

MAYER • BROWN

TREBLE DAMAGES SPELL TRIPLE TROUBLE

HUD-DOJ ENFORCEMENT OF FALSE CLAIMS ACT

Phillip L. Schulman
Partner

202.263.3021
pschulman@mayerbrown.com

Krista Cooley
Partner

202.263.3315
kcooley@mayerbrown.com

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Consumer Finance
MONTHLY BREAKFAST BRIEFING

I. INTRODUCTION



A. Quiz: What do these figures have in common?

- \$132.8 MM
- \$158.3 MM
- \$202.3 MM
- \$1.0 BB
- \$800 MM
- \$1.2 BB
- \$212 MM
- \$200 MM
- \$113 MM
- \$70 MM
- \$64 MM
- \$29.6 MM

I. INTRODUCTION



B. All Recent Settlements

1. Arising from

- False Claims Act (FCA)
- Financial Institutions Reform, Recovery and Enforcement Act (FIRREA)

2. Investigations Conducted by

- U.S. Attorneys Offices
- Department of Justice
- HUD and HUD-OIG

3. How did we go from . . .

- FHA indemnifications
- Civil \$ penalties of a few thousand dollars
- To break the bank enforcement actions

II. FHA UNDERGOES SIGNIFICANT REFORM



A. Lenders Subject to Unprecedented Changes

1. From a HUD Laissez-Faire Attitude
2. To Strict Compliance
3. Greater Accountability and Liability

B. Department of Justice (DOJ) Joins the Party

1. False Claims Act
2. FIRREA

A blurred background image of a business meeting. Several people in professional attire are seated around a table. One person in the foreground is holding a pen over a document. There is a white coffee cup on a saucer and a glass of water on the table. The overall scene is professional and focused.

FALSE CLAIMS ACT

III. FALSE CLAIMS ACT



A. Harshest Civil Action Available to Government

1. FCA Imposes Liability on Entity that:

- a. knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval [31 U.S.C. § 3729(a)(1)(A)]; or
- b. knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim [31 U.S.C. § 3729(a)(1)(B)].

Knowing Violations that Must Be Material to the False Statement or Claim

2. FCA Limits Liability to Claims

3. Bottom Line: FCA covers all fraudulent attempts to cause Government to pay out sums of money

III. FALSE CLAIMS ACT



A. Harshest Civil Action Available to the Government

4. Besides the DOJ

- Private citizens = Relators bring Qui Tam actions
- Share in recovery

5. Claim and False Statement

- Need payment of insurance claim
- Need presence of a false statement
- No claim = No FCA
- No false statement = No FCA

III. FALSE CLAIMS ACT



B. Why is FCA So Scary? Stiff Penalties

1. Treble damages
2. Up to \$11,000 forfeiture per claim
3. Voodoo Math
4. 6 Year Statute of Limitations

III. FALSE CLAIMS ACT



C. Really Scary Stuff = Extrapolation

1. Used to be liability only for cases investigated
2. FCA case law permits extrapolation
 - Select sample from entire portfolio
 - Determine material deficiency rate and average loss per claim
 - Multiply against entire portfolio
3. Hundreds of millions of \$

III. FALSE CLAIMS ACT



D. But, We Don't Engage in Fraud

1. But you do make certifications when you get a loan insured by the FHA
 - Loan level certifications
 - Annual certifications

E. Origination Loan-Level Certifications

1. Lenders Make Many Loan-Level Certifications
2. Addendum to Uniform Residential Loan Application (HUD 92900-A Form)
3. Certification Includes
 - Integrity of data for AU
 - Borrower meets eligibility criteria
 - Personal review on manual underwriting

III. FALSE CLAIMS ACT



F. Annual Certifications

1. Made by Corporate Officers
2. Certify to compliance with ALL HUD regulations and requirements necessary to maintain the Mortgagee's FHA approval as codified in:
 - 24 C.F.R. § 202.5;
 - HUD Handbook 4000.1 Sections I and V, as amended by Mortgage Letter; and
 - any agreements entered into between the lender and HUD.
3. Wise to Say Your Company Cannot Certify
 - Avoid penalties

