot be made.

Unfortunately, certain mortgagees’ relief may be short-lived, as this year, the Division appears to have scrutinized mortgagees that identified “unable to certify” events for the first time in this annual process, but had not reported them as Notices of Material Events (NME) during the calendar year. In some cases, the Division has referred mortgagees to the Mortgagee Review Board (MRB) for failure to file an NME in accordance with FHA requirements, although the MRB may not have issued Notices of Violation yet.

Unfortunately, these mortgagees may have hit an unintentional regulatory speed bump caused

3. Notices of Material Events, through which mortgagees notify HUD of issues potentially impacting their FHA loan program approval. An NME filing must be accompanied by a brief description of the event being reported and supporting documentation. Such filings are the focus of the remainder of this article.

CIRCUMSTANCES REQUIRING NME

Since the early 1990s, mortgagees have been required to timely notify FHA of most corporate changes, including those related to mergers, liquidations, ownership, branch managers, operating losses, and bankruptcy filings. With the release of HUD Handbook 4060.1 in 2006, FHA expanded its notice requirements to include, for example, (1) changes to a mortgagee's contact information, fiscal year, registered offices, direct endorsement underwriter, senior officers, federal employee identification number, (2) termination of supervision by any regulator, (3) net worth and liquid asset deficiencies, and (4) "all other business changes." Subsequent Mortgagee Letters amended or supplemented the guidelines provided in the HUD Handbook. However, these requirements have been inconsistently applied and interpreted.

In addition to the aforementioned events, FHA currently requires submission of an NME in connection with (1) change in partnership or principal owner, (2) operating losses of 20 percent or greater of adjusted net worth, (3) change in fidelity bond and Errors and Omissions coverage, (4) change in principal activity for a non-supervised mortgagee, (5) change in supervising or regulatory agency, (6) change in business form (i.e. conversion from a limited liability company to corporation), (7) bankruptcy, (8) change, revocation or surrender of lending licenses, (9) ceasing operations, and (10) notice of unresolved findings or sanctions. In our experience, the requirement to provide notice of "unresolved findings and sanctions" poses the most significant challenges for mortgagees.

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1. WHAT IS AN "UNRESOLVED FINDING"?

In 2009, Congress passed the Helping Families Save Their Homes Act of 2009, which, in part, restricted participation in FHA programs for "applicant mortgagees" and their officers, directors, partners, principals, managers, supervisors, loan processors, loan underwriters, and loan originators that were "subject to unresolved findings contained in a [HUD] or other governmental audit, investigation or review." After initial implementation of the new restrictions, FHA attempted to clarify the term "unresolved findings" by indicating that such findings may stem from an investigation, audit or review by FHA or another state or federal agency. It considered a matter "unresolved" until an action

was taken by the investigating agency, or the agency formally determined that no action was warranted.

The current definition of "Unresolved Finding," which did not become effective until September 14, 2015, is significantly narrower:

An Unresolved Finding is a material, adverse written Finding, to include fair lending violations of the Fair Housing Act or Equal Credit Opportunity Act, contained in a lawsuit or report produced in connection with an investigation, audit, or review conducted by HUD, another federal, state or local governmental agency, or by any other regulatory or oversight Entity with jurisdiction over the Mortgagee or its officers, partners, directors, principals, managers, supervisors, loan processors, loan underwriters, or loan originators, that has not yet been resolved through final agency or judicial action.

Although this definition provides some helpful clarification and limits the scope of items that may be considered "unresolved findings," it also poses some challenges for mortgagees. Notably:

- While the term "Finding" is defined as a "final determination by the Lender, Mortgagee, or other participants as applicable," this definition does not appear applicable to "Unresolved

Finding” because the latter focuses (1) on third party reports, and (2) on findings that have not reached the stage of finality described in the definition of “Finding”; and

- Although the term “Material Finding” in the context of origination, underwriting and servicing generally indicates that the deficiency would have (1) altered the mortgagee’s decision to approve or seek FHA endorsement for the loan or (2) an adverse impact on the property or FHA, such definitions are not directly applicable in this context, and “material” is otherwise undefined.

Even though mortgagees can limit the risk of a violation by erring on the side of over-reporting, this can be taxing on a mortgagee’s resources and may give rise to unnecessary HUD inquiries.

2. WHAT ARE SANCTIONS?

Although the term “sanction” is not defined, FHA has provided examples of sanctions, including: (1) reimbursement to HUD for claims previously paid, (2) referral to the MRB, (3) suspension or termination, and (4) civil money penalties. However, absent an express definition of “sanction,” it is impossible to know with certainty the manner in which the term may be interpreted.

