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August 17, 2009

Mr. Alfred M. Pollard  
General Counsel  
Federal Housing Finance Agency  
Fourth Floor  
1700 G Street, N.W.  
Washington, D.C. 20552

By courier and by email

Re: Reporting of Fraudulent Financial Instruments; RIN 2590-AA11

Dear Mr. Pollard:

Freddie Mac welcomes the opportunity to comment on the Federal Housing Finance Agency's (FHFA) proposed regulation on reporting of fraudulent financial instruments.<sup>1</sup> Fraud prevention and detection is an integral part of Freddie Mac's business operations. As a company whose mission is to expand homeownership opportunities, we are committed to preventing, identifying, and reporting mortgage fraud.

The proposed regulation would require Freddie Mac, Fannie Mae, and the Federal Home Loan Banks (regulated entities) to report to FHFA any known or possible fraud in connection with a loan or other financial instrument that the regulated entity has purchased or sold. The proposal would implement the fraud reporting, internal controls and protection from liability provisions contained in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Housing and Economic Recovery Act of 2008 (HERA).<sup>2</sup> When the final regulation on reporting of fraudulent financial instruments becomes effective, that regulation will replace the Mortgage Fraud Reporting regulation promulgated in 2005 by the Office of Federal Housing and Enterprise Oversight at 12 CFR part 1731.

We appreciate FHFA's work in implementing the fraud reporting provisions of HERA. We believe that the proposed regulation is generally a well-balanced approach to carrying out the fraud reporting, internal controls and protection from liability provisions in HERA. We respectfully recommend two clarifying changes in order to better capture the underlying public policy objectives of these provisions.

First, we respectfully recommend that FHFA define the reporting requirement under the regulation to mean known or possible fraud in connection with a mortgage, including a mortgage associated with a mortgage-related security or similar financial instrument issued or guaranteed by the regulated entity. This clarifying change is consistent with the legislative history of the fraud reporting provisions of HERA and would provide optimal value to governmental authorities in investigating and prosecuting possible mortgage fraud.

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<sup>1</sup> 74 Fed. Reg. 28636 (June 17, 2009).

<sup>2</sup> 12 U.S.C. § 4642.

Second, we respectfully recommend revising the definition of “entity-affiliated party” to exclude potential wrongdoers from the protections of the HERA safe harbor.

Our comments provide an overview of Freddie Mac’s anti-fraud efforts and then describe the reasons for our recommended clarifying changes.

## **I. OVERVIEW OF FREDDIE MAC’S MORTGAGE-RELATED ANTI-FRAUD EFFORTS**

Freddie Mac has a comprehensive anti-fraud strategy that targets mortgage fraud. In 1989, Freddie Mac established a Fraud Investigations Unit consisting of professional investigators who are dedicated to the prevention and detection of mortgage fraud. Our long-standing efforts combat mortgage-related fraud involving borrowers, title agents, broker/dealers, property appraisers, originators, and other participants in the mortgage origination process and secondary residential mortgage market.

As part of our standard business practices, we have established eligibility and quality control requirements for companies that sell or service mortgage loans for us (“seller/servicers”), and we require our seller/servicers to originate and service mortgages in conformance with the requirements in our Seller/Servicer Guides and other applicable contractual requirements.

We re-underwrite a sample of loans that we purchase and utilize data mining techniques to identify potential mortgage fraud. In addition, we use an “Exclusionary List” to protect us from doing business, directly or indirectly, with parties who we believe have shown a lack of integrity or business competency.

As part of our long-standing commitment to combating mortgage fraud, Freddie Mac also provides extensive seller/servicer and consumer resources to promote mortgage fraud awareness and prevention, including mortgage fraud and “best practices” training to help seller/servicers prevent and mitigate mortgage fraud losses.

## **II. SCOPE OF THE PROPOSED FRAUD REPORTING REGULATION**

The proposed regulation would require a regulated entity to submit a report to FHFA regarding “any fraud or possible fraud occurring in connection with a loan, a series of loans or *other financial instruments* that the regulated entity has purchased or sold” (emphasis added). Neither the proposed regulation nor HERA defines the term “financial instrument.” Therefore, Freddie Mac requests that FHFA clarify the scope of the reporting obligations under the proposed fraud reporting requirement.