III. FALSE CLAIMS ACT



G. Recent Lawsuits and Settlements

(For Both Origination and Servicing FCA Matters)

1. Quality Control Changes

a. Lenders Fail To:

- Review all EPDs
- Devote adequate staff
- Provide adequate guidance
- Take corrective action
- Review third party vendors
- Report fraud or serious, material violations to HUD
- Adequately disclose adverse findings

III. FALSE CLAIMS ACT



G. Recent Lawsuits and Settlements

2. Origination Underwriting Charges

a. Lenders Fail To:

- Document gifts properly
- Develop complete credit histories
- Verify cash investment in property
- Verify employment/income
- Resolve inconsistencies
- Make sure refi borrower current
- Make sure interested parties don't touch verification forms
- Properly verify source of funds
- Data integrity

III. FALSE CLAIMS ACT



H. New Areas of Focus Under the FCA

1. Focus on Servicing of FHA-Insured Loans

- a. FCA has consistently been used to enforce FHA origination rules
- b. Economic downturn and foreclosure crisis put focus on the increased risk regarding servicing FHA loans
- c. In the past few years – ramped up enforcement of FHA servicing requirements and focus on FCA liability for such violations

2. Focus on Home Equity Conversion Mortgage, or HECM, loans

- a. HUD's reverse loan product
- b. Same loan level and annual certifications
- c. Unique servicing requirements have translated into FCA risk

III. FALSE CLAIMS ACT



I. Focus on FHA Servicing

1. False Claims Act

- a. DOJ relies on the same annual certifications for lenders and servicers
- b. Loan level certification – accuracy of the information on the claim form – HUD 27011 Form
- c. Submission of claims for incentives in connection with loss mitigation

2. HUD Administrative Remedy – Civil Money Penalties

- a. Violations of HUD's loss mitigation regulations = **three times the amount of the claim**
- b. Administrative remedy available to HUD without using the FCA or relying on loan-level certification of compliance

III. FALSE CLAIMS ACT



I. Focus on FHA Servicing

3. Loss Mitigation Allegations

- a. HUD regulations regarding loss mitigation require:
 - Servicer to evaluate a delinquent borrower for **eligibility** for loss mitigation before four full monthly mortgage installments are due and unpaid; **and**
 - Servicer to **take appropriate loss mitigation action** based on the evaluation. See 24 C.F.R. § 203.605; Handbook 4000.1; prior Mortgagee Letter 2008-27
- b. For FHA-approved servicers who fail to engage in loss mitigation as provided in Section 203.605, the National Housing Act and HUD regulations authorize HUD to impose **treble damages**

III. FALSE CLAIMS ACT



I. Focus on FHA Servicing

3. Loss Mitigation Allegations

- c. Common Loss Mitigation Compliance Findings
 - Outreach and Evaluation – File does not document that the servicer engaged in aggressive outreach attempts to collect required financial information and/or timely evaluate the borrower for loss mitigation options
 - Selecting the Appropriate Option – Servicer provided borrower with a loss mitigation option that was not the most appropriate option under HUD requirements
 - Proper Implementation of the Option Provided – Servicer did not adhere to specific loss mitigation guidelines in providing the option – modification miscalculated, required documents not provided
- d. Failure to complete any of these activities PLUS the submission of an incentive claim could = FCA Risk

III. FALSE CLAIMS ACT



I. Focus on FHA Servicing

4. Other Areas of Servicing Non-Compliance

- a. Face-to-Face Interview – Must make at least one visit to the property to arrange the meeting unless certain exceptions are met
- b. SFDMS Reporting – Must report the status of all FHA loans that are 30 days delinquent as of the last day of the month to HUD through the SFDMS
 - Potential for data integrity issues if submissions do not match file data
- c. Failure to Curtail Debenture Interest – If miss a servicing deadline, like the initiation, or reasonable prosecution, of foreclosure, must curtail debenture interest on FHA insurance claim
 - Failure to curtail could = allegation of false claim for the overstated amount