3. RESTRICTIONS ON DISCLOSURE OF CSI

The NME requirement presents unique challenges for mortgagees who are prohibited from disclosing certain “unresolved findings” and sanctions because this information is often deemed CSI. The bank regulators, including the Consumer Financial Protection Bureau (CFPB), the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC), as well as numerous state regulators, prohibit the disclosure of CSI to third parties, including other government agencies like HUD. This information is the property of the regulator, not the mortgagee. Thus, before disclosing CSI to a third party—FHA included—mortgagees must obtain express authorization from the agency.

Of course, this approval process makes it practically impossible to provide timely NME certifications

(and equally challenging to complete annual certifications). Although the Division has been alerted to these types of limitations in connection with mortgagees’ “unable to certify” explanations, it may push back on mortgagees’ assertions that they cannot provide certain information due to other regulators’ assertions of confidentiality. Our hope is that HUD will enter into agreements with other regulators to facilitate mortgagees’ ability to comply with HUD’s notice requirement; if this does not occur, mortgagees will continue to face impossible decisions related to satisfying their conflicting obligations to various regulators.

INCREASED FOCUS ON NME FILING AND IMPACT ON ANNUAL CERTIFICATION

Recently, FHA has demonstrated an increased focus on the NME filing requirement. In March 2016, (1) FHA’s Lender Insight publication included a full-page section regarding the ongoing require- ▶

ment to report material events to FHA, and (2) FHA hosted a webinar on Post-Approval Activities and the related required filings in LEAP, emphasizing that “[l]enders are strongly encouraged to notify FHA as soon as the event occurs to prevent delays during annual recertification.” And, as noted, the Division has referred mortgagees to the MRB for failure to fulfill the NME filing requirement.

Failure to timely file NMEs during the calendar year also can delay annual certification. This is because, “[i]f a lender is not able to truthfully certify to any of the statements set forth in the Certification due to events not previously reported to FHA, the lender will be required to notify FHA and provide an acceptable explanation and supporting documentation.” FHA has emphasized that “[e]vents previously reported and reviewed by FHA do not have to be reported again when completing the annual certification unless the status is updated or there is a change to what was previously reported.” We note that, because certain events that trigger the NME requirement include frequent status update changes, mortgagees must continually submit NME filings to remain eligible to affirmatively attest to the annual certification statements each year. For example, in order to keep HUD’s records current, updates to an NME may be expected upon (1) receipt of an initial examination report; (2) submission of an initial response to the examination report; (3) receipt of the final examination report; and (4) imposition of sanctions or fines. To the extent that such updates are not submitted, a mortgagee would need to indicate that it is “unable to certify” on the annual certification, and FHA will review the mortgagee’s explanations related to its inability to certify—which often involves follow-up questions and responses—before the mortgagee is permitted to complete annual certification.


POTENTIAL NEXT STEPS

Mortgagees subject to MRB referrals may wish to explore whether there are justifications available for their failure to file an NME in accordance with FHA requirements. For example, was the event actually material? Would disclosure of any amount of information regarding the event have been a viola-

tion of another regulator’s CSI protections?

In addition, all mortgagees can develop and regularly update their policies, procedures, and practices to foster prompt material event identification and NME filing, including with respect to material events that are “unresolved findings” or “sanctions.” Although, in order to reduce FHA risk, mortgagees may be well served by filing an NME even where there is a question as to whether such filing is required, this strategy may be complicated by the fact that filing of notices may run afoul of other agencies’ restrictions on the sharing of CSI. Absent additional guidance from FHA, mortgagees may consider:

- Preparing standard statements to notify FHA when they become subject to “unresolved findings” or “sanctions” protected from disclosure as CSI. Such statements would provide such limited information as is permitted to be disclosed. Of course, provision of minimal information may result in additional questions and may not fully satisfy HUD; and
- Seeking permission from their regulators to disclose additional detail. If a regulator will not authorize additional disclosure, at a minimum, a mortgagee likely will want to determine whether the name of the regulator and contact information can be provided, so that HUD may follow up with the regulator directly.

To the extent that appropriate mortgagee personnel become aware of an event requiring the filing of an NME after the required notice period has passed, we suggest filing the notice as promptly as possible. This will help to demonstrate the mortgagee’s efforts to comply and should limit the likelihood of delays in connection with annual certification. 

Michelle Rogers and Melissa Klimkiewicz are partners and Kathryn Contario is an associate in the Washington, D.C., office of BuckleySandler LLP. They can be reached at MKlimkiewicz@BuckleySandler.com, MRogers@BuckleySandler.com, and KContario@BuckleySandler.com.