UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of:

SOUTH TEXAS MORTGAGE CORPORATION,

Respondent.

HUDALJ 04-003-MR
Decided: September 3, 2004

Abigail A. Mathews, Esq.
For the Respondent

Phillip A. Kesaris, Esq.
Michael J. Milner, Esq.
For the Government

Before: WILLIAM C. CREGAR
Administrative Law Judge

DECISION AND ORDER

On August 26, 2003, the Secretary of the United States Department of Housing and Urban Development ("HUD"), through the Departmental Enforcement Center, filed a Complaint seeking a civil money penalty of $109,000 (subsequently reduced to $104,500) against South Texas Mortgage Corporation ("STM"), pursuant to The National Housing Act, 12 U.S.C. §1735f-14, and the applicable regulations under 24 C.F.R. Parts 25 and 30. The Complaint charges that Respondent knowingly and materially: 1) accepted 330 Federal Housing Administration ("FHA") insured loans originated by persons not employed by STM; and 2) failed to maintain and implement a Quality Control Plan. A hearing was held on March 9th and 10th, 2004, in San Antonio, Texas. The parties filed Post Hearing Briefs and Proposed Findings of Fact on June 4, 2004. Accordingly, this case is ripe for decision. Having considered the record, including the parties' Proposed Findings of Fact and Post-hearing Briefs, and having assessed the credibility of the witnesses, I conclude that a preponderance of evidence establishes that the proposed civil money penalty is warranted.

Statement of Facts

Both parties submitted excellent Post-hearing Briefs and Proposed Findings of Fact. Most of the significant facts in this case are not in dispute. The exceptions turn on the credibility of witnesses and are discussed below. Because of its comprehensiveness and because I have resolved those credibility determinations in the Government's favor, I adopt the Government's Proposed Findings of Fact (including footnotes) in their entirety:

1. A mortgagee must be approved by the Secretary of HUD in order to originate FHA-insured mortgages under Title II of the National Housing Act. 12 U.S.C. § 1707(b); 24 C.F.R. Part 202; HUD Handbook 4060.1 Rev-1, ¶ 1-2 (Joint Ex. 1).[1] The approval requirement applies to all classes or types of mortgagees, including loan correspondents whose principal activity is the origination of mortgages for sale or transfer to a sponsor that performs the underwriting. 24 C.F.R. § 202.8; HUD Handbook 4060.1 Rev-1, ¶¶ 1-3C, 3-4; HT 265-66. A mortgagee is subject to the initial approval and annual recertification requirements set forth in HUD Handbook 4060.1 Rev-1 in order to ensure that it meets the minimum standards established by FHA. HT 261-63, 268-73. Adherence to these requirements is important to FHA because of the incontestability of FHA mortgage insurance and the fact that mortgagees have been delegated all responsibility for processing of FHA-insured mortgages. HT 272-73. Because the contract of insurance is between the approved mortgagee and FHA, it is critical for FHA to know whom it is dealing with in these transactions in order to ensure accountability. HT 273. The Department provides each approved mortgagee with a unique 10-digit HUD Identification Number for its use in originating FHA-insured mortgages. HUD Handbook 4060.1 Rev-1, ¶ 4-2A1; HT 280, 283.

2. As a condition of approval, the mortgagee must agree to "comply with the provisions of the HUD regulations and other requirements of the Secretary of HUD." Answer, ¶ 15; Gov't Ex. 24, p. 1-1 (section 7a of Application for Approval of South Texas); HT 271. These regulations include 24 C.F.R. Part 202, and the requirements include HUD Handbook 4060.1 Rev-1, Mortgagee Letter 95-36 (Joint Ex. 3), and Mortgagee Letter 00-15 (Joint Ex. 4). Answer, ¶ 15; HT 263.

3. A mortgagee is required to "employ competent personnel trained to perform their assigned responsibilities in ... mortgage lending, including origination." 24 C.F.R.

[1] Citations to an exhibit will appear as "Joint Ex.," "Gov. Ex.," or "Res. Ex.," followed by the number/letter of the exhibit and a page reference if appropriate. Citations to the hearing transcript will appear as "HT," followed by a page reference. References to findings of fact are identified as "FF," followed by the number.

§ 202.5(b); see HUD Handbook 4060.1 Rev-1, ¶ 2-11. These employees include loan officers, whose responsibility is to accept loan applications from borrowers who wish to obtain a mortgage. HT 266, 292-94. In taking the loan application, the loan officer interviews and prescreens the borrower, and thus performs a critical core function of the mortgagee that could materially affect the underwriting decision. HT 267, 331-33, 356-57. Mortgagees are required to "exercise control and responsible management supervision over their employees," including "regular and ongoing reviews of employee performance and of work performed." HUD Handbook 4060.1 Rev-1, ¶ 2-13; see HT 288. In addition, "all employees of the mortgagee except receptionists, whether full time or part-time, must be employed exclusively by the mortgagee at all times, and conduct only the business affairs of the mortgagee during normal business hours." HUD Handbook 4060.1 Rev-1, ¶ 2-14; *see* HT 288. Further, "[a] mortgagee must pay all of its own operating expenses," including the "compensation of all employees of its main and branch offices." HUD Handbook 4060.1 Rev-1, ¶ 2-17; *see* HT 288.

4. A mortgagee may conduct business from a branch office provided that FHA approves the branch office. HUD Handbook 4060.1 Rev-1, ¶¶ 1-2A, 2-16, 3-4D; HT 282-83. An approved branch office is assigned a separate HUD Identification Number. HT 283. A loan correspondent mortgagee would need an additional $25,000 in net worth for each branch office it wishes to establish, up to a maximum requirement of $250,000, in addition to its required net worth of at least $50,000. 24 C.F.R. § 202.8(b)(1); HUD Handbook 4060.1 Rev-1, ¶ 2-4D; HT 257, 269, 283-84.

5. A mortgagee may also conduct business from a satellite office within the jurisdiction of the HUD field office where the mortgagee has an approved branch or home office. Mortgagee Letter 94-39, pp. 1-2 (Aug. 9, 1994) (Joint Ex. 2). However, employees of the mortgagee must staff the satellite office and the mortgagee must pay all operating expenses of the satellite office. *Id.* at p. 2; HT 132, 288-91.

6. Section 4 of Mortgagee Letter 95-36, issued on August 2, 1995, is entitled: "Contracting out of certain loan origination functions." Mortgagee Letter 95-36, p. 4. In this Mortgagee Letter, the Department recognized that there are "certain loan origination functions that do not materially affect underwriting decisions which may be contracted out by mortgagees without increasing the risk to FHA." *Id.* These functions are listed in bullet format: (1) clerical assistance; (2) preparation of loan documents; (3) mailing out and collecting verification forms; (4) ordering credit reports; and (5) preparing for endorsement and shipping loans to investors. *Id.* These services are appropriate for

contracting out because they do not materially affect underwriting decisions. *Id.*; HT 302, 357.[2]

7. Section 4 of Mortgagee Letter 95-36 provides that "underwriting and customary loan officer functions" may not be contracted out. Mortgagee Letter 95-36, p. 4. Although the term "customary loan officer functions" is not defined in the Mortgagee Letter, it encompasses taking the loan application from the borrower, a critical core function of the mortgagee that could materially affect the underwriting decision. HT 266-67, 292-94, 302, 331-33, 356-57.

