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

In the Matter of:	)	
FIDELITY HOMES AND LOANS, INC.,	)	**HUDALJ 10-E-111-MR-72**
Respondent.	)	

INITIAL DECISION

Pursuant to Section 202 of the National Housing Act of 1934, 12 U.S.C. § 1708, for violating Federal Housing Administration ("FHA") requirements, the United States Department of Housing and Urban Development ("HUD") withdrew the HUD/FHA loan correspondent approval of Respondent Fidelity Homes and Loans, Inc., for a period of one year. Respondent appealed the Government's action. After a hearing on May 18, 2010, Respondent was held to have violated FHA requirements as alleged by HUD, and withdrawal of Respondent's loan correspondent approval for one year was affirmed.

BEFORE: The Honorable Susan L. Biro[1]
Chief Administrative Law Judge
U.S. Environmental Protection Agency

ISSUED: August 27, 2010

APPEARANCES:

For the Government:

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Terri L. Román, Esquire
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For Respondent

Z. Frank Bednarski
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[1] The Administrative Law Judges of the United States Environmental Protection Agency. are authorized to hear cases pending before the United States Department of Housing and Urban Development pursuant to an Interagency Agreement in effect beginning March 4, 2010.

I. PROCEDURAL HISTORY

The Mortgagee Review Board ("the Board") of the United States Department of Housing and Urban Development ("the Government" or "HUD") filed a Notice of Administrative Action ("Notice") dated April 16, 2010, initiating this matter and withdrawing for one year its approval of Respondent Fidelity Homes and Loans ("Fidelity") as a HUD/FHA loan correspondent. The Notice specified that the Board voted to withdraw its approval because of Fidelity's submission of a deficient audited financial statement with its application for annual recertification. The Notice clarified that the statements showed Respondent lacked sufficient unrestricted liquid assets to originate loans insured by the FHA. Fidelity, appearing *pro se*, through its president, Zdzislaw Frank Bednarski, filed a response on April 22, 2010, appealing the Government's withdrawal action, and requesting a hearing and immediate reinstatement. Fidelity admitted in its response to reporting insufficient liquidity "at December 31, 2008," but argued that it later corrected the deficiency. Respondent filed a letter on April 27, 2010, stating that its appeal "is based upon working out in good faith with the auditors of HUD a corrective action plan for the liquidity deficiency."

The undersigned issued an Order of Designation and a Notice of Hearing and Prehearing Order ("Prehearing Order"), scheduling the hearing for May 18, 2010. On May 4, 2010, Respondent filed a Motion/Request to Change of Venue [sic] ("Motion"), requesting that the trial be conducted "on paper" or via "telephone conference call." The Government opposed the Motion, but stated its amenability to the use of video conferencing technology. After Respondent secured access to such technology and its compatibility with this Tribunal's system was confirmed, the undersigned ordered that the hearing be held by video conference in an Order Denying Respondent's Motion to Change Venue. On May 10, 2010, the parties filed their Prehearing Exchanges. Then, in a letter dated May 14, 2010, Respondent unsuccessfully attempted to reconcile the matter with the Government and avoid the hearing by arguing that it cured the liquidity deficiency and "is in full compliance."

The hearing in this matter was held on May 18, 2010.[2] Mr. Bednarski and his certified public accountant ("CPA"), George B. Maitland, a fact witness for Respondent, appeared via videoconference from the State of Washington. HUD attorneys Efrosine Kritikos and Terri L. Román, and fact witnesses Ivery W. Himes and Darryl Lesesne, appeared for the Government in person at the U.S. Environmental Protection Agency's Administrative Courtroom in Washington, D.C., where the undersigned presided. In addition to the witnesses' testimony, four documents were offered by the Government and admitted into evidence as Government's Exhibits 1, 2, 4 and 5, and fifteen documents were offered by Respondent and admitted, the first fourteen being

[2] The transcript of the hearing was received by the undersigned on June 8, 2010. Citations to the transcript page and line numbers will be in the following format: "Tr. __ at __."

those exhibits included in Respondent's Prehearing Exchange.[3]

Pursuant to an Order dated June 14, 2010, the parties filed post-hearing briefs on or before June 28, 2010. Respondent's Brief was filed on May 21, 2010 ("R's Brief"), and the Government's Post-Hearing Brief was filed on June 28, 2010 ("G's Brief"), at which time the record in this matter closed.

II. BACKGROUND

On June 27, 1934, Congress approved the National Housing Act ("the Act"), Pub. L. No. 84-345, 48 Stat.1246 (1934), 12 U.S.C. §§ 1701 *et seq.* The Act created the FHA and the Board, provided for the insurance of mortgages by the federal government, and established the Mutual Mortgage Insurance Fund, with which the government could guarantee qualifying insured mortgages. To be eligible for FHA insurance, the Act requires that all federally-insured mortgages shall "[h]ave, or be held by, a mortgagee approved by the Administrator as responsible and able to service the mortgage properly." 12 U.S.C. § 1709(b)(1). The FHA established requirements under the Act to approve and recertify mortgagees to originate FHA-insured loans. These are set forth in the regulations at 24 C.F.R. Part 202, the FHA Title II Mortgagee Approval Handbook (Directive Number 4060.1, Rev-2, August 14, 2006) ("Handbook") and applicable Mortgagee Letters.[4] Pursuant to Section 202 of the Act, the Board may take administrative action against, *inter alia*, any approved mortgagee "found to be engaging in activities in violation of [FHA] requirements . . . ." 12 U.S.C. § 1708(c)(1).

In the applicable Part 202 regulations, the term "mortgagee" is defined to include "loan correspondents," entities which originate loans, submit applications for FHA insurance (if so authorized), and sell or transfer loans to sponsors, rather than hold, purchase or service loans. 24 C.F.R. §§ 202.2, 202.8 (effective until May 19, 2010); Tr. 105 at 5-14. Loan correspondents, commonly referred to as "brokers," approved to originate federally-insured loans under Title II must recertify annually within ninety days of the end of their fiscal year. Tr. 12 at 18-20, 105 at 5-17; 24 C.F.R. §§ 202.8(3), 5.801(a)(5); Handbook 4060.1, Rev-2, ¶ 4-4. Recertification requires the submission of "a yearly verification report form, an annual renewal fee, and [an] acceptable audited financial statement" through HUD's online database, the Lender Assessment Sub-system ("LASS"). Tr. 13 at 9-20; Handbook 4060.1, Rev-2, ¶ 4-4; 24 C.F.R. §§ 5.801(b)(2), (c), (d)(3); Mortgagee Letter 2009-01. Correspondents cannot submit recertification

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[3] Exhibits will be referenced herein as "GX __" (Government's Exhibit), or "RX __" (Respondent's Exhibit), as the Prehearing Order required. The first fourteen of Respondent's exhibits will be referenced consistent with the manner in which Respondent labeled them in its Prehearing Exchange, *including each subpart* (e.g., RX 1.3 or RX 13.6; not RX 1 or RX 13).

[4] These can be found at http://www.hud.gov/offices/hsg/sfh/lender/mtgeekit.cfm. A copy of Handbook 4060.1, Rev-2, Chapter 4, was admitted into evidence as GX 1.

documentation "on paper"; they must submit them electronically. Tr. 31 at 15-18; 24 C.F.R. §§ 5.801(b)(2), (d)(3). HUD representatives then review, or audit, the correspondents' financial statements submitted through LASS to determine whether, among other things, the loan correspondents have maintained the requisite liquidity threshold (20% of net worth) set by Part 202. 24 U.S.C. §§ 202.8(b)(1), (3)(i), (4); Handbook 4060.1, Rev-2, ¶ 4-5(B)(1); Tr. 15 at 16-22; 16 at 1-8; *see* GX 1.

If a correspondent's annual financial statement "discloses that the mortgagee does not consistently maintain the required liquid assets *throughout the year*," the auditor may request interim statements, or take administrative action. Handbook 4060.1, Rev-2, ¶ 4-5(B)(6)(d) (emphasis added). In some cases, the auditor leaves instructions in the LASS system for the correspondent regarding curing the deficiency. Handbook 4060.1, Rev-2, ¶ 4-7; Tr. 46 at 2-5. The Handbook notes that "[f]ailure to submit an acceptable cure within the prescribed timelines outlined in the LASS user manual may result in the loss of [approval]." Handbook 4060.1, Rev-2, ¶ 4-7. Additionally, the matter may be referred to the Board, which may take definitive administrative action based upon the liquidity violation. 12 U.S.C. § 1708(c); 24 C.F.R. § 25.5(a) ("The Board is authorized to take administrative actions . . . including issu[ing] a letter of . . . withdrawal"), 24 C.F.R. § 25.6(h) (violations creating grounds for administrative action include "[f]ailure of approved mortgagee to maintain the applicable net worth [or] liquidity"); Handbook 4060.1, Rev-2, ¶ 4-5(B)(6)(c); Mortgagee Letter 2009-01.

III. FINDINGS OF FACT

Respondent Fidelity Homes and Loans, Inc. ("Fidelity"), established in 1998, is a mortgage brokerage company operating from leased office space at 2505 South 320th Street, Suite 580, Federal Way, Washington 98003. Tr. 103 at 1-17; RX 1.3, 1.6, 14.8. Mr. Zdzislaw "Frank" Bednarski is the company's owner and president, and has worked as a mortgage broker for "at least 15 years." Tr. 6, 103-105. Fidelity has four to five "constantly producing" loan officers, but a total of 12 loan officers are licensed as associates through the company. Tr. 109.

In 2008, Fidelity applied for the first time for approval as a loan correspondent authorized to originate FHA-insured loans under Title II of the National Housing Act, 12 U.S.C. §§ 1707 *et seq.* Tr. 75; 104 at 7-11; 110 at 8-12. As part of Respondent's initial application, Mr. Bednarski submitted a financial statement dated May 31, 2008, which was prepared by Earl Davenport, a Certified Public Accountant (CPA) located in Federal Way, Washington. RX 1.2-1.10, 6.5; Tr. 75 at 5-7; 93-94. The statement listed Respondent's "Adjusted Net Worth for HUD Requirement Purposes" as $89,592, and Respondent's cash total as $26,094. RX 1.5, 1.2-1.10. These figures show that as of the date of the financial statement, more than 20% of Fidelity's net worth (*i.e* more than $17,918) was held in cash.