III. FALSE CLAIMS ACT



J. Focus on HECM Loans

1. Origination Areas

- a. Historically, no credit underwriting of applicants for HECM loans
- b. DOJ has focused its attention on the appraisal of the property and its impact on whether the loan qualified for FHA insurance
- c. Same loan-level certification of compliance with the origination requirements as in forward mortgages (HUD 92900-A Form)

2. Servicing Areas

- a. Failure to curtail debenture interest to the earliest missed timeline
- b. Additional deadlines for HECM loans, including requirement to appraise the property within 30 days of notification of the borrower's death

3. Quality Control Continues to be a Focus for HECM Origination and Servicing Matters

III. FALSE CLAIMS ACT



K. Importance of Quality Control

1. Consistent Theme of all FCA Settlements
2. HUD Requirements
 - a. Maintain and implement a Quality Control Plan and conduct Quality Control reviews to identify and remedy areas of non-compliance
3. Reporting of Fraud and Material Findings
 - a. HUD Quality Control guidelines require mortgagees to report all fraud, material misrepresentations, and “Material Findings” involving violations of origination and servicing requirements, unless the finding has been “Mitigated”
 - b. Updated Quality Control Section of Handbook 4000.1 provides more clear guidance on lenders’ and servicers’ obligation to report “Material Findings”

III. FALSE CLAIMS ACT



K. Importance of Quality Control

3. Reporting of Fraud and Material Findings

c. Definition of “Material Finding”

- **Origination** – Finding is Material if disclosure of the Finding would have altered the Mortgagee’s decision to approve the Mortgage or to endorse or seek endorsement from FHA for insurance of the Mortgage.
- **Servicing** – Finding is material if it has an adverse impact on the property and/or FHA.

III. FALSE CLAIMS ACT



K. Importance of Quality Control

3. Reporting of Fraud and Material Findings

d. Definition of “Mitigated Finding”

- **Origination** – Finding has been Mitigated if the Mortgagee has adequately addressed the deficiencies underlying the Finding, and such deficiencies have been remedied so that the Mortgagee’s decision to approve the Mortgage or to endorse or seek endorsement from FHA for insurance of the Mortgage is acceptable to FHA.
- **Servicing** – Finding is mitigated if the mortgagee has adequately addressed the deficiencies underlying the finding, and such deficiencies have been remedied through mortgage servicing actions taken by the mortgagee so there is no longer an adverse impact on the property and/or FHA.



FIRREA

IV. FIRREA



A. Expanded use of FIRREA

1. Passed in response to 1980's savings and loan crisis
2. Purposes included regulatory reform, creation of deposit insurance for S&Ls, improved supervision, and enhanced civil penalties
3. For 20 years, not used frequently or aggressively
 - Until Obama Administration launched Interagency Financial Fraud Task Force

IV. FIRREA



B. DOJ Off to the Races

1. Since 2010, U.S. has investigated and filed civil suits against large banks
2. Asserting that acts and practices
 - Mortgage origination
 - Mortgage servicing
 - Sale of defective loans to GSEs
3. Harmed or improperly “**affected**” federally insured financial institutions
 - Companion cases with FCA charges
 - Federal mortgage insurance
 - Federal guarantees
4. Billions of dollars at risk

IV. FIRREA



C. Proscribed Acts that “Affect” Financial Institutions

1. Government sees significant elasticity in this language
2. Failure to properly underwrite or service FHA loans warrant maximum penalties
3. Sales of allegedly defective loans to GSEs – improperly “affected” federal financial institutions that held Fannie Mae or Freddie Mac preferred stock
4. One lawsuit filed against S&P Financial Services alleging inflated credit ratings to facilitate RMBS and CDOs “affected” federal financial institutions that purchased these securities