In this regard, we specifically recommend that FHFA define the reporting requirement under the regulation to mean a known or possible fraud in connection with a mortgage, including a mortgage associated with a mortgage-related security or similar financial instrument issued or guaranteed by the regulated entity. We believe the definition should expressly exclude other instruments such as mortgage-related securities where the regulated entity holding the securities has not issued or guaranteed the security or the underlying loans; debt securities; derivatives; commercial paper; Fed funds; non-mortgage asset-backed securities; and similar instruments.

We believe it is important to define the coverage of the regulation consistent with HERA's legislative history and public policy objectives. By focusing the proposed reporting requirement on mortgage fraud, FHFA would enable Freddie Mac to continue to provide information that is of the most value to governmental authorities in investigating and prosecuting persons who may have perpetrated mortgage fraud.

#### A. Non-Mortgage-Related Instruments

The legislative history of HERA does not suggest that Congress intended for regulated entities to file fraud reports on non-mortgage-related financial instruments. At the time that HERA was enacted, mortgage holders and law enforcement agencies were uncovering increasing numbers of fraudulent mortgage transactions, and reports of sham transactions had made their way into the mainstream media. Based on current events at that time and the lack of specific legislative history regarding the term "financial instrument," we believe that Congress intended the fraud reporting requirement in HERA to apply only to mortgage-related instruments. Limiting the scope of the fraud reporting regulation would ensure an appropriate focus on the public policy concerns regarding the role of mortgage fraud in the mortgage finance crisis. In addition, there are other mechanisms that already exist today for providing FHFA with information regarding incidents of fraud that are unrelated to mortgage fraud.

#### B. Mortgage-Related Securities

Freddie Mac purchases mortgages and mortgage-related securities or similar financial instruments that we have not issued or guaranteed. Unlike mortgages that we own or guarantee, we do not possess detailed information on the loans underlying these securities.

Like any other investor in mortgage-related securities or similar financial instruments, Freddie Mac receives monthly payments from the securitizers based on the cash flows of the assets underlying the securities. Therefore, we do not possess detailed, loan-level information regarding individual loans or assets that make up the security. As an investor, we are not in a position to report to governmental authorities meaningful information about fraudulent mortgage loans underlying mortgage-related securities or similar instruments that we have not issued or guaranteed. Rather, the servicer or the trustee for the securities is in the best position to make such reports. For these reasons, we request that FHFA exclude from the fraud reporting regulation mortgage-related securities or similar financial instruments that a regulated entity has not issued or guaranteed.

### III. **SAFE HARBOR: DEFINITION OF "ENTITY-AFFILIATED PARTY"**

Under HERA, a regulated entity and an entity-affiliated party that submits a fraud report in good faith are not liable to any person under any law or regulation or under any contract or other legally enforceable agreement for making such a report or for failing to notify persons who are the subject of the report or who are identified in the report.<sup>3</sup> This important provision helps limit legal risk associated with reporting known or suspected fraud to FHFA.

The safe harbor from liability in HERA also extends to an "entity-affiliated party." Both HERA and the proposed regulation define "entity-affiliated party" to include independent contractors if 1) an independent contractor knowingly or recklessly participates in any violation of a law or

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<sup>3</sup> 12 U.S.C. § 4642(b).

regulation, any breach of a fiduciary duty, or any unsafe or unsound practice and 2) such actions cause or are likely to cause more than a minimal financial loss to or have a significant adverse effect on the regulated entity.

While we believe that the inclusion of these independent contractors in the definition of an "entity-affiliated party" is appropriate in the context of the enforcement provisions of HERA, the statutory and proposed regulatory definitions do not appear to be consistent with the spirit or the purpose of the fraud reporting requirement or the safe harbor from liability for filing such reports. Therefore, we request that FHFA revise the proposal to make clear that, for purposes of the safe harbor, an "entity-affiliated party" includes independent contractors unless an independent contractor knowingly or recklessly violates a law or regulation, breaches a fiduciary duty, or engages in an unsafe or an unsound practice and such actions cause or are likely to cause more than a minimal financial loss to or have a significant adverse effect on the regulated entity.

#### **IV. CONCLUSION**

Thank you for considering Freddie Mac's views on this rulemaking. We hope that our comments are helpful as FHFA finalizes this regulation and issues related guidance. Please contact me if you have any questions or would like additional information.

Sincerely,



Robert E. Bostrom