By letter dated October 23, 2008, the Director of FHA's Lender Approval and Recertification Division, Elliot M. Johnson, Jr., notified Fidelity that it was approved as a "Title

II Nonsupervised Loan Correspondent" and assigned Fidelity FHA lender identification number 28296-0000-3. RX 1.1. The letter constituted an "Origination Approval Agreement" that notified Respondent that its new "authority to originate single family mortgage loans insured by FHA is subject to compliance with all applicable laws and regulations . . . [and] all applicable provisions . . . as explained in the Title II Mortgagee Approval Handbook 4060.1, Rev-2 and all subsequent mortgagee letters," available at the cited online address. *Id.* It also notified Respondent that the Agreement could be terminated by FHA in accordance with procedures in Part 202. *Id.*

Mr. Bednarski paid various bills from funds in Fidelity's checking account in December 2008. Tr. 77-79; 95 at 18-21. As a result, on December 31, 2008, Respondent did not have at least 20% of its adjusted net worth per HUD's requirements in liquid assets. Tr. 66 at 1-3; 76-78; 80; 97 at 18; 102 at 3-6; RX 3.9, 3.12, 3.16, 5.4, 14.1-14.12. In fact, Respondent's cash assets as of December 31, 2008 totaled $301. RX 14.4, 14.7; Tr. 76-78. At hearing, Mr. Bednarski testified that while he was aware of the liquidity requirement necessary to maintain HUD/FHA approval in December 2008, he "just wasn't aware" at the time that he would have to complete a financial audit again for the latter months of 2008, as he had just submitted a financial statement (dated May 31, 2008) in applying for FHA approval a few months before. Tr. 94-95, 111 at 7-17.

On January 7, 2009, Mr. Bednarski accessed Respondent's "Institution Profile" on the FHA's online database, FHA Connection, wherein he was notified that Respondent's "Submission of Audited Financial Statement and Calculated Net Worth" were due in the "Lender Assessment System" by March 31, 2009.[5] RX 2.1. The page directs as follows: "Please click the 'Lender Assessment System' link to fill out the required forms." *Id.* On March 3, 2009, Mr. Bednarski sent an email to "Lass@hud.gov" inquiring whether Fidelity might be exempt from submitting another annual financial statement in late March, given that it had already supplied a statement dated May 31, 2008 representing data from the first months of 2008 as part of its application for Title II approval. RX 2.2. HUD answered in the negative on March 5, 2009, explaining that the company would only be able to skip filing another statement if its previous statement had been dated on or after "June 30, 2008." *Id.*; Tr. 95 at 10-18.

Thereafter, Mr. Bednarski hired an accountant, George Maitland, to audit Respondent's Balance Sheet, Statement of Income and other financial documents, and prepare the audited financial statement for the second half of 2008 needed for Respondent's "recertification with HUD as a Nonsupervised Loan Correspondent." RX 3.8; Tr. 75-78. Mr. Maitland's resulting

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[5] FHA Connection is "an interactive system on the Internet . . . that gives approved FHA lenders real-time access to FHA's Single Family origination and servicing systems," and from which mortgagees may apply and register for a secure HUD user ID in order to access LASS. Mortgagee Letter 98-13 (Feb. 27, 1998); LASS User Manual 1.1 at http://www.hud.gov/offices /hsg/sfh/lass/lass_usermanual.cfm ("LASS is a secure, web-based system that contains sensitive financial and lending information").

audited statement submitted to HUD, entitled "Respondent's Financial Statements As of December 31, 2008" indicated that Respondent's "Adjusted Net Worth per HUD Requirements" as of December 31, 2008 was $68,352, and its "Cash" totaled $301. RX 3.9, 3.12, 3.16, 5.4; Tr. 76-78, 80. These amounts "showed on the LASS system as a deficiency of $13,000" in liquidity, Mr. Maitland acknowledged during his testimony. Tr. 79 at 12-15; 80 at 19-22. However, in a letter accompanying the resultant audited financial statement dated March 24, 2009, Mr. Maitland remarked that "all initial steps required by FHA have been followed" and "no material deficiencies . . . relative to FHA lending requirements were noted." RX 3.1. Mr. Bednarski signed a letter dated March 25, 2009 addressed to Mr. Maitland, regarding the audit, that stated, "I am responsible for establishing and maintaining . . . effective internal control over compliance with HUD requirements . . . ." RX 3.4.

After viewing an auditor note left in the LASS system concerning the $13,000 liquidity deficiency, Mr. Maitland communicated the information to Mr. Bednarski. Tr. 80-81. Mr. Maitland testified that he and Mr. Bednarski then made a series of phone calls to HUD "in April and May" asking about any necessary corrective action to the deficiency. Tr. 81 at 13-20; 82 at 3-13. They were allegedly told to design a corrective action plan, which was, according to Mr. Maitland's testimony, "prepared . . . submitted . . . and completed" in July 2009 via upload to LASS. Tr. 66 at 7-11; 81 at 9-12.

By a Deficiency Notice dated July 27, 2009, Ivery W. Himes, Director of the FHA Lender Approval and Recertification Division, notified Fidelity that it had failed to submit to the agency an acceptable audited financial statement in connection with its recertification. RX 4.1-4.2; GX 2. Ms. Himes' letter warned Respondent that "[f]ailure to cure the deficiency . . . reflected in LASS within the next 30 days may result in this matter being referred to [the Board]" for possible administrative and/or monetary sanctions. RX 4.1-4.2; GX 2; Tr. 34-36.

As of July 31, 2009, Fidelity's "FirstChoice Business" checking account had a balance of $18,625, a sum in excess of the HUD cash liquidity requirements. RX 7.2-7.5, 9.5-9.7; Tr. 88 at 3-7. Through a series of deposits, Respondent had raised the account to such ending sum from a beginning cash balance on June 30, 2009 of approximately $4,278. RX 7.3.

A page printed from LASS dated August 6, 2009, entitled "Create Cure Decision," cites Respondent's "Total Current Assets" of $301 (as of December 31, 2008) as a deficiency of the FHA liquidity requirement, and describes Respondent's option to create a cure. RX 5.3, 5.4. On August 7, 2009, Mr. Maitland wrote an email to LASS, claiming that Respondent had spoken with HUD "technical people" and "came away more confused than ever." RX 6.1. A LASS representative responded to Mr. Maitland on August 11, 2009, recommending that Respondent follow cure procedures. RX 6.3. Mr. Maitland forwarded this message to Mr. Bednarski the same day, indicating that the "lack of acceptable financial statements may be [because] the cash requirement is not there." *Id.*

On August 28, 2009, a LASS representative attempted to contact Mr. Bednarski about the

cure documents required, but the email was not delivered until forwarded to Mr. Maitland and then to Mr. Bednarski on September 2, 2009. RX 6.5-6.7. On September 3, 2009, Mr. Bednarski received an email from "recert@hud.gov" advising that the deficiency of "Insufficient Unrestricted Liquid Assets" must be cured on LASS within 30 days, or Respondent's HUD/FHA approval may be withdrawn. RX 6.8, 6.9.

Respondent submitted to HUD a "Corrective Action Plan" on September 14, 2009, including a cover letter from Mr. Maitland similar to the one that had accompanied Respondent's previously-submitted 2008 financial statement submitted in March 2009. RX 7.1, 10.1; Tr. 70 at 16-21; 72 at 8-12; 96 at 11; 112-114. The submission also included a letter dated September 14, 2009, from Mr. Bednarski to HUD auditor Robert May, stating that Respondent's liquidity as of July 30, 2009, represented by more than $18,000 in the company bank account, exceeded the minimum liquidity required of $13,670. RX 7.2, 11.2. Mr. Bednarski added: "The company plan for monitoring liquidity is to place sufficient funds in a savings account so that by 12/312009 [sic] the 20% liquidity requirement monitoring will be a thing of the past and separate from the operating fund." *Id.*

HUD representative Robert Holland admitted in later correspondence that Respondent did send "a partial 'cure' to HUD on 9/16/09," adding that HUD responded to this submission in "a 9/30/09 email, sharing the errors [of the partial cure] and/or need for more information" and stating that "those were not sent to HUD as 'cure' in the online LASS system." RX 10.1. Mr. Holland explained in the correspondence that in the September submission, according to reviewer "MRWC" on October 6, 2009, certain pieces of information or documents were "missing" from the cure, namely: a schedule of findings, "signed IPA report" with specific required language, sufficiently detailed Corrective Action Plan, signed internal control report, copy of real estate loan assumption signed by all parties, title of vehicle transferred, and registration of vehicle showing company ownership. RX 10.1-10.2.

HUD issued a Notice of Violation dated October 27, 2009, to Respondent, citing "Insufficient Unrestricted Liquid Assets as required by HUD-FHA." RX 8.1-8.3; Tr. 37-38. Subsequently, Mr. Bednarksi mailed to the Mortgagee Review Board Docket Clerk on November 25, 2009 via Federal Express a bank statement, an updated "Financial Statement As of December 31, 2008" which admitted a $13,369 liquidity "non compliance at December 31, 2008," and other documents. RX 9.1-9.32; Tr. 66 at 12-22; 84 at 2-9; 112 at 18-20; 117 at 8-14

No correspondence took place between Mr. Bednarski and HUD representatives between November 2009 and February 16, 2010. Tr. 112 at 20-22.

Fidelity's November 28, 2009 to January 28, 2010 bank statements reflect a savings account balance just over $20,000, and a checking account balance between approximately $2000 to $6500. RX 11.3-11.10.

Mr. Maitland testified that he believes Respondent has been in full compliance with

FHA's liquidity requirement since November 2009. Tr. 117 at 8-14. Respondent's cash assets at the end of 2009 were $28,226. RX 14.4.

On February 17, 2010, HUD representative Robert Holland notified Respondent in an email that he had until noon that Friday, February 19, 2010, to send the corrections to Respondent's partial cure using the official cure process, "which is explained in Chapter 5.13 of the online LASS User Manual." RX 10.1, 10.2.

On February 18, 2010, Mr. Bednarski told Mr. Holland in an email that he could not complete the cure on LASS by February 19, 2010, and requested that a HUD representative call him. RX 10.3.

On the morning of February 19, 2010, Mr. Holland emailed Mr. Bednarski asking for any updated audited financial data before the close of business that day, after which an internal HUD report was to be submitted. RX 10.4.

Mr. Bednarski sent a letter dated February 20, 2010 to HUD auditor Robert May, stating that in response to the February 17, 2010 email from Mr. Holland, he had attached a copy of his September correspondence, which "will show that I complied . . . as of December 31, 2009 and again at January 31, 2010 by having a separate savings account with at least $20,000.00, thus correcting the $13,369.00 liquidity deficiency." RX 11.1. The bank statements that appear to be attached to Mr. Bednarski's February 20, 2010 letter reflect a balance of over $20,000 in a "FirstChoice Business" savings account with Bank of America in Respondent's name in statements ending December 30, 2009, and January 28, 2010. RX 11.3, 11.8.