IV. FIRREA



D. Lower Standard of Proof

1. FIRREA imposes substantial civil remedies against those who commit acts prohibited by 14 criminal statutes
 - mail fraud – 18 U.S.C. § 1341
 - wire fraud – 18 U.S.C. § 1341
 - false statements to federal gov't – 18 U.S.C. § 1001
2. However, Gov't need not prove knowing or intentional wrong doing “beyond a reasonable doubt” like in a criminal proceeding
 - here, civil standard “preponderance of the evidence” applies
 - allows Gov't to pursue civil claims that might not be available criminally

IV. FIRREA



E. Substantial Penalties and Broad Pre-Trial Discovery

1. \$1.0 MM for each violation
2. For continuing violations
3. Plus, if violation caused gain or loss, Gov't can recover 100% of the gain or loss
4. Broad ability to subpoena documents and testimony in civil investigations (far beyond FCA cases)

IV. FIRREA



F. Longer Statute of Limitations (SOL)

1. Six year SOL in FCA case
2. 10 year SOL after claim accrues under FIRREA
3. Lengthy time frame and substantial penalties enhance attractiveness of FIRREA to government lawyers
 - FCA needs underlying harm to government money
 - no such limitation under FIRREA

V. WHAT'S A COMPANY TO DO



A. Take All Certifications Seriously

1. Loan Level
2. Annual certifications

B. Monitor New Regulations

1. Track changes
2. Update policies and procedures manuals
3. Train staff

V. WHAT'S A COMPANY TO DO



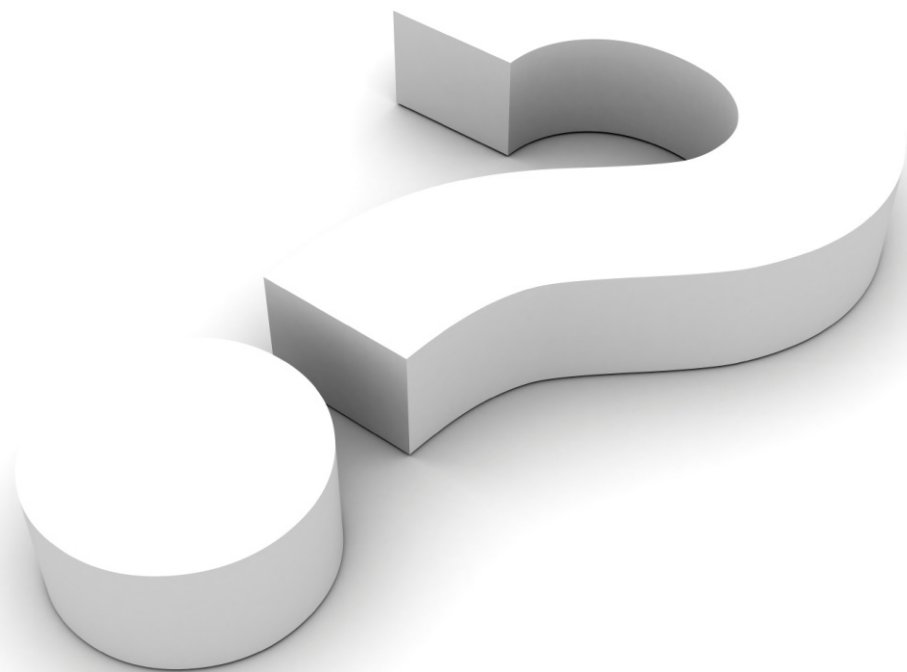
C. Implement Effective Internal Controls

1. Measure performance
2. Identify deficiencies
3. Take corrective actions
4. Record corrective actions
5. Audit items the Gov't audits

D. Stakes Have Never Been Higher

1. May not get a chance to get a second chance

QUESTIONS?



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