

Client Alert

February 2018

HUD, Annual Recertifications and CMPS: Administrative Violations Now Mean Long-Lasting Penalties

Before the end of the first quarter of 2018, institutions must comply with their annual recertification requirements. While those requirements are seemingly administrative, failure to timely meet them for continued Department of Housing & Urban Development (HUD)/Federal Housing Administration (FHA) approval, or inadvertent inaccuracies in those certifications, can result in long-lasting consequences for the institution and its insiders.

Since 2014, there has been a dramatic up-tick in the number of civil money penalties (CMPs) imposed by HUD's Mortgagee Review Board for what were previously perceived as "foot fault" administrative failures. In 2014, only three (3) institutions were assessed CMPs ranging from \$3,500 to \$7,500 for failure to timely meet the requirements for annual recertification of HUD/FHA approval.¹ In 2015, eleven (11) institutions were assessed CMPs, again ranging from \$3,500 to \$7,500.² In 2016, this number continued to increase to fifteen (15) institutions that were assessed CMPs.³ Then, in 2017, this number exponentially jumped to 106 institutions that were assessed CMPs by HUD for failure to timely meet the requirements for annual recertification, ranging from \$3,500 to \$9,468.⁴ Based on our experience in the industry, we expect to see similarly high numbers reported in 2018, with the baseline CMP increased to \$4,500, on average.

In each of these actions, the institution was forced to either agree to a CMP through a publicly reported settlement, or face the costs of a formal administrative action. In an administrative proceeding, the institution is permitted to respond to the administrative complaint and request a formal hearing before an administrative law judge to present its defenses. Notwithstanding, given the costs of defense in an administrative proceeding, the risk of facing the maximum penalty of \$9,468 per violation should the institution lose⁵ and that HUD keeps the proposed CMPs just *de minimis* enough (typically in the \$3,500 to \$4,500 range), most institutions simply find that it is not cost-effective to fight the alleged violation, even when there may have been compelling defenses.

While seemingly the most cost-effective approach in the short-term, institutions must be mindful that these CMPs result in much more than a monetary penalty. Such CMPs will likely need to be reported and explained each time a person who is a director, executive officer or principal shareholder of the institution needs to complete certain government biographical and financial reports. For instance, the individual biographical and financial report (the IBFR), required in various circumstances by the federal banking regulators, typically inquire as to whether the individual or any depository institution company with which

¹ Available at <https://www.federalregister.gov/documents/2014/07/16/2014-16722/mortgagee-review-board-administrative-actions> (last visited February 7, 2018).

² Available at <https://www.federalregister.gov/documents/2015/04/06/2015-07868/mortgagee-review-board-administrative-actions> (last visited February 7, 2018).

³ Available at <https://www.federalregister.gov/documents/2016/05/11/2016-11045/mortgagee-review-board-administrative-actions> (last visited February 7, 2018).

⁴ Available at <https://www.federalregister.gov/documents/2017/04/04/2017-06642/mortgagee-review-board-administrative-actions> (last visited February 7, 2018).

⁵ See 82 FR 24521 (setting FHA mortgagee and lender violation maximum at \$9,468 per violation, and \$1,893,610 per year).

the individual is or was associated has been subject to any supervisory agreement, enforcement action, or civil money penalty. Similarly, many state applications for mortgage licenses and federal lender approvals require disclosure about CMPs paid by an institution with which a person serves or has ever served. Thus, as we have repeatedly cautioned,⁶ there may be significant nonfinancial benefits that need to be carefully evaluated in assessing whether to fight a potential CMP assessment.

