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Federal Housing Administration

Look Before You LEAP – This Year's FHA Annual Recertification Process



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It's that time of year again. No, not spring break; the Federal Housing Administration's ("FHA") annual recertification deadline is upon us (or, more specifically, FHA program participants). The good news is that, this year, mortgagees with a December 31st fiscal year end will have some extra time to complete their recertifications because of system changes that the U.S. Department of Housing and Urban Development ("HUD") is implementing. The bad news is that many institutions are questioning how they can certify at all. In fact, as more institutions realize that the risks associated with the annual certification process have never been higher, lenders and servicers are increasingly finding that they are "unable to certify." And, while selecting "unable to certify" does not mean an institution will be denied re-approval, the process does require more preparation than simply checking a box, including thoughtful consideration of the reasons why the institution cannot attest to particular certification statements.

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With these considerations in mind, this year's extension is a great opportunity for FHA mortgagees to ensure that they know all the facts — and the risks — that apply to their organization prior to completing the recertification process. Failure to do so could result in FHA penalties or program approval issues, or even worse, high-stakes litigation under the False Claims Act ("FCA").

Goodbye, LASS – Hello, LEAP

This year, HUD is replacing its legacy Lender Assessment Subsystem ("LASS") with the new Lender Electronic Assessment Portal ("LEAP") to consolidate all FHA approval and recertification business processes.¹ LEAP will facilitate management of mortgagee information, performance of profile functions (e.g., cash flow account setup), automation of requests and notifications that currently require manual processes, and completion of the annual recertification process. Program participants with a December 31, 2013 fiscal year end will be required to use LEAP to complete their annual certification, submission of financial reports, and payment of recertification fees this spring. Ordinarily, these lenders and servicers would have until March 31 to complete these tasks. However, because LEAP's recertification functionality will not be deployed until mid-April at the earliest, the recertification deadline for

¹ As of March 31, 2014, mortgagees and independent public accountants ("IPAs") will no longer be able to access LASS.

these program participants has been extended until 30 days after LEAP's deployment.

In connection with LEAP's launch, FHA is consolidating lender identification numbers for mortgagees with both Title I and Title II approvals. Effective March 31, such mortgagees will use their current Title II identification number on an institution-wide basis, and the Title I identification numbers will be defunct. Additional mortgagee data consolidations will occur on LEAP's go-live date for program participants with Title I and Title II approvals.

HUD has gone to great lengths to publicize these changes, including by distributing informal guidance via e-mail and HUD's website, issuing a mortgagee letter, and holding multiple webinars to get the word out. The message is clear: HUD would like to avoid the backlog that has grown with late and more complicated filings, and wants to stave off any claims that mortgagees were unaware of the new process.

Get Ready to Recertify

In concert with its deployment of LEAP, FHA is implementing several changes to the annual re-approval process. These include the following:

- FHA will permit only three corporate officers to be designated as having annual certification authority. This cap will apply to all mortgagees on an institution-wide basis, including those with both Title I and Title II authority;

- To the extent that a mortgagee is unable to attest to certain statements in the annual certification, LEAP will require the mortgagee to indicate which specific statement(s) it is "unable to certify" and to upload supporting documentation; and

- LEAP will assign Audit Related Questions ("ARQs") and Financial Data Templates ("FDTs") to mortgagees by segment (i.e., non-supervised, large supervised, small supervised, investing). Sample ARQs and FDTs are available on HUD's website so that program participants can prepare the data that will need to be entered into LEAP. Mortgagees' IPAs will complete the Agreed Upon Procedures ("AUP") attestation for audited financial data entered into LEAP.

Mortgagees should be proactive in ensuring preparedness for this year's annual recertification. This includes, prior to March 31 that mortgagees:

- Make any necessary changes to their profile information in LASS. LASS will not be available in April, and LEAP will not be functional for at least a couple of weeks after LASS is shut down. Examples of changes that may need to be made to lender profile information include, among other things, updating corporate offices, branch managers, and regional managers;

- Save their institution's LASS profile information. After March 31, historical LASS data will only be available by requesting hard copies directly from HUD, which is likely to result in some delays; and

- Implement any system or process changes required as a result of the Title I and II identification number consolidation.