On March 1, 2010, Mr. Bednarski emailed Mr. Holland, wherein he stated, "I have submitted cure in LASS. Please let me know if this is all I need to do." RX 10.4. Mr. Holland responded that same day by informing Mr. Bednarski that his role was to summarize Respondent's recertification status "at a point in time" and share that with the Mortgagee Review Board, and that this had been done. *Id.* Mr. Holland instructed Mr. Bednarski to monitor the audit's status on LASS. *Id.*

A Notice of Administrative Action dated April 16, 2010 was issued to Respondent, citing "Insufficient Unrestricted Liquid Assets as required by HUD/FHA." RX 13.5-13.7; GX 5. In a letter dated April 21, 2010, Respondent requested an "immediate appeal hearing," and Mr. Bednarski stated that Respondent "admits the Insufficient Unrestricted Liquid Assets at December 31, 2008," but argued that it had already corrected the deficiency. RX 13.3. Mr. Bednarski further alleged that in March 2009, LASS showed Respondent's application had been accepted, but as of April 21, 2010, the status showed "TERMINATED." *Id.* Mr. Bednarski argued that he "worked with [HUD's] auditors in good faith . . . and understood that once the plan was in place that the issue would be resolved." *Id.* Emphasizing that Respondent's "current business is predominately FHA loans," Mr. Bednarski requested Respondent's immediate reinstatement. RX 13.3-13.4.

Finally, in a April 26, 2010 letter (misdated April 26, *2009*), Mr. Bednarski reiterated to HUD that Respondent's corrective action plan was "put into place in late 2009" as a result of its "good faith" efforts to resolve the liquidity deficiency. RX 13.1. A financial statement dated April 24, 2010, representing Respondent's financial information from December 31, 2008 through December 31, 2009, shows that Respondent had at the end of 2009 cash assets of $28,226, which is at least 20% of its adjusted net worth per HUD requirements in liquid assets. Tr. 14.1-14.12.

Mr. Bednarski filed a letter on May 14, 2010, in which he outlined the "disconnect" between the Government and Respondent regarding the resolution of the liquidity deficiency. RX 15. Mr. Bednarski asserted in the letter that the corrective action plan put into place by Respondent "somehow . . . never made it properly into the LASS system," that the plan and "subsequent communications" were timely submitted both to LASS and directly to HUD auditors, and other documents that would cure or supplement any partial cure that Respondent had attempted, had been mailed to HUD and/or were entered into LASS, but were never accepted or received by HUD. *Id.*

IV. APPLICABLE LAW AND REGULATIONS

The Board is "empowered to initiate the issuance of 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). Mortgagee approval, including that given loan correspondents, may be suspended or withdrawn by the Board as provided in Part 25. 24 C.F.R. §§ 25.5(a), 202.3(d).

Violations of FHA requirements that provide grounds for suspension or withdrawal of approval include the following:

> **§ 25.6 Violations creating grounds for administrative action.**
>
> Any administrative action imposed under 12 U.S.C. 1708(c) shall be based upon one or more of the following violations:
>
> * * *
>
> (e) The failure of a nonsupervised mortgagee to submit the required annual audit report of its financial condition prepared in accordance with instructions issued by the Secretary within 90 days of the close of its fiscal year . . .;
>
> * * *
>
> (g) Failure to comply with any agreement, certification, undertaking, or condition of approval listed on, or applicable to, either a mortgagee's application for approval or an approved mortgagee's branch office notification;
>
> (h) Failure of an approved mortgagee to meet or maintain the applicable net worth,

liquidity or warehouse line of credit requirements of 24 CFR part 202 pertaining to net worth, liquid assets, and warehouse line of credit or other acceptable funding plan;

* * *

(j) Violation of the requirements of any contract or agreement with the Department, or violation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction;

* * *

(p) Business practices which do not conform to generally accepted practices of prudent mortgagees or which demonstrate irresponsibility;

* * *

(ff) Any other violation of Federal Housing Administration requirements that the Board or the Secretary determines to be so serious as to justify an administrative sanction.

24 C.F.R. § 25.6.

Regulations at Part 202 establish the minimum standards and requirements for participation in the Title II mortgage lending program. 24 C.F.R. Part 202. To gain initial approval to participate, and "to maintain [that] approval," a mortgagee "shall meet and continue to meet the general requirements of paragraphs (a)-(n)" of Section 202.5 (application fee payment, quality control plan implementation, etc.), *as well as* "the requirements for one of the eligible classes of lenders or mortgagees in §§ 202.6 through 202.10." 24 C.F.R. § 202.5.

The requirements for the class of "Loan correspondent lenders," set forth in section 202.8, include "maintain[ing] liquid assets consisting of cash or its equivalent acceptable to the Secretary in the amount of 20 percent of [] net worth, up to a maximum liquidity requirement of $ 100,000" and complying with the "financial reporting requirements in 24 CFR part 5, subpart H . . . ." 24 C.F.R. §§ 202.8(b)(3), (b)(4). Subpart H of Part 5 provides that "HUD-approved Title I and Title II nonsupervised lenders, nonsupervised mortgagees, and loan correspondents" must provide to HUD such financial information:

(1) Prepared in accordance with Generally Accepted Accounting Principles . . .;
(2) Submitted electronically to HUD through the internet . . .; and
(3) Submitted in such form and substance as prescribed by HUD.

24 C.F.R. § 5.801(b).[6]

Part 202 of the regulations clarifies the requirements for a correspondent's "Audit report."

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[6] The regulations emphasize the requirement of electronic transmission again: "Audited financial statements submitted by lenders with fiscal years ending on or after September 30, 2002, must be submitted electronically." 24 C.F.R. § 5.801(d)(3).

24 C.F.R. § 202.8(b)(3).[7] "Audit reports shall be based on audits performed by a certified public accountant," and shall include:

> (i) A financial statement in a form acceptable to the Secretary, including a balance sheet, statement of operations and retained earnings, a statement of cash flows, an analysis of the net worth adjusted to reflect only assets acceptable to the Secretary, and an analysis of escrow funds; and
>
> (ii) Such other financial information as the Secretary may require to determine the accuracy and validity of the audit report.

24 C.F.R. § 202.8(b)(3).

Similarly, Handbook 4060.1, Rev-2, Chapter 4, provides that nonsupervised loan correspondents must upload annual audited financial statements to LASS that show, among other things, that they have "maintained their required Liquidity for their program type." Handbook 4060.1, Rev-2, ¶ 4-5(B)(1). Paragraph 4-9 of the Handbook, entitled "Termination of FHA Mortgagee Approval," provided mortgagees which failed to submit acceptable recertification documents the opportunity to settle with HUD for $1,000 and "rectify the violation" before the Board was notified of the deficiency. Mortgagee Letter 2009-01 (Jan. 6, 2009); Handbook 4060.1, Rev-2, ¶ 4-9(C)(2). However, in 2009, HUD rescinded Paragraph 4-9, explaining in Mortgagee Letter 2009-01:

> The Department will no longer permit mortgagees to settle the matter prior to consideration by the Mortgagee Review Board. *The mortgagee may, however, cure the violation, which will be taken into account by the Mortgagee Review Board when it considers the matter.*

Mortgagee Letter 2009-01 (emphasis added).

Once the Board determines that a mortgagee has failed to meet FHA requirements, and at least thirty days prior to taking any action against the mortgagee on those grounds, the Board issues a written Notice of Violation in accordance with 24 C.F.R. § 25.7, informing the mortgagee of the specific violations alleged against it, and how to reply. The mortgagee may respond within thirty days after receiving the Notice, in accordance with 24 C.F.R. § 25.7, and the Board is tasked with considering a mortgagee's response. *R&G Mortgage Corp.*, HUDALJ 07-052-MR at 9, 2007 WL 4296673 (ALJ, Nov. 20, 2007); *see* 12 U.S.C. § 1708(c)(4)(A); 24

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[7] The version of Section 202.8 cited here was in effect at the time of Respondent's violation in 2009 through May 20, 2010, after which date revisions took effect that essentially terminated the loan correspondent approval process beginning 2011. Mortgagee Letter 2010-20 (Implementation of Final Rule FR 5356-F-02, "Federal Housing Administration: Continuation of FHA Reform–Strengthening Risk Management through Responsible FHA-Approved Lenders").

C.F.R. § 25.7. Only "[i]f the mortgagee fails to reply," may the Board determine the appropriate action under Section 1708(c) (letter of reprimand, probation, suspension, or withdrawal) "without considering any comments of the mortgagee." 12 U.S.C. § 1708(c)(4)(A).

At this point, the Board must consider whether an administrative action should be taken, and if so, which action:

> In determining which administrative action under 12 U.S.C. 1708(c), if any, should be taken, the Board will consider, among other factors, the seriousness and extent of the violations, the degree of mortgagee responsibility for the occurrences, and any other mitigating or aggravating facts.

24 C.F.R. § 25.8. Withdrawal actions carry special considerations:

> The Board may issue an order withdrawing a mortgagee if the Board has made a determination of a serious violation or repeated violations by the mortgagee. The Board shall determine the terms of such withdrawal, but the term shall be not less than 1 year. Where the Board has determined that the violation is egregious or willful, the withdrawal shall be permanent.

12 U.S.C. 1708(c)(3)(D); *see* 24 C.F.R. § 25.8. The Board may also determine the effective date of withdrawal:

> (i) If the Board determines that immediate action is in the public interest or in the best interests of the Department, then withdrawal shall be effective upon receipt of the Board's notice of withdrawal.
>
> (ii) If the Board does not determine that immediate action is necessary . . . then withdrawal shall be effective either:
>
> > (A) Upon the expiration of the 30-day period [after the Notice of Administrative Action is issued], if the mortgagee has not requested a hearing; or
> >
> > (B) Upon receipt of the [final decision], if the mortgagee requests a hearing.

24 C.F.R. § 25.5(e)(2)(i).

If, after these considerations, the Board decides to pursue a withdrawal action, it must issue a Notice of Administrative Action to the mortgagee, specifying the nature and duration of the action it intends to take, and the specific reasons for doing so. 12 U.S.C. § 1708(c)(4)(B); 24 C.F.R. § 25.9(b). The Board shall also inform the mortgagee of its right to a hearing and the manner and time in which to request one. 24 C.F.R. § 25.9(b).

Once the mortgagee receives the Notice of Administrative Action, it has thirty days to request a hearing before an Administrative Law Judge, who conducts a de novo hearing within thirty days of receiving the request, unless the mortgagee requests an extension of time. 24 C.F.R. § 1708(c)(4); 24 C.F.R. § 25.10. The hearing is conducted in accordance with the "applicable provisions" of 24 C.F.R. Part 26, in Washington, D.C., unless a party makes a showing of undue hardship or other good cause, for which the ALJ may hold the hearing in a different location. 24 C.F.R. § 25.10(c)(3).

The Government must prove Respondent's liability by a preponderance of the evidence in order to prevail, and Respondent must prove any affirmative defenses and/or mitigating factors by the same standard. 24 C.F.R. § 26.45(e).