8. Section 4 of Mortgagee Letter 95-36 provides that contracting out of the five types of services that are listed in bullet format must be with "a commercial provider of the types of services being requested." Mortgagee Letter 95-36, p. 5. There are companies whose primary business is performing one or more of these "contract processing" services for mortgagees. HT 295, 337, 362-63. The Mortgagee Letter also provides that contracting out of the listed services cannot be with "third party loan originators, real estate brokers, and other similar entities." Mortgagee Letter 95-36, p. 5. A "third party originator" is a separate mortgage company that is not approved by FHA. HT 294, 301-02, 329, 334-38. Such a separate legal entity cannot originate FHA-insured mortgages even if it happens to be partially or fully owned by the approved mortgagee. HT 302-03.

9. Pursuant to Mortgagee Letter 00-15, issued on May 1, 2000, the Department provided mortgagees with further guidance and clarification regarding the requirements for branch offices, based upon certain types of prohibited branch office arrangements that had come to its attention. Mortgagee Letter 00-15, p. 1. The Mortgagee Letter explained that a "prohibited net branch arrangement" exists when a mortgagee "tak[es] on an existing, separate mortgage company or broker as a branch and allow[s] that separate entity to originate insured mortgages under the approved mortgagee's HUD Mortgagee Number." *Id.* Further, "separate entities may not operate as 'branches' of a HUD/FHA approved mortgagee and if the separate entity lacks HUD/FHA approval, its mortgages constitute third party originations which violate Departmental requirements." *Id.* Mortgagee Letter 00-15 concluded with the following statement: "The Department believes that the origination of insured mortgages by lenders that have not received HUD/FHA approval increases the risk to the FHA insurance funds and to the public. Accordingly, mortgagees found to be in violation may be subject to the full range of HUD sanctions." *Id.* at p. 2. The main purpose of Mortgagee Letter 00-15 was to reaffirm the

[2] The Mortgagee Letter also provides that a mortgagee may contract out "[s]uch other functions as may be approved by the Department." *Id.* There is no evidence in the record that HUD has approved the contracting out of other functions beyond the five listed in this Mortgagee Letter.

Department's position that unapproved entities may not originate FHA-insured mortgages. HT 303-05.

10. A mortgagee must maintain and implement a written Quality Control Plan that is acceptable to HUD. 24 C.F.R. § 202.5(h); HUD Handbook 4060.1 Rev-1, Chapter 6; HT 270, 305-06, 346. A copy of the Quality Control Plan, or a checklist with a certification that the Quality Control Plan complies with FHA requirements, must be submitted with the mortgagee's application for FHA approval. Gov't Ex. 24, pp. 1-8 and 1-9 (checklist submitted by South Texas with its Application for Approval); HT 270-71, 277, 280-82. The purpose of a Quality Control Plan is to ensure that the mortgagee is operating in compliance with FHA requirements. HT 306. The Quality Control Plan, among other things, requires the mortgagee to undertake an independent review of its operational procedures and a sampling of loans to detect instances of noncompliance with FHA requirements and report them to senior management so that corrective action can be taken at an early stage. HUD Handbook 4060.1 Rev-1, Chapter 6; HT 306-08.

11. A sponsor of a loan correspondent mortgagee is required to conduct quality control reviews of a sampling of loans originated by the loan correspondent. HUD Handbook 4060.1 Rev-1, ¶ 6.1D.5. However, this is not meant to be a substitute for the correspondent's own quality control. *Id.*; HT 308, 364.

12. InterAmericorp, Inc. ("InterAmericorp") was chartered as a corporation by the State of Texas on November 12, 1992. Gov. Ex. 14; HT 199-200, 239. InterAmericorp became an FHA-approved Title II loan correspondent mortgagee in April 1993. HT 122. At all relevant times, InterAmericorp used the d/b/a of Independent Mortgage Services and had a main office located in San Antonio, Texas. Gov. Ex. 40, p. 3 (Admission #9); HT 117-18, 122, 199, 240.

13. Peter S. Velasco and Rick Adams were initially each 50% owners of InterAmericorp. HT 239, 385. They were good friends and had a close personal and business relationship since the early 1980s. HT 216, 232, 236, 247, 383, 395. In approximately 1994, Mr. Adams relocated to Corpus Christi, Texas, and managed a satellite office of InterAmericorp at that location. HT 242-45, 252-54, 386, 391. Thereafter, Mr. Adams agreed to sell 90% of his stock in InterAmericorp to Mr. Velasco for $70,000, pursuant to a stock purchase agreement secured by a promissory note in the amount of $60,000. HT 200-01, 245-46, 388-89, 441. Mr. Velasco and Mr. Adams subsequently disputed whether the stock purchase agreement had ever been

consummated, and the matter was never formally resolved. HT 201, 488-89.[3] As of 1999, Mr. Velasco still owed Mr. Adams a portion of the funds he had agreed to pay under the promissory note. HT 255.[4]

14. At all relevant times, Mr. Velasco was at least a 50% owner of InterAmericorp, and served as the sole officer of the company. HT 199-200; 204-05.

15. Mr. Adams formed a new corporation, South Texas, which was chartered by the State of Texas on May 20, 1996. Gov. Ex. 24, p. 1-10; HT 278, 381, 387. South Texas became an FHA-approved Title II loan correspondent mortgagee on February 25, 1997. Answer, ¶ 3; Gov. Ex. 24, p. 11; HT 148, 280, 390. [At this time Mr. Adams transferred his stock in InterAmericorp to SMT. Accordingly, SMT was a part owner of InterAmericorp. HT 246, 387-88.] At all relevant times, Mr. Adams was the sole officer and owner of South Texas, the company used the d/b/a of Independent Mortgage, and the company's only office was located in Corpus Christi, Texas. Gov. Ex. 24; Gov. Ex. 40, pp. 3-4 (Admission #6 and #10); HT 101-03, 131-32, 202, 279-80, 386-87, 401.