HUD's authority to seek CMPs for what amounts to foot fault violations, that are generally first-time offenses, is also suspect. While HUD purports to invoke its right to impose a CMP pursuant to 12 U.S.C. § 1735f-14, HUD ignores that § 1735f-14 is reserved for violations of law with a heightened standard of conduct. Fundamentally, 12 U.S.C. § 1735f-14 provides that if a "mortgagee approved under the chapter ... knowingly and materially violates any applicable provision of subsection (b) of this section, the Secretary may impose a civil money penalty on the mortgagee or lender, or such other person or entity, in accordance with this section." *Id.* at § 1735f-14(a)(1) (emphasis added). In our experience, we have seen a variety of reasons for an institution's failure to timely meet the recertification requirements, from an employee change that resulted in the institution missing the recertification deadline, to a failure to timely notify HUD of a business structure change within ten (10) business days of that activity (despite that the change was public and approved by HUD's sister agencies), to a serious medical condition on the part of the certifying officer that resulted in the institution seeking an extension of time from HUD. While these excuses would undoubtedly have resulted in an extension of time or a showing of good cause if presented in a court of law, HUD refused to consider such excuses but instead took the position that each failure was a knowing and material violation of the law that justified the assessment of CMPs.

The recent jump in the number of CMPs assessed by HUD reflects a policy sea change since 2015. The Mortgagee Review Board previously allowed some flexibility in crafting settlements pursuant to § 1708(c)(1), including "a letter of reprimand, the probation, suspension or withdrawal of any mortgagee found to be engaging in activities in violation of Federal Housing Administration requirements ..." 12 U.S.C. § 1708(c)(1). Indeed, section 1708 specifically authorizes a letter of reprimand once to a mortgagee without the Board taking further action. In the Office of Inspector General's May 2009 Evaluation of Mortgagee Review Board Enforcement Actions, the report noted that the Board had frequently agreed to administrative fees, rather than CMPs through settlements. Even as recently as 2015, HUD continued to have flexibility in reaching settlements, authorizing administrative payments, rather than CMPs for foot fault violations.⁷ Despite that these lesser penalty options are authorized by statute, HUD appears to now be taking a strict liability approach and adopted a policy of seeking a CMP for every violation of its requirements, no matter how hyper-technical they may be perceived to be. Further, we understand from our representations in the industry that HUD is planning to take this same strict liability approach in evaluating the veracity of certifying officer signatures for potential inadvertent inaccuracies or nondisclosures in connection with this process.

Accordingly, as we approach the close of the first quarter of 2018, institutions should carefully consider the recertification deadline, as each approved lender must complete an annual HUD/FHA recertification package within 90 days of its fiscal year-end. Further, institutions must carefully evaluate the statements that must be verified as true by certifying officers as part of this process, and err on the side of seeking counsel should you have any questions regarding your disclosure obligations. And throughout the year, institutions must be mindful of any business structure changes that may require prompt reporting to HUD (often within ten (10) business days of the activity).

Finally, if an institution finds itself in receipt of a notice of violation from HUD, it is imperative that the institution promptly seeks counsel to present its strongest defenses in the initial response to avoid or mitigate the amount of the potential penalty. That initial response is critical, as it will be carefully evaluated by the Mortgagee Review Board as part of their decision to assess a potential penalty, and once the Mortgagee Review Board votes to assess a CMP it is difficult to persuade them to change their

⁶ [Client Alert on Foot Faults and CMPs](#).

⁷ See, e.g., Docket No. 15-1505-MR (July 1, 2015); Docket No. 14-1655-MRT (June 4, 2014).

decision. Do not let administrative reporting requirements turn into long-lasting penalties for you and your institution.

Abigail Lyle is a member of the Consumer Financial Compliance and Litigation practice group, focusing her practice on regulatory compliance and defending financial institutions in enforcement actions and litigation involving lending practices and consumer financial services laws. This article presents the views of Ms. Lyle and does not necessarily reflect those of Hunton & Williams or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article. Ms. Lyle writes and speaks frequently on topics of interest to financial institutions. She may be reached at (214) 979-8219, or alyle@hunton.com.

Contacts

Peter G. Weinstock

pweinstock@hunton.com

Abigail M. Lyle

alyle@hunton.com

© 2018 Hunton & Williams LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.