On March 31st, mortgagees with both Title I and II authority should ensure that their lender profile information, insured loan portfolios, reserve balances, cash

flow accounts, and historical data are accurately reflected in their institution-level profiles. In addition, FHA Connection users of mortgagees with both Title I and II authority (including IPAs) should verify that they continue to have appropriate access and authorities in FHA Connection.

Prior to LEAP going live, mortgagees should guarantee that financial statements (including ARQs and FDTs) will be ready for submission shortly after LEAP goes live, and confirm that their IPAs are using FHA's audit guidelines. After LEAP's go-live date, mortgagees should confirm the accuracy of their profile information in LEAP, and promptly make any changes that may be required.

Finally, and perhaps most importantly, mortgagees should review and analyze the certification language to determine whether there are any statements that cannot be certified this year. This analysis should begin as soon as possible, to ensure that it can be completed prior to the certification deadline (which will be 30 days after the LEAP go-live date).

Are We Able to Certify?

FHA requires mortgagees to attest to several broad annual certification statements. For example, among other things, the individual signing the certification must swear that the *company* "complied with and agrees to continue to comply with HUD-FHA regulations, handbooks, Mortgagee Letters, Title I Letters, policies, and terms of any agreements entered into with [HUD]" under penalty of "administrative, civil and/or criminal penalties; including debarment, fines, and imprisonment under applicable federal law." As a general matter, the following circumstances, among others, will make a mortgagee "unable to certify":

- Failure to comply with *any* HUD or FHA rules or guidance;

- Unresolved government reviews, audits, investigations, enforcement actions, and litigation. A matter is considered "unresolved" until either the government takes an action or the government formally determines that no action is warranted;

- Resolved government reviews, audits, investigations, enforcement actions, and litigation that resulted in any adverse action, by a federal, state, or local government; or

- Having been refused a license or sanctioned by any state or states in which the mortgagee originates or services FHA mortgages.

Program participants that determine they are "unable to certify" must identify each of the certification statements to which they are unable to attest, draft explanations of the reasons for their inability to attest, and prepare supporting documentation for HUD's review. Not surprisingly, careful consideration of the explanations is critical, given the potential that disclosures may create risk in other contexts, including, for example, questions related to supervisory examination and attorney-client privilege protections. HUD will then evaluate the mortgagees' materials to determine whether to recertify their FHA approval for another year, notwithstanding the mortgagees' inability to provide unqualified attestations to the annual certification statements. FHA may or may not request additional information prior to making a final decision. In our exper-

rience, mortgagees generally have been granted re-approval following this review.

Program participants must carefully review each certification statement to analyze whether there is anything that arguably may prevent them from certifying. For example, even a routine FHA National Servicing Center desk review or state regulator examination that has not been fully closed is an “unresolved” review that could prevent a mortgagee from completing the annual certification without submitting an “unable to certify” explanation. In addition, nonmaterial deficiencies in meeting any FHA or HUD requirements arguably may prevent a mortgagee from completing the annual recertification without providing an “unable to certify” explanation.

Certifying officers must ensure that the individuals on whom they rely to identify any bases for being “unable to certify” are well-informed regarding the meaning of the certification language and the consequences of false certification. This may involve placing inquiries throughout their organizations, and providing a basic level of training on the certification language for a cross-section of employees. For example, appropriate diligence may include, among other things, contacting “principals, owners, officers, directors, managers, supervisors, loan processors, loan underwriters, loan originators and all other employees conducting FHA business” in advance of certification to determine whether any of these individuals are “currently involved in, or have been involved in, a proceeding and/or investigation that could result or has resulted in a criminal conviction, debarment, limited denial of participation, suspension, civil money penalty or other adverse action by a federal, state, or local government.” Being able to certify accurately requires full participation by the necessary parties, and an understanding on their part of the information sought. Mortgagees are increasingly formalizing their processes, including turning to checklists to record the bases for their certification, given the stakes involved. Not surprisingly, this approach takes time — all the more reason to start thinking about this now.