16. In April 1998, Mr. Velasco sold a portion of the physical assets of InterAmericorp to another entity, National Mortgage Link (NML), and Mr. Velasco became an employee of NML. Gov. Ex. 9; HT 247-48. On September 14, 1998, the FHA approval of InterAmericorp was withdrawn due to its failure to submit the required annual audited financial statement and pay the required annual recertification fee. HT

[3] Mr. Adams claimed that Mr. Velasco defaulted on their agreement by failing to make timely payments, and that his stock was reclaimed by him in June 1996 and transferred to South Texas, giving South Texas a 50% interest in InterAmericorp. HT 387-90, 444, 487-88. Mr. Adams' claim that South Texas owns 50% of InterAmericorp is inconsistent with section B of the Texas Franchise Tax Public Information Reports filed by South Texas for 1998, 1999, and 2001, which certified that South Texas had no interest of 10% or more in any other corporation, Gov. Ex. 31; HT 448-49; with section C of the Texas Franchise Tax Public Information Reports filed by InterAmericorp for 1998, 1999, 2000, and 2001, which certified that no corporation had an interest of 10% or more in InterAmericorp, Gov. Ex. 21; with the federal tax returns of South Texas for 1998, 1999, and 2000, which certified that South Texas had no interest of 50% or more in any other corporation, Res. Ex. CCC, DDD, EEE; HT 454-55; and with the federal tax returns of InterAmericorp for 1999, 2000, and 2001, which reported that Mr. Velasco was the sole owner of the company, HT 201. The federal tax returns of InterAmericorp for these years are also inconsistent with Mr. Velasco's claim that South Texas owns 5% of InterAmericorp. HT 200-01.

[4] Mr. Adams claimed that once he reclaimed his stock in InterAmericorp in June 1996, Mr. Velasco's obligation to make further payments to him under the stock purchase agreement was nullified. HT 443-44. However, Mr. Adams continued to accept payments from Mr. Velasco on the stock purchase agreement after June 1996. HT 444-45.

122-23, 205, 317-18, 321; *see* HUD Handbook 4060.1 Rev-1, ¶ 5-5.[5] In November-December 1998, Mr. Velasco's employment with NML was terminated. Gov. Ex. 9.

17. Following the withdrawal of InterAmericorp's FHA approval and the termination of Mr. Velasco's employment with NML, Mr. Adams, on behalf of South Texas, entered into an oral agreement with Mr. Velasco allowing InterAmericorp to originate FHA-insured loans on behalf of South Texas. HT 216-17, 247, 257-58.[6] There were no "terms" to this oral agreement. HT 216. However, pursuant to the oral agreement, persons who were the exclusive employees of InterAmericorp originated FHA-insured loans on behalf of South Texas from January 1999 through July 2001, including the 330 loans at issue in this case. Joint Ex. 5; HT 208-16, 249-50.

18. The employees of InterAmericorp who originated the 330 FHA-insured loans at issue used the 10-digit HUD Identification Number (#10184-0000-0) assigned to South Texas. HT 220. The loan packages prepared by InterAmericorp identified the HUD Identification Number of South Texas. *Id.*[7] As to these loans, InterAmericorp's employees took the loan applications from the potential borrowers, in addition to performing other loan origination functions, and submitted the loan packages directly to South Texas' sponsors for underwriting. Gov. Ex. 40, p. 6 (Admission #29); HT 218, 220, 249-50. InterAmericorp prepared and maintained the loan file for each of the loans it originated on behalf of South Texas. HT 256. It obtained the FHA case number for these loans from South Texas. HT 219, 250, 255, 259.[8]

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[5] This withdrawal was required to be effective for a one-year period, pursuant to 12 U.S.C. § 1708(c)(3)(D). Thus, InterAmericorp was barred from obtaining its own FHA approval prior to September 14, 1999. HT 318-20. Mr. Velasco was incorrect in testifying that InterAmericorp's approval was not withdrawn. HT 248.

[6] Mr. Velasco testified that he entered into the oral agreement with Mr. Adams "sometime after October of 1998." HT 217. Mr. Adams disputed Mr. Velasco on this point, claiming that the oral agreement occurred in early 1998, before InterAmericorp's FHA approval was terminated on September 14, 1998. HT 391-95. To support this claim, Mr. Adams noted that 1 of the 330 FHA-insured loans at issue, Case No. 495-5097657 (Jesus Rodriguez), had an application date of July 2, 1998. Joint Ex. 5; HT 393-95. However, this loan was closed on February 11, 1999, approximately five months after InterAmericorp's FHA approval was terminated. Joint Ex. 5. At another point in his testimony, Mr. Adams seemed to agree with his counsel that the origination arrangement between South Texas and InterAmericorp began in the "late [f]all of 1998." HT 399.

[7] Mr. Adams claimed that he never allowed InterAmericorp to "use" the 10-digit HUD Identification Number assigned to South Texas. HT 396. Mr. Adams stated that South Texas inputted its 10-digit HUD Identification Number into HUD's automated system to obtain the FHA case numbers for the loans at issue, and then communicated those case numbers to InterAmericorp. HT 396-98. However, InterAmericorp could not have originated the loans at issue without "using" the 10-digit HUD Identification Number of South Texas because InterAmericorp was not a FHA-approved mortgagee when these loans were originated.

[8] Mr. Adams claimed that South Texas checked the limited denial of participation list to determine whether the borrowers on the loans at issue were banned from participation in FHA programs, and checked another HUD

19. The employees of InterAmericorp who originated the 330 FHA-insured loans at issue were under the exclusive supervision and control of Mr. Velasco, the President of InterAmericorp. HT 206-07. The employees were paid solely by InterAmericorp, and InterAmericorp paid all of the operating expenses of the office(s) used by its employees while originating these loans. HT 207. All of the funds generated from these loans went solely to InterAmericorp. Gov. Ex. 40, p. 7 (Admission #34); HT 218.

20. InterAmericorp operated as a mortgage originator and broker from January 1999 through July 2001, originating conventional and Veterans Administration-guaranteed loans in its own name, in addition to originating the 330 FHA-insured loans at issue on behalf of South Texas. HT 199, 201-02, 206. InterAmericorp, using its d/b/a of Independent Mortgage Services, advertised itself in the October 2000 Greater San Antonio Yellow Pages as: "Offering More FHA, VA & Conventional Loan Programs Than Any Lender In San Antonio." Gov. Ex. 39; HT 223-26.

21. InterAmericorp has never been a commercial provider of loan origination services to any other mortgagee. HT 222. It did not advertise or provide services such as clerical assistance, preparation of loan documents, mailing out and collecting verification forms, ordering credit reports, and/or preparing for endorsement and shipping loans to investors, to any other mortgagee. *Id.*

22. By letter to Mr. Adams dated December 15, 2000, Mr. Velasco stated: "As per our discussion on the phone, I understand your concern regarding the future origination of loans, as it pertains to HUD's current guidelines. I realize that up to now it has been convenient for both of us and appreciate your patience in allowing me to build up my operation once again, to the point where I could submit for my own HUD/FHA Approval." Gov. Ex. 23. The "concern" of Mr. Adams' that is referenced in this letter was that his origination arrangement with Mr. Velasco resembled a "net branch" that violated Mortgagee Letter 00-15, and that therefore should be terminated. HT 227, 232-33, 401, 471-72; Gov. Ex. 9 (statements by Mr. Adams that in 1999-2000 "the San Antonio operation grows beyond the scope of an origination office and is determined to be a Net Branch"; "It is decided that San Antonio must apply for a branch designation or a separate HUD ID#"; and that in December 2000 "notice is given to Peter that the San Antonio office must apply for a unique HUD ID#."); Gov. Ex. 32, p. 7 (statement by Mr. Adams that "[w]ith this new guidance [Mortgagee Letter 00-15], Mr. Velasco and I discussed our situation and felt it best for him *once again* to obtain a separate approval