V. THE GOVERNMENT'S ARGUMENTS

The Government argues that Respondent "failed to comply with a fundamental annual recertification requirement critical to HUD" which was a "serious" violation of FHA requirements warranting the Board's withdrawal of Respondent's approval for one year. G's Brief at 1, 3. The Government asserts that Respondent, already an FHA participant, "was aware" of the liquidity requirement, and "understood that he was breaking the rules, but thought he would not be caught." G's Brief at 1-2. The Government cites to *R&G Mortgage*, HUDALJ 07-052-MR, at 14, wherein it was concluded, after HUD's witnesses testified to the importance of having access to lenders' financial status, that "failure to submit acceptable audited financial statements is a very serious infraction." G's Brief at 5.

Citing a Mortgagee Letter, the Government argues that timely and accurate reporting of mortgagees' net worth and liquidity "are key to HUD's reliance on the information contained therein" to "determine if the mortgagee poses a risk to the Department, its programs, or the public." G's Brief at 2; Mortgagee Letter 2009-01. Without acceptable statements, HUD is left with "no assurance that the mortgagee is in good standing or is a responsible business partner," leaving HUD with "no other option than to withdraw that mortgagee to protect itself and the public." G's Brief at 4-5.

The Government points out that Respondent was required to upload to LASS an acceptable audited financial statement by March 31, 2009, showing that Respondent had 20% of its net worth in liquid assets during the part of 2008 when it held FHA approval, but Respondent's statement dated March 24, 2009 showed its liquid assets totaled only $301 on December 31, 2008, while its adjusted net worth was $68,352. RX 3.9, 3.12, 3.16, 5.4; Tr. 76-78, 80. The Government alleges that Respondent's failure to meet the 20% liquidity requirement violates 24 C.F.R. § 202.8(b)(4) and Handbook 4060.1, Rev-2, 4-5(B)(1).

Ms. Himes, the Director of HUD's Lender Approval and Recertification Division, and Mr. Lesesne, the Branch Chief of the Lender Recertification Branch, testified as to the serious

nature of Respondent's failure to submit acceptable statements. Ms. Himes affirmed that "usually" a mortgagee's net worth and liquidity threshold are material requirements of an acceptable audited financial statement. Tr. 15 at 16-19. Additionally, a lender's failure to submit evidence of sufficient liquidity in these statements, Ms. Himes confirmed, is a material violation of HUD requirements. Tr. 17 at 11-15. Ms. Himes further explained why the liquid assets requirement is an "important" part of the statements:

> Well, the liquid assets are important because in the business world, particularly today's economy, a company's liquidity amount allows for the company to have continued business operations; for example, to be able to pay their salaried employees, to be able to pay their monthly lease expense, to be able to pay utilities, business taxes, things of that nature in the event of an emergency. A company's liquid portion of its net worth could be the difference between a company staying afloat or actually having to close its doors in the event of financial hardship.

Tr. 16-17. Ms. Himes explained in more detail:

> . . . HUD, FHA, actually insures the mortgage that a lender originates. And if that mortgage goes into default, then the department has to use money out of its mortgage insurance funds to cover the loan. Sometimes the department has to go back to a lender and have it indemnify the department for a bad mortgage, and so it needs to know that a lender does have some assets or liquid assets that it can access. Sometimes it has to go back and penalize – you know, actually impose a financial penalty to a lender for violating an underwriting requirement. So it needs to know there are funds available.

Tr. 20 at 6-18.

After showing insufficient liquidity on its statement at the end of December 2008, Respondent could not have achieved compliance simply by proving that seven months later, in July 2009 it finally obtained sufficient liquidity, Ms. Himes asserted. Tr. 21 at 14-18. Because FHA lenders are required to maintain the required liquidity consistently, a six month window between insufficient liquidity and sufficient liquidity is "not acceptable" to HUD. Tr. 22 at 1-6. Ms. Himes instructed that the only "grace period" for a lender, or time in which to prove sufficient liquidity and achieve compliance, is the thirty days between the issuance of the Deficiency Notice and the Notice of Violation. Tr. 22-23. Ms. Himes also pointed out that the responsibility to submit financial statements falls on each lender "because the department has a contract of insurance with an FHA-approved lender." Tr. 17 at 5-10.

Mr. Lesesne, as Branch Chief of the Lender Recertification Branch, reviews audited financial statements. Tr. 34 at 1-6. He testified to Respondent's net worth of approximately $68,000 at the end of 2008, the portion required to be liquid ("about thirteen, six"), and Respondent's "purported liquid assets" of approximately $300. Tr. 37-38. Mr. Lesesne testified

that Respondent was not in compliance with the liquidity requirement when he reviewed Respondent's financial statements two or three weeks prior to the hearing, when he spoke with Respondent about one week prior to the hearing, and at the time of the hearing. Tr. 41 at 15-17; 59; 61.

Describing the auditing process, Mr. Lesesne explained that three accountants review the submitted financial statements sequentially, based on a hierarchy of experience and training. Tr. 42-45. The first-tier reviewer gives an opinion to a second reviewer on whether documentation is sufficient. Tr. 43-44. Then "the second level review is more experienced, looking more at the audited financial statements as well as the first reviewer's findings." Tr. 44 at 4-6. Comments made by the second-lever reviewer are accessible by lenders on LASS. Tr. 45-46. The third reviewer oversees "everything headed for final decision," and also makes comments accessible. Tr. 44 at 7-10. Once the documentation is deemed "accepted," all comments are archived. Tr. 47. A third-tier reviewer may contact the lender directly, through email or telephone contact, to provide instructions regarding the submissions to LASS, but he or she is not required to; "for the most part, it's LASS . . . that we're corresponding with," Mr. Lesesne explained. Tr. 47-49.

The two acceptable methods of submitting the required data into LASS are: 1) inputting numbers from paper financial statements into a formula on LASS, and 2) creating a PDF format of the documents and uploading them into LASS. Tr. 52 at 3-17. "Flags for identification," presumably of problems with the documents, "come up immediately." Tr. 53 at 2-5. Because, however, a liquidity deficiency may not be automatically flagged upon input, and the reviewers may not reach out to correspondents upon finding a deficiency; "it's incumbent upon them to review the LASS system on a pretty much ongoing basis" for comments on the status of their recertification. Tr. 54 at 1-8.

VI. RESPONDENT'S ARGUMENTS

Fidelity does not contest in this proceeding the Government's assertion that the company did not submit acceptable audited financial statements to LASS for the fiscal year 2008. In fact, both Mr. Bednarski and Mr. Maitland candidly conceded at the hearing that Respondent was not in compliance with the 20% liquidity requirement on December 31, 2008. Tr. 66; 102 at 3-6. Fidelity's president, Mr. Bednarski acknowledged: "I knew I showed no cash or liquid asset . . . . I apologize for it." Tr. 95 at 20-22. Mr. Maitland stated, "[Y]ou'll see the evidence that will basically show that the audited statements clearly state that there is a liquidity issue. . . . There is no absolutely no [sic] question whatsoever that Fidelity was deficient in liquidity as of 2008." Tr. 11 at 1-3; 66 at 1-3; *see also* Tr. 117 at 6-7. Such concessions are consistent with the March 2009 statements that Mr. Maitland prepared for Respondent which show that as of December 31, 2008, Respondent's net worth was $68,352, of which $301 was cash. RX 3.9, 3.12, 3.16, 5.4; Tr. 76-78, 80. This same data is restated in subsequent financial statements prepared by Mr. Maitland and submitted to HUD. RX 9.13, 9.17 (updated financial statement for period ending December 31, 2008, dated September 10, 2009); RX 14.4, 14.7, 14.11 (updated financial

statement for years ending December 31, 2008, and December 31, 2009, dated April 24, 2010).

Nevertheless, Fidelity contests the sanction the Government proposes for the violation and offers a series of reasons therefor. First, Respondent asserts that the liquidity deficiency resulted essentially from an innocent business judgment, and that had the company been aware of the need to report Fidelity's liquidity as of December 2008, he would have maintained sufficient liquidity. Such claim is based upon Mr. Bednarski's testimony:

> Had I known there was a required report I would not have paid all the bills before year end. Fidelity Homes and Loan is a subchapter S corporation that filed income tax reports on a cash basis therefore to minimize federal income tax paid all its bills.

R's Brief at 2; *see* Tr. 95 at 19-21.

Second, Respondent asserts that upon becoming aware of the error of the action, Mr. Bednarski personally and actively undertook to correct the problem, concluding "I just knew there's got to be a way I can correct that," adding "that was the first time I ever had a contact with the [LASS] system," and had "never been required to do anything of this type of recording," and "I gave George [Maitland] all of the other things." Tr. 95-96. Thereafter, consistent with the testimony of Mr. Maitland, Mr. Bednarski argues he made a "concerted good faith" effort to correct, or cure, the deficiency on the LASS system, but was hindered by a faulty government computer system. Tr. 10, 99-100. Specifically, he explained he uploaded to LASS a corrective action plan "in July [2009]" consisting of "a written plan with bank statements as requested by HUD." Tr. 66 at 9-12. Furthermore, Mr. Maitland stated, "we did it again in November [2009] where we had segregated money in a savings account, $20,000, well in excess of the requirements of HUD." Tr. 66 at 12-15.

Mr. Bednarski further testified that after getting the Deficiency notice in the "summer of 2009," he was told by HUD to prepare certain items, which he alleges were "submitted in September." Tr. 96 at 10-11. Specifically, Mr. Bednarski and Mr. Maitland claim they were asked for and/or supplied to HUD bank statements, a sales contract, information about real property owned by Respondent, a statement of equity, and a corrective action plan. Tr. 73-74; 114 at 9-21. "All these documents had been inputted into the LASS system by me but it appears that HUD does not have these documents." RX 15 at 3. Mr. Maitland added that "the LASS system would not take [the September 10, 2009 'Financial Statements As of December 31, 2008'] because the company had been decertified with no access." Tr. 71 at 20-22. Mr. Bednarski described the frustration he experienced attempting to cure though the LASS system:

> You send it over there. I'm not in control. I don't know if that's overwritten previous things, push them out through the system, or many times we open the system and they still look like the original one. I don't know.

Tr. 99-100. After he got another notice from HUD in October, he stated:

> I go to the review Board with the same tables submitted in September. From November to February, end of February, I don't have nothing from HUD. All of a sudden, I get an email in February that it's still no good. They need this and this. I prepare everything on March the 5th. It's something I need to enter into the LASS, but seems like – it seems like I'm dealing with a black hole. I put something in. It disappear. Or I put in the wrong things and nobody corrects me.

Tr. 96 at 11-22. Thus, in sum, Respondent suggests any delay in cure is not attributable to it:

> It is my contention that either HUD did not receive my corrective action plan as submitted through the LASS system and made it decision to withdraw Fidelity Homes and Loan on that assumed fact or that they have some other non disclosed motivation to force the company out as a Non-supervised Loan Correspondent FHA lender.

R's Brief at 2.

As a third argument, Fidelity states that it has cured the deficiency and is now in compliance:

> HUD is bound to follow its own policy and reinstate Fidelity Homes and Loan as an approved FHA lender as Fidelity did in fact comply with the request to submit a corrective action plan and has documented completion of that corrective action plan.