We’re Really Busy. Can’t We Just Sign?

Mortgagees may suffer severe consequences for failing to identify issues that should have made them unable to complete the annual certification.

As an initial matter, HUD’s Mortgagee Review Board can, and does, bring actions against mortgagees for improper annual certifications. Mortgagees that are found to have improperly attested to the certification statements face civil money penalties, and also have their Mortgagee Review Board cases reported in the Federal Register. When improper annual certifications are combined with other HUD/FHA compliance issues, mortgagees may face suspension or termination of their approval to participate in the FHA loan program. In addition, officers may be sanctioned for executing an improper certification or having such a certification submitted at their direction.

Even more of a risk, however, may be the use of allegedly improper annual certifications as the basis for actions under the FCA and the Financial Institutions Reform, Recovery, and Enforcement Act (“FIRREA”). Treble damages and civil penalties are available under

the FCA for submission of false claims on FHA loans, and civil penalties are available under FIRREA for violations of certain criminal laws in connection with FHA loans.

In several of the mortgage fraud cases brought since 2011, the federal government has alleged that mortgage lenders and servicers violated the FCA by submitting annual certifications attesting to compliance with HUD requirements when the lenders and servicers knew (as defined by the FCA) that they had not complied with such requirements. In these cases, the government’s theory has been that (i) lenders and servicers falsely certified annual compliance with FHA requirements—including certifying that they maintained an effective quality control program; (ii) these certifications were the basis for the lenders and servicers being permitted to continue participating in the FHA loan program; and (iii) each claim submitted by the lender or servicer is a false claim due to the false annual certification. The government has relied on this theory in several cases to broadly allege fraud in the origination of FHA loans without identifying specific loan-level defects.

This theory may be used to extract large settlements from FHA program participants. For example, in March 2012, the U.S. Department of Justice (“DOJ”), HUD, and forty-nine state attorneys general (“AGs”) announced the filing of a historic \$25 billion dollar settlement agreement with five of the largest mortgage servicers to resolve alleged violations of various federal and state laws, including the FCA. The DOJ, HUD, and the AGs alleged that (i) the five servicers were able to procure insurance payments from the FHA and maintain their lender approval by submitting the standard annual certification, which asserts compliance with all HUD/FHA regulations, handbooks, and policies; and (ii) the FHA would not have made a financial commitment to pay the mortgage insurance claims submitted by the servicers if the FHA had known about the servicers’ quality control failures or false certifications.²

Given the significant risk associated with annual certification, mortgagees should consider using the extra time afforded by the LEAP conversion to conduct thorough diligence with respect to their ability to certify. Failure to consider and address any potential issues before completing the recertification process in LEAP may expose a mortgagee to unnecessary and expensive administrative and enforcement risk.

² Notwithstanding the government’s assertions in past (and ongoing) matters, the annual certification theory for an FCA case is subject to challenge. For example, in November 2013, a U.S. District Court, in considering and granting a certifying officer’s motion to dismiss, rejected the theory that a lender’s annual certification provides a basis for FCA allegations. Instead, the court indicated that FCA allegations are appropriately based on loan-level certifications and that the “annual certification was – not to obtain the FHA’s endorsement as to each loan transaction at issue – but to prospectively maintain [the lender’s] status with the FHA.” Because the FHA’s payment of each insurance claim was alleged to be dependent on loan level certifications, and not on the annual certification, the conduct attributed to the certifying officer (signing the annual certification) did not state a claim for implied false certification. See *United States v. Reunion Mortgage, Inc.* N.D. Cal., No. 13-cv-02340, 11/5/13.