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database to determine whether the borrowers on the loans at issue had previously defaulted on a loan. HT 398-99, 438.

for the San Antonio base of operations") (emphasis in original).[9]

23. The origination agreement between Mr. Adams and Mr. Velasco enabled Mr. Velasco and InterAmericorp to remain profitable and stay in business, and to build up net worth to the point where Mr. Velasco could apply for FHA approval. Gov. Ex. 23; HT 233-34. Once this was accomplished, Mr. Velasco established a new corporation, Trannah Asset Management, d/b/a Independent Mortgage Services, which was approved by FHA as a Title II loan correspondent mortgagee on May 21, 2001. HT 125, 197-98, 234.[10] After Mr. Velasco obtained FHA approval for Trannah Asset Management, he no longer had a reason to use the HUD Identification Number of South Texas to originate FHA-insured loans. HT 234.

24. Of the 330 FHA-insured loans at issue, approximately 180 were originated by InterAmericorp employees using the HUD Identification Number of South Texas after the May 1, 2000 issuance of Mortgagee Letter 00-15. Joint Ex. 5. InterAmericorp employees continued to originate FHA-insured loans using the HUD Identification Number of South Texas until July 2001. *Id.*

25. By letter dated April 23, 2001, Valeria F. Lopez, a Field Monitor for the HUD Quality Assurance Division, advised Mr. Adams that a monitoring review of the FHA-insured loan origination activities of South Texas had been scheduled. Gov. Ex. 2; HT 100-04, 161, 402. From July 15-20, 2001, Ms. Lopez conducted an on-site review of South Texas at its office in Corpus Christi, Texas. HT 109, 161, 403.

26. Mr. Adams represented to Ms. Lopez, at the commencement of her review, that no non-employees/brokers take applications for FHA-insured loans. Gov. Ex. 3, p. 2.

27. Ms. Lopez selected 21 loans for review due to their early payment default status. HT 111, 133, 163, 186, 192-93. While reviewing the files relating to these loans, Ms. Lopez discovered several instances where persons who were not on the list of

[9] Mr. Velasco did not admit that he and Mr. Adams determined that the operation in San Antonio constituted a "net branch." HT 229-30. However, he acknowledged that the term "HUD's current guidelines" in his letter to Mr. Adams (Gov. Ex. 23) referred in part to Mortgagee Letter 00-15, and that this Mortgagee Letter was a "point of consideration" in deciding to stop originating loans on behalf of South Texas. HT 227, 233.

[10] Mr. Adams stated that Mr. Velasco obtained this approval "*before* [South Texas] was ever notified of a Quality Assurance Review." Gov. Ex. 32, p. 2 (emphasis in original). In fact, Mr. Velasco obtained this approval on May 21, 2001, approximately one month *after* South Texas was notified of its review by Ms. Lopez. Gov. Ex. 2; HT 198.

employees of South Texas had taken the loan applications. Gov. Ex. 5; HT 108-12.[11] The persons who took the loan applications were not W-2 employees of South Texas. Gov. Ex. 6; HT 113-15. Rather, they were employees of InterAmericorp. Gov. Ex. 4; Gov. Ex. 22; HT 117-20, 165. Mr. Adams wrote to Ms. Lopez that these persons "were the employees of Peter Velasco operating as an originator in San Antonio," and stated that "[t]heir compensation came from Peter directly." Gov. Ex. 4; HT 113, 117-20, 165. Mr. Adams also told Ms. Lopez that he had no knowledge of how many loans were originated by InterAmericorp, and that Mr. Velasco was totally in charge of everything that went on in San Antonio. HT 121-22. Mr. Adams repeatedly informed Ms. Lopez that his origination arrangement with Mr. Velasco was due to their long friendship. HT 165, 181.

28. Mr. Adams provided Ms. Lopez with a copy of a letter dated December 15, 2000, from Mr. Velasco to him, discussing the plan to terminate the origination agreement between South Texas and InterAmericorp. Gov. Ex. 23; HT 124. Mr. Adams admitted to Ms. Lopez that "net branching" was probably what had occurred between him and Mr. Velasco because he was allowing Mr. Velasco to use the 10-digit HUD Identification Number assigned to South Texas. HT 125, 163-64.[12]

29. Mr. Adams provided Ms. Lopez with a chronology of his business relationship with Mr. Velasco. Gov. Ex. 9; HT 126-30, 181-82, 511-12. This chronology, in pertinent part, stated that the San Antonio office was, in 1999-2000, "determined to be a Net Branch" and that the office "must apply for a branch designation or a separate HUD ID#." Gov. Ex. 9. The chronology also stated that, in December 2000, "notice [was] given to Peter [Velasco] that the San Antonio office must apply for a unique HUD ID#." *Id.*[13]

30. Ms. Lopez had requested that Mr. Adams provide her with quality control reports/results of the last two quality control reviews pertaining to loans originated by South Texas. Gov. Ex. 2; HT 140. Mr. Adams did not provide any such reports to Ms. Lopez. Gov. Ex. 40, p. 8 (Admission #45); HT 140. Mr. Adams gave Ms. Lopez a

[11] Of the 21 loans reviewed by Ms. Lopez, 13 are included in the 330 loans at issue in this case. *Compare* Gov. Ex. 1, Appendix A (loans with asterisk) with Joint Ex. 5. An additional loan that was reviewed by Ms. Lopez, Case No. 495-5271123 (Chris Rivas), was dropped from this case when the Government withdrew Count 90 of the Complaint on March 1, 2004.

[12] Mr. Adams denied that he made these particular verbal statements to Ms. Lopez. HT 415.

[13] Mr. Adams admitted that the words on the bottom of the chronology ("Valerie, I hope this helps. Sorry it took so long to finish. Rick") were written in his handwriting, but denied that he wrote these words on the chronology or that he prepared the chronology and gave it to Ms. Lopez. HT 416-20, 487. Mr. Adams further stated that he had not had an opportunity to see the original of the chronology, and that the words written in his handwriting were put on a different document that he had sent to Ms. Lopez (Gov. Ex. 8). HT 420. However, the original of the chronology was produced during the hearing, showing that Mr. Adams' handwritten material was in fact written on the bottom of this chronology. Gov. Ex. 42; HT 500-02, 508-12.

document entitled "Internal Quality Control Policy: 2000" with an attached excerpt from a Title I handbook concerning quality control, HUD Handbook 4700.2 Rev-1, Chapter 6 (Sept. 1995). Gov. Ex. 11; HT 141, 188, 406.[14] Ms. Lopez advised Mr. Adams that this document was totally inadequate and not in compliance with the relevant handbook requirements. HT 142, 155-58, 163, 409, 439, 480.[15] Ms. Lopez gave Mr. Adams a checklist to use so that he could create a Quality Control Plan in compliance with HUD Handbook 4060.1 Rev-1, Chapter 6. HT 188-89, 405, 409-10.