R's Brief at 2. Such argument is consistent with Mr. Maitland's testimony at the May 2010 hearing that "Fidelity Loans in all good conscience, good faith, complied with [the plan] and believes it is in full compliance with the liquidity issue as of today and has been since November of last year." Tr. 117 at 9-13. The audited financial statement dated April 24, 2010, and representing Respondent's financial information from December 31, 2008, through December 31, 2009, demonstrates Respondent's alleged liquidity compliance, Respondent asserts. RX 13.1, 14.1-14.12. The statement shows Respondent's cash at the end of 2008 to be $301, but at the end of 2009 to be $28,226, when its adjusted net worth "per HUD Requirements" was $88,650. RX 14.7, 14.11. Similarly, in a letter misdated April 26, "2009" (which should be 2010) addressed to HUD, Mr. Bednarski restated that Respondent's corrective action plan was "put into place in late 2009" as a result of its "good faith" efforts to resolve the liquidity deficiency. RX 13.1.

Finally, at hearing Mr. Bednarski expressed the hardship that caused him to apply for HUD/FHA approval, and emphasized the negative consequences of the withdrawal of the approval. He testified that in 2008, "[a]fter a lot of time, effort, and money, in order to stay in business, I put everything on one side and I fought for the FHA approval because without FHA, the business would not survive." Tr. 94-95. Speaking generally about the market, Mr. Bednarski testified that "[w]ith all the changes, all the other, you know, lending avenues disappearing, we

all know that FHA became from 2 to 4 percent all the way to totaling 40 percent of the business, of the total business." Tr. 95 at 2-6. Today's housing market "is not easy on mortgage brokers," he explained. Tr. 110 at 7. For Respondent in particular, Mr. Bednarski continued, in 2009 and in the beginning of 2010, approximately 30-40% of the housing loans Respondent originated were FHA loans. Tr. 107 at 6-17. Furthermore, as he alleged, the four or five loan officers currently working with Respondent "who produce" may leave if Respondent's approval is not reinstated. Tr. 108 at 18-21. In May 2010, ("this last month"), Mr. Bednarski explains, "not having the approval already make [sic] a tremendous impasse [sic] on my business, not to mention myself." Tr. 100 at 5-8.

VII. DISCUSSION

The hearing in this matter was conducted de novo in accordance with 24 C.F.R. § 25.10(b). "As such, the Hearing Officer is not bound by the decision of the Board." *Accuracy Nat'l Mortgage, Inc.*, Docket No. 78-2-MR, 1978 HUD BCA LEXIS 51, at *10 (Decision of Hearing Officer ("HO"), May 19, 1978); *see also, Mechanics Nat'l Bank v. U.S. Dep't of Housing and Urban Dev.*, 522 F. Supp. 25, at *30 (D.D.C. 1981) (noting HUD's wide discretion to administer the FHA lending programs and finding there is no "requirement of uniform sanctions for similar offenses"). Instead, applying the same laws and regulations that the Board considered to the facts presented at the hearing, this Tribunal may make an independent determination as to the appropriate outcome.

In prior withdrawal cases, the Board's determinations have been affirmed, modified, and reversed. *See Flagship Mortgage Services, Inc.*, HUDALJ 90-154-MR, 1991 WL 11668525 (ALJ, Jan. 16, 1991) (affirming the Board's one year withdrawal of FHA-insured loan originator's approval); *Puller Mortgage Assoc., Inc.*, HUDALJ 89-112-MR (ALJ, Oct. 17, 1990) (affirming the Board's indefinite withdrawal); *PFG Mortgage Inc. & Potter*, HUDBCA Nos. 92-G-7577-MR6, 92-G-7598-D58, 1992 WL 308270 (Decision of Administrative Judge ("AJ"), Oct. 9, 1992) (withdrawing the mortgagee's approval for approximately three years, even though the Board had imposed a six year withdrawal); *Horizon Savings Assoc.*, HUDBCA No. 91-5946-MR12, 1992 HUD BCA LEXIS 8 (AJ, Sept. 1, 1992) (shortening the Board-imposed three-year withdrawal to eighteen-months); *R&G Mortgage*, HUDALJ 07-052-MR (rescinding the Board's imposition of a withdrawal); *Zarrilli & Mark Twain Bank*, HUDBCA Nos. 89-4509-D47, 90-5242-M5, 1990 HUD BCA LEXIS 11 (AJ, Nov. 28, 1990) (terminating the Board's indefinite withdrawal, and restoring mortgagee's approval); *Stratford Mortgage Corp.*, HUDBCA No. 92-G-7615-MR18, 1994 HUD BCA LEXIS 5 (AJ, June 1, 1994) (reversing the Board's three-year withdrawal); *see also Accuracy*, at *12 (withdrawing mortgagee's approval *not* for a specified period of time, but "until it is found to be in compliance"). Accordingly, this Tribunal is not limited to making a determination either affirming or reversing the Board's determination.

In determining the appropriate outcome, "the hearing officer is required to consider the same regulatory requirements which the Board was bound to consider in the first instance," and

"shall issue an initial decision based only on the record." *Puller Mortgage*, HUDALJ 89-112-MR, at 8; *R&G Mortgage*, HUDALJ 07-052-MR, at 13; *Stratford*, 1994 HUD BCA LEXIS 5, at *38; 24 C.F.R. § 26.50(a).

A. Respondent's Liability

Respondent, as represented by Mr. Bednarski, admits that it failed to consistently maintain 20% of its net worth in liquid assets for Fiscal Year 2008. RX 3.1-3.16; Tr. 95 at 21-22, 97 at 18, 102 at 5-6. As such, there is no dispute that Respondent failed to comply with the requirement of 24 C.F.R. § 202.8(b)(4) that it "maintain liquid assets consisting of cash or its equivalent acceptable to the Secretary in the amount of 20 percent of its net worth, up to a maximum liquidity requirement of $100,000." *See also,* Handbook 4060.1, Rev-2, ¶ 4-5(B)(1). Therefore, administrative action under 12 U.S.C. § 1708(c) is appropriate under 24 C.F.R. § 25.6(h) for Respondent's "Failure . . . to meet or maintain the applicable net worth, liquidity or warehouse line of credit requirements of 24 CFR part 202 . . . ."

It is noted, however, that the Notice of Administrative Action dated April 16, 2010, does not specifically cite to 24 C.F.R. § 202.8(b)(4) or 24 C.F.R. § 25.6(h). The Notice alleges that --

> . . . the Board voted to immediately withdraw the Mortgagee's HUD/FHA approval based upon the following violations of HUD/FHA recertification requirements:
>
> Failure to submit the following required item(s) in a timely and appropriate manner:
>
> > Audited Financial Statements: The following deficiencies were found in the audited financial statement . . . .
>
> 1. Insufficient Unrestricted Liquid Assets as required by HUD-FHA.
>
> The Mortgagee's actions are in violation of the Department's regulations at 24 CFR Part 202 and the requirements cited above. These violations are grounds for the withdrawal of the Mortgagee's HUD/FHA approval pursuant to 24 CFR Sections 25.6(e), (g), (j), (p), and (ff).

GX 5. Nevertheless, the omission of a reference to the pertinent regulatory provisions in the Notice of Administrative Action is not fatal to a finding of liability. *Northrop v. Hoffman of Simsbury, Inc.,* 134 F.3d 41, 45-46 (2d Cir. 1997)(plaintiff's failure to cite proper statute in complaint did not affect merits of claim or preclude court from considering that statute as potential basis for liability, as Federal Rule of Civil Procedure 8 only requires statement of claim, not legal theory; factual allegations are what matters); *Samuel T. Isaac & Assoc., Inc. and Isaac*, HUDBCA Nos. 80-452-M2, 80-485-D29, 1983 HUD BCA LEXIS 10, at *57 n. 3 (HO, Nov. 10, 1983)(mortgagee's approval withdrawn although HUD failed to cite specific subsections of 24

C.F.R. § 24.5 as grounds for withdrawal of approval, where respondents were not prejudiced); *see also, Brandon v. Holt*, 469 U.S. 464, 471 (1985)(court should decide issues without formally requiring amendment of a complaint where allegations plainly identify a claim); *Hildebrand v. Honeywell*, 622 F.2d 179, 181 (5th Cir. 1980)(it is well settled that where a complaint fails to cite the statute conferring jurisdiction, the omission will not defeat jurisdiction if the facts alleged in the complaint satisfy the jurisdictional requirements of the statute). Both the Notice of Administrative Action and the Notice of Violation, dated October 27, clearly allege that Respondent had insufficient liquid assets as required by HUD regulations. GX 4, 5. Furthermore, there is no claim or other indication that Respondent was prejudiced by the failure of the Government to cite to 24 C.F.R. §§ 202.8(b)(4) and 25.6(h) in the Notice of Administrative Action.

In addition, Section 25.6(g) provides grounds for a sanction when there is a "[f]ailure to comply with any agreement, certification, undertaking, or condition of approval listed on, or applicable to, either a mortgagee's application for approval or an approved mortgagee's branch office notification." 24 C.F.R. § 25.6(g). The Origination Approval Agreement between FHA and Respondent (the letter from FHA dated October 23, 2008), granting approval to Respondent to originate FHA-insured loans, qualifies as an "agreement . . . applicable to" Respondent's application for approval. RX 1.1. It notified Respondent that the letter bound Respondent to the requirements listed within it, including those it later admittedly violated in Part 202 and the Handbook. *Id.*; *see, Samuel T. Isaac & Assoc., Inc. and Isaac*, HUDBCA Nos. 80-452-M2, 80-485-D29, 1983 HUD BCA LEXIS 10, at *56-57 (HO, Nov. 10, 1983) (holding that failure to "conform to HUD's regulations and other requirements as a condition for HUD's approval . . . provides ample grounds for withdrawal"). Section 25.6(j) also provides grounds for a sanction for "[v]iolation of the requirements of any contract or agreement with the Department, or violation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction." 24 C.F.R. § 25.6(j). Respondent's liquidity deficiency is a violation of those conditions of lending approval and regulatory and guidance materials referred to in Section 25.6(j), specifically, Part 202 and the Handbook. As the court stated in *Mechanics National Bank and Mechanics National Mortgage Corp.*, "[t]he relationship between [mortgagees] and HUD/FHA is contractual." *Mechanics Nat'l Mortgage*, Docket No. 77-5-MR, 1979 HUD BCA LEXIS 9, at *20.