31. Mr. Adams informed Ms. Lopez that he believed South Texas could rely upon its sponsors to conduct its quality control reviews. HT 158, 408. Ms. Lopez viewed this as incorrect because the applicable handbook, HUD Handbook 4060.1 Rev-1, ¶ 6-1D5, states that quality control reviews conducted by sponsors "are not a substitute for the correspondent's own quality control." HT 177-78.

32. Mr. Adams informed Ms. Lopez that he would correct the deficient quality control procedures of South Texas, and later sent Ms. Lopez a letter stating this and further advising that he had implemented a quarterly review by an employee with no processing or underwriting responsibilities as required by HUD Handbook 4060.1 Rev-1, Chapter 6. Res. Ex. OO; HT 142, 169-72, 410-13.[16]

33. By letter dated October 29, 2001, Ms. Lopez provided Mr. Adams with a spreadsheet consisting of a list of loans originated between January 1, 1999 and August 1, 2001 under the 10- digit HUD Identification Number of South Texas, and requested that Mr. Adams annotate the list to indicate whether or not South Texas originated these loans. Gov. Ex. 7; HT 132-36. In response, Mr. Adams faxed back the spreadsheet with his annotations, identifying 360 loans that were "originated by Peter Velasco from San Antonio location." Gov. Ex. 8; HT 136-39, 416, 482-83. When he faxed the spreadsheet back to Ms. Lopez, Mr. Adams had a conversation with Ms. Lopez in which he stated that he did not realize that Mr. Velasco had originated that many loans on behalf of South Texas. HT 138.

34. Ms. Lopez's findings were communicated to her supervisor, David E. Hintz,

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[14] The Title I program, which concerns consumer loans for manufactured housing and home renovation, is not involved in this case. HT 153-55, 314-15. The quality control requirements applicable to South Texas, a Title II mortgagee, are found in HUD Handbook 4060.1 Rev-1, Chapter 6. HT 176-77.

[15] Mr. Adams also gave Ms. Lopez a "Post Closing Quality Control" worksheet that he said was used by South Texas. Res. Ex. XXX; HT 406-08.

[16] South Texas has admitted that it "did not prepare periodic quality control reports, as required by HUD, during the years 1999 through July, 2001." Gov. Ex. 40, p. 8 (Admission #44).

Quality Assurance Division, Denver Homeownership Center, HUD, and were subject to several layers of supervisory review at the Denver Homeownership Center, and at HUD Headquarters. Gov. Ex. 10; HT 50-54, 66, 101, 142-43, 159-60, 172-73, 179-81.

35. By letter dated July 25, 2002, the Board issued a Notice of Intent to Seek Civil Money Penalties ("Notice") to South Texas pursuant to 24 C.F.R. § 30.70, advising that it was considering seeking civil money penalties against South Texas based upon violations of FHA requirements that were discovered during the Quality Assurance Division review. Gov. Ex. 1. The two violations cited in the Notice, as set forth in Attachment A thereto, were: (1) acceptance of 345 loans originated by personnel not employed by South Texas; and (2) failure to maintain and implement a Quality Control Plan in compliance with FHA requirements. *Id.* The Notice informed South Texas of its right to respond in writing within 30 days. *Id.*

36. South Texas responded to the Notice by letter dated August 20, 2002. Answer, ¶ 8; Gov. Ex. 32; HT 423.

37. In April 2003, the Board, after considering the Notice, the response thereto by South Texas, and the factors set forth in 12 U.S.C. § 1735f-14(c)(3) and 24 C.F.R. § 30.80, voted to seek civil money penalties against South Texas in the amount of $109,000. Complaint, ¶ 9-10. With respect to the first violation, the Board determined that a civil money penalty of $1,000 per loan, for a total of $345,000, was warranted. *Id.* at ¶ 10(A). As to the second violation, the Board determined that a civil money penalty of $5,500 was warranted. However, based upon the net worth of South Texas and consideration of its ability to pay civil money penalties,[17] the total amount of penalties sought by the Board was reduced from $350,500 to $109,000. *Id.* at ¶ 10(c).[18]

38. Pursuant to 24 C.F.R. § 30.85, the Board issued a Complaint to South Texas on August 26, 2003. South Texas submitted an Answer on September 10, 2003, and this matter was subsequently referred to the Office of Administrative Law Judges to conduct a hearing pursuant to 24 C.F.R. § 30.95 and 24 C.F.R. Part 26, Subpart B. A hearing was held in this matter on March 9-10, 2004, in San Antonio, Texas. At the conclusion of the hearing, the Court directed the parties to file post-hearing briefs by June 4, 2004, and requested that the briefs include proposed findings of fact in addition to argument. HT 512-13.

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[17] The net worth of South Texas at the end of fiscal year 2002 was $70,000. HT 287, 429.

[18] The $109,000 amount was reduced to $104,500 prior to the hearing in this matter, pursuant to the Government's Withdrawal of Counts 16, 20, 26, 42, 51, 90, 92, 100, 164, 197, 262, 293, 333, and 334, filed March 1, 2004.

Discussion

The National Housing Act authorizes HUD's Mortgagee Review Board to impose civil money penalties against FHA-approved mortgagees for violations of FHA requirements. *See* 12 U.S.C. § 1735f-14; 24 C.F.R. §§ 25.12, 30.35. Penalties may be imposed for "[f]ailure to comply with an agreement, certification, or condition of approval set forth on, or applicable to . . . the application of a mortgagee . . . for approval by the Secretary," or [v]iolation of any . . . implementing regulation or handbook that is issued under this Act." 12 U.S.C. § 1735f-14(b)(1)(G), (H); 24 C.F.R. § 30.35(a)(1). Violations must be both "material" and "knowing." *Id.* To constitute a "material" violation, the infraction must be "[i]n some significant aspect or to some degree." 24 C.F.R. § 30.10. To ascertain materiality, the Secretary of HUD looks to the "totality of the circumstances," including factors used to determine the amount of a penalty after a violation has been found. *See In the Matter of Associate Trust Financial Services*, HUDALJ 96-008-CMP at 4-6 (Sept. 16, 1997, Order on Secretarial Review). These factors include the "gravity of the offense," and "the injury to the public." 24 C.F.R. § 30.80.[19] A "knowing" violation requires that the actor have "actual knowledge of or [act] with deliberate ignorance of or reckless disregard for the prohibitions. . . ." 12 U.S.C. § 1735f(g); 24 C.F.R. § 30.10. Accordingly, under the circumstances of this case, imposition of a civil money depends upon a preponderance of evidence establishing that: 1) Respondents failed to comply with an agreement, certification, or condition of approval or violated an implementing regulation or handbook; 2) that the failure(s) to comply or the violation was material; and 3) that the failure(s) to comply or the violation was knowing.

Failure to Comply with HUD Regulations and Requirements

The record establishes that STM allowed personnel other than its exclusive employees to originate 330 FHA-Insured loans. By virtue of an oral arrangement between STM's President, Rick Adams, and Peter S. Velasco, President of InterAmericorp, STM permitted InterAmericorp to originate these loans using STM's HUD 10-digit loan identification numbers. Having obtained the HUD identification numbers from STM, employees of InterAmericorp accepted the loan applications, performed other loan origination functions, submitted completed loan packages to STM's sponsors for underwriting, and maintained the loan file for each of the loans it originated. Although partly owned by STM, InterAmericorp was a separate corporate entity. STM and

[19] Some of these factors are irrelevant to a determination of whether a violation is "material." These include a Respondent's ability to pay the penalty, and the deterrence of future violations. However, HUD has nonetheless determined that they are relevant.

InterAmericorp filed separate corporate tax returns and were organized as separate corporations under Texas law. InterAmericorp's employees were not employees of STM and were compensated solely by InterAmericorp. Between January 1999 and July 2001, the period during which these loans were originated, InterAmericorp was not a HUD-approved mortgagee. FF 17-19. STM's transfer of the loan origination function to a loan originator not approved by HUD violated the FHA requirements set forth in 24 C.F.R. Part 202, HUD Handbook 4060.1 Rev-1, and Mortgagee Letters 95-36 and 00-15.

The record also establishes that STM failed to maintain a Quality Control Plan. The copy of STM's Internal Quality Control Policy: 2000 attaching an inapplicable Title I handbook that Mr. Adams gave to Ms. Lopez did not satisfy HUD requirements. Proper Quality Control Plans insure that actions taken after loans are completed are completed accurately. HUD Handbook 4060.1 Rev-1. Chapter 6 (Joint Ex. 1). The "Internal Quality Control Policy: 2000" consists solely of a list of instructions on how to process loans. Gov. Ex 11; HT 314-15. The second document Mr. Adams furnished to Ms. Lopez, the "Post Closing Quality Control" is merely a worksheet and does not include an implementation procedure to assure that STM was actually undertaking quality control. It is not a written plan for an audit. Res. Ex. XXX; HT 345-46, 406-08. Finally, Respondent admitted that it did not prepare "periodic quality control reports, as required by HUD, during the years 1999 through July, 2001." Gov. Ex. 40 (Respondent's Response to the Government's First Request for Admissions, No. 44).

Materiality

By permitting employees of InterAmericorp to use its HUD 10-digit loan identification numbers to originate loans, STM increased "the risk to the FHA insurance funds and to the public." Joint Ex. 4, p. 2; HT 305. Because HUD mortgage insurance is incontestible, it is critical that FHA know with whom it is dealing in order to assure accountability. The gravity of this violation and the potential injury to the public establish that STM's violation was material.

In addition, STM's failure to maintain an acceptable Quality Control Plan subjected HUD and the public to a risk that improperly originated loans would not be detected. Accordingly, the gravity of this violation and the potential injury to the public establish that the failure to establish and maintain an acceptable Quality Control Plan was also a material violation.

Knowledge

Respondent's defenses are based upon a claimed lack of knowledge that its conduct

violated HUD regulations and requirements. It claims that: 1) Section 4 of Mortgagee Letter 95-36 was sufficiently ambiguous that Mr. Adams could reasonably believe that it permitted the use of HUD 10-digit loan identification numbers by InterAmericorp; 2) that Mr. Adams held an honest belief that HUD permitted this practice, and 3) that a HUD employee approved a similar arrangement in approximately 1994. I reject these claims.

InterAmericorp's Loan Originations

A. Mortgagee Letter 95-36 was issued on August 2, 1995. Section 4 is entitled: "Contracting out of Certain Loan Origination Functions." The "certain" functions that may be contracted out are stated to be those that "do not materially affect underwriting decisions." Joint Ex. 3, p. 3. These are: clerical assistance; preparation of loan documents; mailing out and collecting verification forms; ordering credit reports; preparing for endorsement and shipping loans to investors; and such other functions as may be approved by the Department. *Id.* The letter goes on to state: "The contracting out of such loan origination functions must be with a commercial provider of the types of services being requested, and may not be contracted out to third party loan originators . . . ." *Id.*

On May 1, 2000, HUD issued Mortgagee Letter 00-15. This letter states that mortgagees may not take on what some of them refer to as a "net branch." The letter goes on to state that even though approved mortgagees are permitted to originate loans out of branch offices, these branches must also have HUD approval. Otherwise, they are considered to be prohibited "third party" loan originators. Joint Ex. 4.

Respondent contends that InterAmericorp was a "commercial provider of the types of services being requested." Gov. Ex. 32; HT 470. It argues that the term "commercial provider" is undefined by HUD, and that the services InterAmericorp provided could reasonably be understood to be substantially similar to those permitted by Section 4 of Mortgagee Letter 95-36.

I note at the outset that Respondent's claimed defense, even if credited, could only be valid for the InterAmericorp loan originations that were completed prior to May 1, 2000, the issue date of Mortgagee Letter 00-15. In fact, STM continued to allow InterAmericorp to originate at least 180 of the 330 FHA loans on its behalf after that date. Gov. Ex. 5. Indeed, the oral arrangement between Mr. Adams and Mr. Velasco did not terminate until after Trannah Asset Management obtained HUD approval in May 2001. HT 125, 197-98, 234. Be that as it may, I do not credit Mr. Adams' testimony that he reasonably and honestly believed that Mortgagee Letter 95-36 permitted STM's arrangement with InterAmericorp for the following reasons: 1) Mortgagee Letter 95-36

cannot be reasonably interpreted as permitting the origination of FHA-insured loans by unapproved entities using HUD 10-digit loan identification numbers, and 2) as discussed below, Mr. Adams' testimony that he honestly relied upon Mortgagee Letter 95-36 was not credible.[20]

B. Mortgagee Letter 95-36 cannot reasonably be interpreted as permitting the origination of FHA-insured loans by unapproved entities for the simple reason that the phrase, "*certain* loan origination functions," negates the proposition that *all* loan origination functions can be contracted out. *See, e.g., Pryor v. Nat's Lead Co.*, 87 F.2d 461, 463-64 (8th Cir. 1937) ("certain employees" in the title of an act meant that the legislature did not intend to cover "every employee" in the state). Three other limitations are set forth in Mortgagee Letter 95-36. These are: 1) the "loan origination functions" listed in Mortgagee Letter 95-36 that may be contracted out do not "materially affect underwriting decisions;" 2) the functions are to be performed by "commercial providers" of the types of services being requested; and 3) loan origination functions cannot be contracted out to "third party loan originators."