Fidelity's only argument specifically directed to its liability for the violation, rather than in mitigation of the penalty therefor, is Mr. Bednarski's assertion of "innocent mistake," that he depleted the company's cash in December 2008 in order to decrease his tax liability and not intending to cause the company to fall below the liquidity threshold.[8] However, the record shows

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[8] Mr. Bednarski testified that he established Fidelity in 1998 "for tax purposes," "because I have 1099 incomes [sic]" and that it is a Subchapter S corporation. Tr. 103, 95. A corporation organized under Subchapter S of the tax code does not pay any federal income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. The (continued...)

the depletion was no innocent accounting error, quickly corrected. Mr. Bednarski admitted at hearing that he was aware of the liquidity requirement to maintain his approved status as a correspondent with HUD at the time he depleted the company's bank account. Tr. 111 at 7-17. Nevertheless, he stated that he went ahead and depleted the bank account *because* he "wasn't aware" that he would have to file a statement reporting the amount of the company's liquid assets as of the end of the year to HUD. *Id.* Moreover, the evidence of record suggests that Fidelity thereafter did not come back into compliance with the liquidity requirement until July of 2009, and thus remained out of compliance for some six months. *See*, RX 7.3 (Bank Statement evidencing balance as of June 30, 2009 of approximately $4,200 and ending balance as of July 30, 2009 of $18,825). As such, the record does not support Fidelity's claim of innocent mistake, but rather is suggestive of a knowing violation, laced with an intent to conceal knowledge of the same from HUD, by a company indifferent to, or incapable of, meeting its liquidity requirement. As such, it is found that Respondent's proffered explanation for the violation provides no legal defense thereto. *See, Accuracy Nat'l Mortgage, Inc.*, Docket No. 78-2-MR, 1978 HUD BCA LEXIS 51, at * 3, 9-12 (HO, May 19, 1978)(mortgagee that failed to maintain required net worth had its approval withdrawn; claim of failure to maintain the required net worth due to "extenuating circumstances" of an additional $3,000 cost to have CPA comply with the reporting requirement, and of an effort to "hide publicly some of the assets from underworld elements . . . because of alleged illegal influences in the California mortgage business," provided no legal excuse for non-compliance); *Isaac*, 1983 HUD BCA LEXIS 10, at *62 (approved correspondents have a duty to avoid "placing themselves in a position where their own interests might conflict" with those with whom they share a fiduciary relationship within the FHA's mortgage insurance program.).

Mr. Bednarski also suggests in Respondent's Brief that the Government may have had some "non disclosed motivation to force the company out as a Non-supervised Loan Correspondent FHA lender." R's Brief at 2. Nowhere in the record is this "selective enforcement" defense addressed or supported, and accordingly it is rejected.

B. Penalty Determination

1. Seriousness of Violation

When "a basis for an administrative action against a mortgagee exists, the Board shall take one of the following administrative actions" – issuing a letter of reprimand, imposing probation, or imposing suspension. 12 U.S.C. § 1708(c)(3). The Board may only impose a withdrawal of a mortgagee's FHA approval "if the Board has made a determination of a *serious*

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[8](...continued)
shareholders then report the income or loss on their own individual income tax returns. 31 U.S.C. §§ 1361-1379. Thus, paying corporate expenses by the end of December would reduce the income Mr. Bednarski as a shareholder would have to report on his own tax return for that year. Tr. 103 at 10-17.

violation or repeated violations by the mortgagee." 12 U.S.C. § 1708(c)(3)(D)(emphasis added).

Testimony at the hearing described in detail the important reasons for requiring loan correspondents to consistently maintain 20% of its net worth in liquid assets, and importantly, for HUD to have the information available in a timely manner in order to determine whether they do maintain this liquidity. As Ms. Himes explained, "[a] company's liquid portion of its net worth could be the difference between a company staying afloat or actually having to close its doors in the event of financial hardship." Tr. 16-17. Because FHA insures the loans Respondent originates, if any of those mortgages go into default, "then the department has to use money out of its mortgage insurance funds to cover the loan," and "it *needs to know* there are funds available." Tr. 20 at 6-18 (emphasis added).

Indeed, it has been held that the "failure to submit acceptable audited financial statements is a very serious infraction," and that "[i]f a lender is financially unstable, engaging in risky behavior, or any number of financial misadventures, it could not only endanger the FHA fund and HUD's program, but the low-medium housing market as a whole." *R&G Mortgage*, HUDALJ 07-052-MR, at 14. As such, under the circumstances of this case, it is concluded that the Board was justified in determining that Respondent committed a "serious" violation of FHA requirements, warranting its consideration of the administrative sanction of withdrawal under 12 U.S.C. § 1708(c)(3)(D).

The Rules also provide that "[w]here the Board is considering a withdrawal action, the Board will also consider whether the violations were egregious or willful, in order to determine whether a *permanent withdrawal* is mandated by 12 U.S.C. 1708(c)." 24 C.F.R. § 25.8 (italics added). In that the Board has not requested "permanent withdrawal" in this case a finding with regard to such factors is not required. However, it is noted that there is evidence of record which would support such a finding if one was required in that the record shows that Fidelity willfully, *i.e.* knowingly and voluntarily, caused its assets to fall below the requisite liquidity threshold and the violation was "egregious" in the sense that it was done with the intent to hide such violation from HUD.

2. <u>Extent of the Violation</u>

With regard to determining the appropriate penalty for a violation in any case, the applicable regulation provides that:

> the Board will consider, among other factors, the seriousness and extent of the violations, the degree of mortgagee responsibility for the occurrences, and any other mitigating or aggravating facts.

24 C.F.R. § 25.8. The penalty factor of seriousness of the violation was discussed above, and the remaining factors are each discussed in turn below.

As to extent, it is observed that although Respondent timely submitted a comprehensive financial statement to HUD with only one figure deficient, having only $301 in liquid assets, when $13,000 more was required, is a deficiency the extent of which cannot be said to be minimal. Instead of 20% or more of net worth in liquid assets, Respondent had less than 1% of its assets in cash. If Respondent could not maintain 20% of its net worth in cash, and the 30-40% of its customers participating in the FHA program begin to default, or if one of Respondent's employees does not follow origination procedures and exposes Respondent to liability, then FHA and its insurance fund are likewise exposed.

Additionally, the evidence of record suggests that the insufficient liquidity was not a "temporary setback," that will not recur. *See Puller Mortgage*, HUDALJ 89-112-MR, slip op. at 8. Rather, the evidence suggests that for a significant period of time Respondent was unable or unwilling to maintain the requisite liquidity. Specifically, Respondent presented copies of its bank account statements for June 30 to July 30, 2009 and November 28, 2009 to January 28, 2010 to show that its liquidity exceeded the 20% minimum. RX 7.2-7.5, 9.5-9.7, 11.3-11.10. However, it conspicuously presented no statements for January - June 2009, the six months immediately following the occurrence of the deficiency. Further, the June-July statement shows an opening balance of approximately $4,200 in the checking account and $99 in savings, and a minimum balance over the month of $1287, indicating that Respondent was well below the liquidity threshold at various times in June 2009. Moreover, while the bank statements for November 28, 2009 to January 28, 2010 show a savings account containing just over $20,000, and a checking account with a balance between approximately $2000 to $6500, such sums are not so large as to reassure this Tribunal that the company is not likely to ever again fall below the liquidity threshold. RX 7.2-7.5, 9.5-9.7, 11.3-11.10. It is reasonable for HUD to decide not to continue a partnership with a mortgagee whose continued financial health is a matter of "speculation." *Puller Mortgage*, slip op. at 8. Thus, the extent of the violation supports the imposition of the sanction of withdrawal.

3. Degree of Mortgagee Responsibility

The letter granting Respondent approval to participate in the FHA-lending program as a loan correspondent stated clearly the ramifications of such participation:

> This letter also constitutes an Origination Approval Agreement (OAA) authorizing your institution to originate FHA insured single family mortgages in your area approved for business.
>
> * * *
>
> Origination of any mortgage loans pursuant to this agreement constitutes your acknowledgment that your authority to originate single family mortgage loans insured by FHA is subject to compliance with all applicable laws and regulations, both existing and amended.

RX 1.1. The FHA-insured mortgage lending program benefits mortgagees and borrowers in a certain part of the housing market – the part that has grown more popular as private financing has receded in the recent economic environment. The OAA outlined the location of these standards and directed Fidelity to abide by them or lose approval. From the very beginning of Respondent's participation in the FHA lending program, Mr. Bednarski was made aware of the accompanying responsibilities. He admitted to receiving the OAA, which explicitly outlines Respondent's obligation to follow FHA requirements and to renew as directed. RX 1.1. He admitted "[y]es, yes, yes," when asked at the hearing whether he was aware, at the time of Respondent's application, of the liquidity requirement that would have to be maintained. Tr. 111 at 7-10. Mr. Bednarski testified that he withdrew money from the company bank account in December 2009 to pay bills, knowing he would then "show[] no cash or liquid asset [sic]." Tr. 95 at 19-22. In addition, he confirmed that he personally undertook responsibility for inputting data into LASS in response to the Notice of Deficiency. Tr. 111 at 18-22. He testified, "Anything I can do myself . . . . If I don't have to pay nobody, the business saves and maybe I can go forward." Tr. 112 at 1-4. Further, Mr. Bednarski signed a statement dated March 25, 2009, that accompanied the March 2009 Financial Statement reflecting insufficient liquidity, which read:

> With respect to HUD programs; . . . I am responsible for establishing and maintaining, and have established and maintained, effective internal control over compliance with HUD requirements that provide reasonable assurance that we are managing HUD programs in compliance with laws [and] regulations . . . .

RX 3.4. Such evidence all points to Fidelity, the "mortgagee," being fully and solely responsible for the violation.

Moreover, it is observed that the degree of Fidelity's responsibility for the violation is not diminished by the involvement and activities of Mr. Maitland, who described himself as an "independent auditor." Tr. 91 at 2-3. First, Mr. Maitland's involvement began only after the violation occurred. Tr. 75. Second, he had no particular expertise or experience with HUD authorized lenders' financial statements, which may explain why he failed to note the company's insufficient liquidity as a "material deficiency," in his March 27, 2009 letter accompanying the audited statement. Tr. 75-76; RX 3.1. Third, he expressly stated in his audited statement that his responsibilities in regard thereto were limited: "This financial statement is the responsibility of the Corporation's management. Our responsibility is to express and [sic] opinion on this financial statement based on our audit." RX 1.4. Fourth, it is noted that Mr. Maitland's role with regard to cure was also limited in that he did not input into the LASS system Respondent's deed, original note for the property or the other documents requested. Tr. 89 at 2-21.

In addition, it is noted that the degree of Respondent's responsibility for the violation is not reduced by LASS' alleged operating problems. At hearing, Mr. Bednarski repeatedly expressed frustration at LASS describing it as "a remarkable black hole" "I put something in It disappear. [sic] Or I put in the wrong things and nobody corrects me." Tr. 99 at 18; 96 at 20-22.

He testified, "I'm not in control," and "completely confused and very tired." Tr. 99 at 19; 98 at 14-15. It is observed, however, that Mr. Bednarski's complaints in this regard are not related to the occurrence of the violation, but go instead to the problems involving HUD accepting its attempt at cure. Tr. 98 at 12-14.