First, each of the five services listed in Mortgagee Letter 95-36 is of a routine, clerical nature and cannot affect the ultimate underwriting decision. This is not true of the taking of loan applications from borrowers, a task performed by the employees of InterAmericorp. Prescreening of the potential borrower occurs at this point in the loan process. The interviewer probes the borrower, asking questions and ascertaining the types of documentation that will be required. HT 356-57. The initial intake of the loan application may substantially affect the nature and quality of information that will ultimately be relied upon by the underwriter.

Second, the term, "commercial provider" while undefined in HUD's regulations and handbooks, when placed in context, must be understood to refer to companies whose primary business is to perform one or more of the five services.[21] In contrast to loan originators whose primary business is the origination of loans, these are companies that are in the business of providing clerical assistance, preparing loan documents, mailing and

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[20]The Government cites Texas law to the effect that the oral arrangement between Mr. Adams and Mr. Velasco was not a valid contract. Because the arrangement was indeterminate and appears to lack consideration , it may not satisfy the formal requirements of a Texas contract law. However, it is not necessary to decide whether Mortgage Letter 95-36's use of the term "contracting out" envisions legally binding contracts between loan originators and providers of certain loan services. Indeed, I believe this to be an instance appropriate for the exercise of judicial restraint. It may be that such oral arrangements are not uncommon in the industry and that such arrangements have not met with HUD's disapproval. The record is silent on this question, and it is unnecessary to address it to decide this case.

[21]I quote the letter: "The contracting out of such loan origination functions must be with a commercial provider *of the types of services being requested*. . . ." (Emphasis added).

collecting verification forms, ordering credit reports, and/or preparing for endorsement and shipping loans to investors. HT 362-63.

Finally, Mortgagee Letter 95-36 unambiguously prohibits the contracting out of services to "third party loan originators." This term, like "commercial provider" is also undefined in HUD regulations and handbooks. However, its meaning is clear from the context of the letter. A "third party" *must* be an entity outside of the two-party relationship between HUD and the HUD-approved lender. Accordingly, a "third party" can only be a non-approved lender. InterAmericorp, even though partially owned by STM, was a separate entity under Texas law. It was not a HUD-approved lender.

C. Mr. Adams was not a credible witness. For example, he only reluctantly acknowledged that Assumed Name Certificates filed with HUD and the State of Texas were in his handwriting.[22] HT 463. He also provided false testimony when he denied: 1) that he told Ms. Lopez during her July 2001, visit to STM that "net branching" probably occurred; and 2) that he gave her a typed chronology that contained an admission to that effect. HT 416-20, 487; *cf.* FF Nos. 28-29.

At the bottom of the chronology is a handwritten note stating: "Valerie, I hope this helps. Sorry, it took so long to finish, Rick." Gov. Ex. 9. Although admitting that the note was in his handwriting, Mr. Adams denied being aware of the existence of the chronology during Ms. Lopez' visit. He 1) testified that he believed that he first saw it after receiving the notice from the Mortgagee Review Board and 2) implied that the chronology was a doctored document combining the narrative events list with his handwritten note. HT 417 and 420. I do not credit his testimony. Gov. Ex. 9 is a *copy* of the chronology. At the conclusion of the hearing the Government recalled Ms. Lopez who produced the original. The original contains the handwritten note in Mr. Adams' handwriting, thus eliminating the possibility that the copy was a doctored version. Ms. Lopez' possession of the original in Mr. Adams' handwriting addressing her by her first name, "Valerie," corroborates Ms. Lopez' testimony that he gave her the chronology during her visit. Accordingly, I conclude that Mr. Adams falsely testified that he did not see the chronology prior to receiving the notice from the Mortgagee Review Board. Gov. Ex. 42; HT 500-02, 508-12.

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[22] STM sent HUD a copy of the Assumed Name Certificate STM had filed with the State of Texas. HUD's copy contains the word "Services" after the words "Independent Mortgage" in Mr. Adams' handwriting. The Assumed Name Certificate STM filed with the State of Texas is identical except that it does not contain the handwritten word "Services." (InterAmericorp's filing with the State of Texas also indicates that the firm would be d/b/a "Independant Mortgage Services.") The effect of this addition was to convey to HUD the impression that STM and InterAmericorp were one and the same, whereas to the State of Texas they were separate entities. Initially, Mr. Adams was reluctant at hearing to acknowledge his own handwriting; he later claimed that he did not know why he added the word "Services" to HUD's copy of the Assumed Name Certificate. Gov. Exs. 24 p. 1-11, 33; HT 463-66, 492-93.

The chronology contains the following sentences: 1) "1999-2000 the San Antonio operation [InterAmericorp] grows beyond the scope of an origination office and is determined to be a Net Branch. It is decided that San Antonio must apply for a branch designation or a separate HUD ID#; " and, 2) "notice [was] given to Peter [Velasco] that the San Antonio office must apply for a unique HUD ID#." Gov. Ex. 9. The term "net branch" is the term HUD used in Mortgagee Letter 00-15 to describe an unauthorized loan originator. The chronology makes it clear that its author recognized that InterAmericorp should have applied for a HUD branch designation from 1999 to 2000. The second quoted sentence establishes that Mr Velasco was given notice that he had to obtain HUD approval for InterAmericorp. Even if he did not author the chronology, Mr. Adams had to have been familiar with its contents when he gave it to Ms. Lopez. Thus, the chronology establishes Mr. Adams' knowledge that InterAmericorp was improperly originating loans.

Based on the chronology and the testimony of Ms. Lopez,[23] I conclude: 1) that Mr. Adams falsely testified that he did not provide the chronology to Ms. Lopez; and, 2) that at the time of Ms. Lopez' visit, Mr. Adams was aware that Mortgagee Letter 95-36 did not authorize the origination of loans by InterAmericorp. Because Mr. Adams was aware of the contents of the chronology he furnished to Ms. Lopez, and because he attempted to conceal his awareness, I conclude that he knowingly allowed SMT to furnish its HUD 10-digit loan numbers to employees of InterAmericorp for the purpose of originating HUD insured loans.

D. Respondent's claim that any violation of HUD requirements was not a knowing violation because a "similar" arrangement had been approved by HUD employees Steve Williams and Bo Garcia in 1994 when setting up InterAemericorp's Corpus Christie office, is also without merit. With HUD's permission, InterAmericorp opened up a "satellite office" in Corpus Christie. HT 242-45; 252-54; 386, 391. At that time InterAmercorp not only had HUD approval to originate FHA insured loans, InterAmericorp staffed the Corpus Christie office with its own employees and paid the operating expenses of the Corpus Christie office. Here, STM did not receive HUD's permission to set up the San Antonio office as a satellite office, STM did not staff the San Antonio office with its own employees, and STM did not pay the operating expenses of the San Antonio office. These are crucial distinctions. Accordingly, the arrangement permitting an unapproved third party lender to originate FHA-insured loans is not "similar."

Quality Control Plan

The requirement to maintain a Quality Control Plan is regulatory. *See* 24 C.F.R. §

[23] I found Ms. Lopez to be a credible witness. Her recollections were consistent and accurate.

202.5(h). The contents of Quality Control Plans are spelled out in HUD Handbook 4060.1 Rev-1, Chapter 6 (Joint Ex. 1). Key components of the plan are that they be in writing and that they utilize internal or external audits or provide for an independent review by personnel with no direct loan processing or underwriting responsibilities. *Id.* at ¶ 6-1A. While admitting that it did not satisfy all of HUD's requirements, Respondent takes the position that it had a Quality Control Plan. Mr. Adams blames HUD, particularly Ms. Lopez, for any inadequacies in STM's quality control. He argues that he was excused by her failure to inform him of the steps he needed to take following her interview and that he was blindsided by HUD's action to impose a civil money penalty for his failure to take those steps. Resp. Post Hearing Brief at p. 22; HT 422. Gov. Ex. 32, p. 8. Even assuming that Mr. Adams lacked knowledge that the essence of a Quality Control Plan is an after-the-fact independent audit, he was constructively on notice of this fact after Ms. Lopez told him during her July 2001, visit that he lacked an adequate plan. Ms. Lopez gave Mr. Adams a checklist to use so that he could create a Quality Control Plan in compliance with HUD Handbook 4060.1 Rev-1, Chapter 6. HT 188-89, 405, 409-10. He responded by sending back the "Post Closing Quality Control" which, as noted above, is merely a worksheet and does not include an implementation procedure to assure that STM was actually undertaking quality control. Res. Ex. XXX; HT 345-46, 406-08. Mr. Adams is not unfamiliar with HUD's programs and ignorant of where and how to obtain information about them. He has served as Public Policy Chairman of the National Association of Realtors and was appointed to FHA's Single Family Business Practice Working Group. HT 435. I conclude from his knowledge of HUD programs that after Ms. Lopez' visit in July 2001, he acted with deliberate ignorance or reckless disregard by not informing himself of the steps STM was required to take to implement a proper quality control program. I further conclude that the evidence is insufficient to establish that STM failed to implement and maintain a Quality Control Plan before Ms. Lopez' visit out of reckless disregard, or with actual knowledge, or in deliberate ignorance, of those requirements.

Appropriateness of the Civil Money Penalty

Having found that a preponderance of evidence establishes that proposed civil money penalties are warranted, it is necessary to consider the factors set forth at 12 U.S.C. § 1735-f-14(c)(3) and 24 C.F.R. § 30.80.

Gravity of the Offense

Respondent's improper origination of 330 loans exposed the FHA insurance fund to a high risk of loss. Respondent circumvented FHA requirements requiring loan origination by properly trained, supervised, and accountable personnel. FHA mortgages are incontestable. Respondent's actions placed the risk of loss of bad loans squarely on the

taxpayer. These were serious violations. Respondent's failure to take steps to implement a Quality Control Plan after learning that its existing program was insufficient, also placed the fund at risk and, although less serious than the loan origination violations, this violation was not a minor infraction.

History of Prior Offenses

STM has no history of prior offenses.

Ability to Pay the Penalty

STM reported a net worth of $70,000 at the end of fiscal year 2002. It did not make a profit until 2001, when it had a net income of $15,801. Gov. Ex. 32, p. 23. For the years 1999-2001 it suffered losses averaging $10,000 per year. Res. Exs. CCC, DDD, EEE. A civil money penalty of $104,500 is greater than STM's net worth. The Government suggests a payoff under an appropriate installment arrangement. I concur with this suggestion provided that the annual payoff amount is realistic and does not force STM to close its doors.

Injury to the Public

With the exception of HUD's litigation costs, the record fails to demonstrate a concrete loss to HUD and the public as a result of Respondent's improper loan originations. Nonetheless, the potential for loan defaults continues. Similarly, the absence of an effective Quality Control Plan may yet result in future losses to the insurance fund. Finally, the costs of investigating and prosecuting this case have resulted in a tangible injury to the public, i.e, the expenditure of public funds.

Benefits to the Violator

It was in Mr. Adams' and STM's interest that Mr. Velasco repay his debt to Mr. Adams. For Mr. Velasco to repay the debt or for the company shares to have value, InterAmericorp had to be an operating and viable company. After HUD withdrew its approval for InterAmericorp to originate FHA loans, InterAmericorp lost substantial business and was at risk. Therefore, Mr. Adams allowed InterAmericorp to originate FHA loans for STM, in the process avoiding HUD's net worth requirements and the additional expenses that would have been incurred through the operation of an approved branch. These expenses would have included rent, utilities, salaries, health and retirement benefits, and insurance. STM also benefitted by avoiding the expense of maintaining and operating

an acceptable Quality Control Plan over the branch office.

Extent of Potential Benefit to Other Persons

Mr. Velasco also received benefits from the origination arrangement. He was able to keep any profits generated by the improperly originated FHA-insured loans. He was also placed in a position in which he could pay down his debt to Mr. Adams and build up his business to the point where his company would have sufficient assets to apply for FHA approval. Gov. Ex. 23; HT 233-34.

Deterrence of Future Violations

The public fisk must be protected. A substantial civil money penalty will act as a deterrent to Respondent from engaging in future misconduct and to insure that it will in future comply with HUD's requirements.

Degree of the Violator's Culpability

Respondent was "solely at fault." It did not act "as an agenct or at the behest of another entity." *See In the Matter of Entercare, Inc.*, HUDALJ 01-061-CMP. Respondent had actual knowledge that the loan origination arrangement with InterAmericorp violated HUD requirements. It also acted with "deliberate ignorance" or :reckless disregard" of HUD requirements to maintain an effective Quality Control Plan after having been put on notice during Ms. Lopez' visit.

Such Other Matters as Justice May Require

Mr. Adams' false testimony supplies an additional reason for the imposition of the proposed civil money penalty.

Conclusion and Order

Respondent 1) knowingly and materially violated 12 U.S.C. § 1735f-14(b)(1)(G), (H); 24 C.F.R. § 30.35(a)(1); HUD Handbook 4060.1 Rev-1 (September 2003); and Mortgagee Letters 95-36 and 00-15 by permitting 330 FHA-insured loans to be originated by persons not employed by STM; and 2) knowingly and materially violated 12 U.S.C. § 1735f-14(b)(1)(C); 24 C.F.R. § 202.5(h); and HUD Handbook 4060.1 Rev-1 (September 2003) by failing to maintain and implement a Quality Control Plan.

It is **ORDERED** that

1. Respondent shall pay to the Secretary of HUD a civil money penalty of $104,500, that shall be due and payable by Respondent in installment amounts to be determined by the Secretary of HUD; and

2. Either party may file a petition for review with the Secretary within 30 days after the date of this decision, pursuant to 24 C.F.R. § 26.50(a).

WILLIAM C. CREGAR
Administrative Law Judge

Dated: September 3, 2004

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