4. Good Faith Efforts to Cure

HUD allows that "[t]he mortgagee may . . . cure the violation, which will be taken into account by the Mortgagee Review Board when it considers the matter." Mortgagee Letter 2009-01. Therefore, this Tribunal will examine Respondent's alleged "good faith" efforts to cure the violation, to determine if any mitigation of the sanction on this basis is appropriate. RX 13.1.

Almost three months after Mr. Bednarski discovered that an audited financial statement was due on LASS by March 31, 2009, Mr. Maitland emailed a LASS representative to inquire whether Respondent may be exempt from filing a statement because it had submitted one in 2008 to process its application for approval. RX 2.2. Two days later, Mr. Maitland was informed that Respondent did indeed need to file a statement by the end of March. *Id.* After Respondent filed the statement in March, LASS showed a liquidity "deficiency of $13,000." Tr. 79 at 12-15; 80 at 19-22. Then, in April and/or May, Mr. Maitland testified, he and Mr. Bednarski called HUD to try and correct such deficiency. Tr. 81 at 13-20; 82 at 3-13.

However, not until July of 2009 did Respondent allegedly attempted to submit documents to LASS to "cure" the liquidity deficiency, which is several months after Mr. Maitland and Mr. Bednarski discovered the deficiency. Tr. 66 at 7-11; 81 at 9-12. Thereafter, Respondent received the Government's Deficiency Notice, which provided another window of thirty days within which Respondent could complete a cure. RX 4.1. As Ms. Himes confirmed, this was a kind of "grace period" before the Notice of Deficiency would be issued, where the Respondent could cure the violation without a determination having been made by the Board to take administrative action. Tr. 22-23; RX 4.1.

Again, LASS guided Respondent how to cure the deficiency on a print out from Respondent's page dated August 6, 2009. RX 5.3, 5.4. Yet still, Mr. Maitland emailed a LASS representative claiming he was "more confused than ever." RX 6.1. On August 11, 2009, more than four months after Respondent uploaded its statement to LASS for recertification, Mr. Maitland wrote an email to Mr. Bednarski suggesting that the deficiency "*may be* [because] the cash requirement is not there." RX 6.3 (italics added). Then, in late August and early September, HUD emailed Mr. Bednarski stating that the deficiency "must" be cured on LASS within thirty days, or withdrawal may be imposed. RX. 6.8, 6.9. This was the second thirty-day cure window offered to Respondent.

Respondent's "'partial' cure" in September 2009 failed, the Notice of Violation was issued, and Mr. Bednarski attempted to submit cure documents one last time via Federal Express

on November 25, 2009, despite being repeatedly informed that any data must be uploaded online only. RX 10.1. Months later, on February 17, 2010, Mr. Holland notified Mr. Bednarski that he should upload any additional cure materials by the end of that week before an internal report was compiled and submitted to the Board. RX 10.1-10.4. By this date, February 19, 2010, Respondent had not yet recertified as an approved loan correspondent for 2009, yet its approval was not yet withdrawn, and presumably was originating loans while not in compliance for several months. Later, Mr. Bednarski tried to explain to HUD that it did have sufficient liquidity on December 31, 2009, and therefore, had "corrected the deficiency." RX 13.3.

While there is evidence that Mr. Bednarski and Mr. Maitland did communicate many times with HUD regarding the liquidity deficiency, and did submit some documents to LASS in regard thereto, the evidence does not demonstrate a good faith and sincere attempt to timely correct the deficiency. *See, Heritage Mortgage Co.*, Docket No. 92-284-MR, 1993 HUD BCA LEXIS 15, at *30 (Sept. 2, 1993)("the explanations and excuses set forth in [Respondent's] letters, no matter how well-meaning, [are] not exculpatory"). Mr. Bednarski knew the liquidity requirement from the date of its application for HUD/FHA approval, or had reason to know through its Origination Approval Agreement and the many regulations and Handbook guidance governing approved loan correspondents' recertification. He went ahead and caused the liquidity violation in December 2008 and it appears from the record did not effect an actual "cure," *i.e.* cause the company to once again have sufficient liquid assets until July 2009, six months later. Mere correspondence about the deficiency and the cure procedure in the interim, combined with submission of some of the documents and information requested by HUD, months after they were required, cannot mitigate Respondent's violation.

At hearing, Mr. Maitland argued on behalf of Respondent that the "company had been decertified with no access" to LASS as of September 10, 2009, when Respondent allegedly attempted to upload cure documents. Tr. 71 at 20-22. However, this contention is not supported by any other evidence in the record. Moreover, even if Respondent was prevented from submitting materials on LASS, and could not have otherwise successfully uploaded a complete cure at that time, an acceptable statement was already more than five months overdue. In *Isaac*, the respondent mortgagee's lending approval was permanently withdrawn for multiple violations of HUD requirements. Rejecting the mortgagee's defense that "upon notice" of deficiencies from an audit report, it "corrected such deviations," the ALJ pointed out that it "did not correct most of the deficiencies until five to nine months after" such notice. *Isaac*, 1983 HUD BCA LEXIS 10, at *63-64. Like in *Isaac*, the record here does not support a finding that Respondent's deficiency was "expeditiously remedied" and therefore a mitigating circumstance, when five months had passed before Respondent's attempt to upload an acceptable statement and cure. *Id.* at *64. Indeed, Ms. Himes specifically rejected the suggestion that even if Respondent could have shown sufficient liquidity in July 2009, it would have "cured" the statement deficiency. Tr. 22 at 1-6.

In addition, if Mr. Maitland and Mr. Bednarski were "confused" after speaking with HUD representatives, the agency's lengthy, detailed resources on HUD's website, in the form of

Handbooks and the LASS User Manual, the detailed emails from agency representatives and the LASS/FHA Connection step-by-step directions, were available to help clarify the procedures. Indeed, the burden is on mortgagees to learn the requirements of program approval for which they apply and from which they benefit. *See Flagship Mortgage* ("[t]he burden was on Respondent to devise an acceptable plan in writing," when loan originator failed to develop a Quality Control Plan six months after HUD reviewers complained to the mortgagee that it did not have one). It is concluded that Respondent's efforts to cure the liquidity deficiency in its March 2009 audited financial statement do not mitigate the sanction in this case.

5. Elimination of FHA Loan Correspondent Approval

It is noted that HUD has issued Final Rule FR 5356-F-02, "Federal Housing Administration: Continuation of FHA Reform – Strengthening Risk Management through Responsible FHA-Approved Lenders." 75 Fed. Reg. 20718 (April 20, 2010); correction at 75 Fed. Reg. 23582 (May 4, 2010); *see* Mortgagee Letter 2010-20. The implications are outlined in Mortgagee Letter 2010-20:

> This rule increased the net worth requirements for FHA-approved mortgagees, eliminated FHA approval of loan correspondents . . . and made minor modifications to other aspects of FHA's regulations governing lender activities. Changes to applicable HUD Handbooks are forthcoming.
>
> * * *
>
> **Elimination of Loan Correspondent Approval for Single Family Programs**
>
> Loan Correspondent Approval Expiration
>
> Loan correspondents approved and in good standing will be permitted to retain their approval through December 31, 2010.
>
> * * *
>
> After December 31, 2010, loan correspondents . . . will be permitted to continue participation in FHA programs by establishing a sponsorship relationship with an FHA-approved mortgagee, as explained in the rule. Effective January 1, 2011, formerly approved loan correspondents will no longer have access to non-public FHA systems, including FHA Connection.
>
> * * *
>
> Effective **May 20, 2010**, FHA no longer accepts any new applications for loan correspondent approval.

Mortgagee Letter 2010-20 at 1, 3. In the publication of the final rule, the agency explained that these changes "are designed to strengthen FHA by improving its management of risk." 75 FR at 20718. Loan correspondents will "continue to have the opportunity to participate in FHA programs as third-party originators (TPOs) through sponsorship by FHA-approved mortgagees . .

or through application to be approved as an FHA-approved mortgagee." *Id.*

> In eliminating FHA's approval of loan correspondents, FHA-approved mortgagees assume full responsibility to ensure that a sponsored loan correspondent adheres to FHA's loan origination and processing requirements.
>
> * * *
>
> HUD advised that it is the mortgage lender with the greatest control over the mortgage loan that should be subject to FHA's rigorous lender approval and oversight processes, and bear the greatest degree of responsibility and liability for the mortgage loan obtained by the mortgage borrower and insured by FHA.

75 FR at 20718, 20719.

A ruling affirming the Board's one-year withdrawal, which would technically expire in April 2011, would, in reality, only be effective until December 31, 2010, after which date no loan correspondents may recertify according to the Final Rule. In the same vein, a ruling in favor of immediate reinstatement would only allow Respondent to originate FHA mortgages until December 31, 2010, for approximately four months. The law does not provide for a withdrawal "less than 1 year," but any decision this Tribunal makes will necessarily be limited to the remaining months in 2010 due to the agency's new final rule. 12 U.S.C. § 1708(c)(3)(D). This practical consideration removes some of the severity that may accompany the sanction of withdrawal because of the rule-imposed limitation on the withdrawal period.

Additionally, these "policy changes designed to enhance FHA's risk management functions" help clarify those Departmental interests the Board is supposed to protect with administrative actions such as withdrawal. 75 FR at 20718. As HUD explains:

> [T]he housing market remains in stress . . . [and] as in previous economic crises, FHA once again positioned itself . . . to quickly respond to the needs of homeowners in distress and qualified homebuyers without access to credit. As a result, the volume of FHA insurance increased as private sources of mortgage finance retreated from the market.

75 FR at 20721. Mr. Lesesne concurred in his testimony, implying that a major rule change resulting "disallow[ing]" loan correspondents began taking effect "two years ago" when correspondents were double (approximately10,000) what they are today (approximately 5,000). Tr. 49 at 3-22. The fast growth of a few years ago, combined with declining housing prices, defaults, and foreclosures has allegedly reduced FHA's capital reserve ratio. 75 FR at 20721. "FHA cannot continue to be a stabilizing force in the mortgage market if FHA's own condition is not stable and strong." *Id.* By focusing its resources on regulating mortgagees, "the entities with the greatest degree of control over an FHA-insured mortgage loan" through underwriting, servicing and/or owning the loan, the agency intends to better oversee "the parties to the loan transaction that pose the greatest risk to HUD." 75 FR at 20723.

The agency describes the elimination of the loan correspondent approval and recertification process as "prudent." *Id.* It would *not* seem prudent, given the Department's compelling reasons listed above for the program's discontinuation, to reinstate Respondent's approval to participate in such program.

6. Appropriate Term of Withdrawal

The purpose of withdrawing a mortgagee's HUD-FHA approval is to protect both the public and the federal agency from doing business with a lender that fails to adhere to prudent lending practices. *Horizon*, 1992 HUD BCA LEXIS 8, at *35. The mortgagee originating federally-insured loans acts as the "eyes and ears of HUD." *Id.* at *36. "Failure to adhere to HUD program requirements and prudent lending practices jeopardizes the HUD-FHA mortgage insurance program and the public fisc that funds it." *Id.*

"Without the conscientious and responsible conduct of its program participants, particularly of those involved in the preparation of financial documents . . . HUD is exposed to serious financial risk." *Heritage*, 1993 HUD BCA LEXIS 15, at *30.

> As a HUD/FHA approved mortgagee, the company and . . . its principal should have had an acute sense of responsibility to conduct themselves in general . . . so as not to reflect adversely in their general conduct upon the United States Government, or HUD in particular, with whose interests their interests are inextricably intertwined.
>
> * * *
>
> With the mantle of HUD's approval, such mortgagees are inevitably benefitted in their business dealings with third parties who rely upon the implication of competence and trustworthiness which that mantle bestows.

Ramsey A. Agan, HUDBCA No. 83-773-D17, 1983 HUD BCA LEXIS 24, at *33 (AJ, Apr. 21, 1983). The sanctions available to the Board under Part 25 "are prospective sanctions designed to protect the Department and the public from potential misconduct." *Heritage* 1993 HUD BCA LEXIS 15, at *33. The Government's testimony indicates that it is not in the public's interest for HUD to "do business with companies that are just barely making it." Tr. 27-28.

Testimony from Ms. Himes and Mr. Lesesne also demonstrated the importance of the FHA lending program to the overall housing market, including loan correspondents like Respondent and the borrowing community. Ms. Himes stated that it is difficult right now to originate conventional mortgages – those that are made by a bank without federal government insurance. Tr. 24. This is presumably because borrowers in an economic downturn do not carry the same credit worthiness or have the ability to pay a standard down payment. Tr. 24-26, 32. While the down payment for FHA loans is 5%, Ms. Himes explained, the standard (for conventional mortgages) is 10%, "and these days its 20%." Tr. 32 at 13-16. Ms. Himes indicated that there is a specific segment of society that can only borrow loans insured by FHA.

Tr. 32 at 17-20. Mr. Bednarski clarified that Respondent does business in the part of South King County near Tacoma, Washington, which is "more of the working class neighborhoods than [north] of King County, north of Seattle, east of Seattle." Tr. 105.

From the lender's perspective, Mr. Bednarski explained that the last three years have been "very tough on us." Tr. 104 at 17-18. "Like everybody, I went through a little downsizing," he stated, from employing approximately thirty loan officers to thirteen, "and without the FHA that's [sic] no way I can hold this many." Tr. 104 at 17-22.

> There's no way anybody can be in business right now without having the FHA, with not being able to originate FHA loans. I'm talking about the bank, correspondent, net worth, doesn't matter what type of, you know, work they organize, not having FHA loans, it's – it's almost impossible to stay in business. Never say never, but almost impossible.

Tr. 105-106.

In an economic downturn, where there is a higher probability of a borrower defaulting, it is logical to assume that the FHA loan market and FHA lenders would be in high demand. In the FHA program, if a borrower defaults, the FHA-approved lender may be able to recover as much as "76 cents on the dollar" from the federal government. Tr. 25-26. Ms. Himes admitted that FHA loans are the "best game in town." Tr. 24 at 11-16. Mr. Bednarski's testimony confirmed that Respondent's competitors, other FHA lenders, are not only in the same community, but "[i]n the same building." Tr. 106 at 7-12.

> This relationship of trust governs the general context in which the specific regulatory requirements imposed by HUD, and accepted by HUD/FHA mortgagees . . . must be adhered to. With the mantle of HUD's approval, such mortgagees are inevitably benefitted in their business dealings with third parties who rely upon the implication of competence and trustworthiness which that mantle bestows.

Isaac, 1983 HUD BCA LEXIS 10, at *61.

In the present case, the interests of the public and the agency are closely linked. A failure to maintain sufficient liquid assets leaves the agency's mortgage insurance funds vulnerable in certain circumstances, *e.g.* if a federally-insured loan goes into default and HUD seeks indemnification from the loan's originator, or if the originator files an insurance claim for benefits. Tr. 20, 25, 26. For that reason, "the department seeks to do business with entities that are financially – and operationally sound." Tr. 27 at 19-21. Also, because of the paramount need to protect the public money that funds the FHA program, "[i]t is immaterial whether a mortgagee deliberately avoids and subverts the regulations and requirements imposed on it, or if it fails to follow them through misunderstanding, carelessness, or lack of knowledge." *Stratford*, 1994 HUD BCA LEXIS 5, at *38.

The remaining issue is, "what is the scope and extent of the sanction necessary to protect the public interest in FHA insurance programs vis-a-vis" Respondent? *Mechanics National Bank*, 1979 HUD BCA LEXIS 9, at *45. The Notice of Administrative Action stated that Respondent may "appeal . . . and request reinstatement," or accept the one-year withdrawal effective upon receipt of the letter. GX 5. However, as explained above, this Tribunal is making a determination in this case de novo, and therefore, may affirm the Board's one-year withdrawal of Respondent's HUD/FHA loan correspondent approval, may reinstate Respondent's approval immediately, or may reach another finding allowable under the law and regulations.

In *R&G Mortgage Corp.*, the court found that while "failure to submit acceptable audited financial statements is a very serious infraction," the degree of the mortgagee's responsibility was "almost non-existent," and there were several mitigating factors that warranted the rescinding of HUD's withdrawal. *R&G Mortgage*, HUDALJ 07-052-MR, at 14-16. The respondent had made good faith efforts to resolve the financial statement deficiency, had a history of compliance with HUD requirements, could demonstrate its financial soundness by other means, and was regulated by other regulatory entities that considered it financially sound. *Id.* Additionally, testimony in *R&G Mortgage* revealed that "removal of [the mortgagee's] FHA approval could have a significant negative impact on the housing market and loan market for the type of loans that are insured by the FHA." *Id.* at 14.

The circumstances that warranted a reversal of the Board's withdrawal in *R&G Mortgage* do not exist here. Notably, Respondent was solely responsible for its failure to maintain sufficient liquid assets and file a statement demonstrating such compliance. The evidence shows Respondent's slow and unambitious attempts to gather some documents, regardless of HUD's specific instructions, and upload or FedEx them to HUD months after being found deficient. There is no evidence of a history of compliance with HUD requirements. Fidelity was approved as a loan correspondent in late October 2008, and by December 2008 its liquidity level had dropped below 20% of its net worth, and likely stayed below until July 2009. Further, while Respondent has demonstrated that during half of 2009 and the beginning of 2010 it was maintaining the required liquidity level, Respondent has not shown that its financial health is secured by the proper submission of a corrective action plan. Moreover, Respondent offered no evidence that it was regulated by other entities that considered it financially sound. Finally, while the FHA lending program is critical to a group of borrowers and to the low-mid level housing market overall, Mr. Bednarski admitted that, unlike the respondent in *R&G Mortgage*, Respondent was not the only source of FHA-insured mortgage origination in its community. In fact, at least four of Respondent's competitors are located in the same building. Tr. 106-107.

In *Zarrilli and Mark Twain Bank*, mitigating circumstances were found where "[t]he record reveals, at best, a violation of a regulation that was apparently not being enforced by the HUD [local office]." *Zarrilli*, 1990 HUD BCA LEXIS 11, at *37. In further mitigation were the findings that the mortgagee did not engage in intentional wrongdoing, the errors "appear to be one time, isolated acts which occurred under unique and somewhat trying circumstances," there

was no evidence of intent to deceive HUD, or any wrongful gains, or any financial injury to HUD. *Id.* at *41-42. The underlying conduct took place four years earlier, the was no evidence of any "irresponsible conduct" by the respondent since then, and the respondent had taken tangible corrective action. *Id.* It was concluded that withdrawal for an indefinite period of time, as the Board had imposed, was not warranted, and that "a sufficient period of time to protect the public interest ha[d] [already] elapsed during which [the respondent] did not participate as a HUD/FHA mortgagee." *Id.* at 43. The court's ruling was issued just one week shy of one year after the mortgagee's approval was withdrawn, and therefore was in effect a withdrawal of approval for a period of almost one year.

Similarly, in the present matter, Respondent's violation is based on the one act of uploading an audited financial statement onto LASS that failed to show sufficient liquid assets, and Respondent's circumstances in early 2009 may have been "somewhat trying," as were the respondent's in *Zarrilli*. Further, while the evidence does not suggest HUD was not enforcing the liquidity rule, it certainly appears to have been lenient in regard to allowing Respondent to continue to operate while "attempting a cure." However, the evidence in the record is suggestive of an intentional and/or knowing violation with the expectation that such could be concealed from HUD. Further, the Board has not requested in this case "indefinite suspension," as was the case in *Zarrilli*, so the factors relevant in that case do not, upon balance, weigh in favor of mitigating the one-year term of withdrawal in this case.

CONCLUSION AND ORDER

The Government has demonstrated by a preponderance of the evidence that Respondent Fidelity Homes and Loans, Inc., committed a serious violation of FHA requirements warranting the Mortgagee Review Board's one-year withdrawal of its FHA Title II Loan Correspondent approval. The seriousness of the violation, for which Respondent is solely responsible, is not mitigated by Respondent's efforts to cure the deficiency in its financial statement or by any other considerations.

It is hereby **ORDERED** that the FHA Title II Nonsupervised Loan Correspondent approval of Fidelity Homes and Loans, Inc., FHA ID No. 28296-0000-3 (Title II), is withdrawn for a period of one (1) year from the date of the Notice of Administrative Action dated April 16, 2010, as set forth therein.

Susan L. Biro
Chief Administrative Law Judge

Dated: August 27, 2010
Washington, D.C.

NOTICE OF APPEAL RIGHTS

Any party may request, in writing, review of this Initial Decision by the Secretary of the Department of Housing and Urban Development within thirty (30) days after it is issued. 24 C.F.R. § 26.50(b). Requests for Secretarial review, and briefs in support, should be sent to the below address through mail, delivery, facsimile, or electronic submission in accordance with Sections 26.50 and 26.52. 24 C.F.R. §§ 26.50(b), 26.52.

U.S. Department of Housing and Urban Development
Attention: Carole Wilson
1250 Maryland Avenue, S.W., Portals Bldg., Suite 200
Washington, DC 20024

This Initial Decision "shall not become effective unless it becomes or is incorporated into final agency action in accordance with §§ 26.50(c) or 26.62(l)." 24 C.F.R. § 26.50(a); *see* 24 C.F.R. §§ 26.50(c) 26.52(l). Also, the Initial Decision may not modify or otherwise disturb the order or notice by the Mortgagee Review Board unless the Initial Decision becomes final agency action. 24 C.F.R. § 25.11.