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

In the Matter of: R&G Mortgage Corporation, Respondent	HUDALJ 07-052-MR OGC 07-7033-MRT Decided: November 20, 2007

Elissa O'Leary, Esq.,
Maura Malone, Esq.,
HUD Office of General Counsel,
For the Government

Timothy A. Vanderver, Jr., Esq.,
Nancy A. Murray, Esq.,
Patton Boggs, LLP,
For the Respondent

Before: Arthur A. Liberty
Chief Administrative Law Judge

RECOMMENDED DECISION

Respondent, R&G Mortgage Corporation ("R&G") has appealed the June 29, 2007, Notice of Withdrawal ("Notice" or "withdrawal") of its HUD-FHA mortgagee approval from the Department of Housing and Urban Development ("the Government" or "HUD"), by the Director of the Office of Lender Activities and Program Compliance (formerly the Office of Lender Activities and Land Sales) ("OLA"), acting on behalf of HUD's Mortgagee Review Board ("the Board" or "MRB"). Respondent failed to submit acceptable audited financial reports for 2006 within the proscribed 90-day time period. The Government stated its immediate withdrawal of Respondent's mortgagee status was predicated upon this failure. Respondent thereafter timely requested an appeal hearing to present evidence why it should not be sanctioned.

PROCEDURAL HISTORY

Prior to the scheduled hearing date, Respondent submitted a Motion on September 4, 2007, requesting that the Administrative Law Judge ("ALJ") "find that the Notice take effect in accordance with the provisions of 24 C.F.R. § 25.5(e)(2)(ii). Accordingly, we request that the [ALJ] find that R&G must be reinstated as an FHA-approved mortgagee pending the completion of the appeal process proscribed in 24 C.F.R. Part 25." Respondent disputed the imposition of an immediate withdrawal of its mortgagee status, asserting that, because Respondent requested an appeal hearing, the withdrawal should not take effect until after the appeal process is complete. Respondent cited and discussed several applicable regulatory provisions in support of its contention that the Director of OLA does not have authority to make a determination that an immediate withdrawal is in the best interest of the public or HUD, such determination is required prior to an immediate withdrawal sanction, and the Government thus violated its own regulations to the detriment of Respondent and the public.

The Government responded on September 12, 2007, asserting that the Board had delegated non-discretionary authority to the Director of OLA, requiring the Director to impose immediate withdrawal as a sanction in every case in which a respondent fails to submit acceptable audited financial reports within the required time. The Government asserted that the Board had previously made a determination that failure to submit such audited reports was sufficiently egregious to warrant immediate withdrawal in every case.

I issued an interlocutory Order Reinstating Respondent's Status as an FHA-Approved Lender on September 28, 2007, granting Respondent's Motion. I determined that the Board could not delegate its discretionary authority to determine whether an immediate sanction was warranted, and the Board had not made such a determination itself. An immediate sanction could therefore not be imposed and Respondent should be reinstated as an approved lender pending the outcome of this hearing and decision process.

On October 9, 2007, the Government filed with the Hearing Officer a Motion to Vacate the Administrative Law Judge's Decision and to Refer the Matter Back to the ALJ for Completed Findings of Fact and Conclusions of Law ("Motion to Vacate"). The Government asserted that the September 28, 2007 Order exceeded the scope of the referral. The Hearing Officer determined that the Order was not outside the scope of the referral and that further findings of fact and conclusions of law were already anticipated in the Recommended Decision. The Government's Motion was therefore denied by the Hearing Officer's Order on October 17, 2007.

The hearing in this matter was held on September 25-26, 2007, and post-hearing briefs were submitted by both parties. This matter is thus ripe for decision.[1]

FINDINGS OF FACT

Respondent, R&G Mortgage Corporation ("R&G"), is a mortgage corporation in Puerto Rico. It is a wholly- and solely-owned subsidiary of R&G Financial. Stip. 6; J-Exh. 2. Both entities are regulated by the Federal Reserve Board. Stip. 5, 6; J-Exh. 2; Tr. 82-83. R&G is also regulated by the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico. Stip.5. Respondent was most recently examined by the Federal Reserve during the first quarter of 2007, during which time the Reserve examined the company's financial statements, its underwriting practices, its secondary market policies and procedures, its servicing practices, its delinquency management, and more. Tr. 83.

Respondent is also an FHA-approved mortgagee, approved and regulated for that purpose by HUD. HUD has approved R&G as an FHA "non-supervised" mortgagee. Stip. 1. Pursuant to 24 C.F.R. § 202.7(a), a non-supervised mortgagee is defined as "a lending institution which has as its principal activity the lending or investing of funds in real estate mortgages . . . and which is not approved under any other section of this part." R&G was not approved under any other section. Stip. 1. A supervised mortgagee is "a financial institution which is a member of the Federal Reserve System or an institution whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration." 24 C.F.R. § 202.5. R&G's parent company, R&G Financial, is a member of the Federal Reserve System and thus R&G, as a wholly- and solely-owned subsidiary, is subjected to the same oversight and scrutiny. Tr. 82-84.

It is this status that has led to the issue in the instant case. R&G, as an unsupervised mortgagee, is required to submit acceptable audited financial statements to HUD within 90 days of the end of R&G's fiscal year. 24 C.F.R. §§ 202.7(b)(4), 202.8(b)(3), and HUD Handbook 4060.1. Failure to submit such acceptable audited financial reports within 90 days of the close of its fiscal year is a violation of HUD's regulations, set forth at 24 C.F.R. § 25.9(e). Failure to submit acceptable audited financial reports is also a violation of the approval requirements listed in 24 C.F.R. §§ 202.5 and 202.7. R&G has failed to submit acceptable audited financial statements for fiscal year 2006 within the required time, or at all, thus far. Stip. 2, 3. R&G currently remains unable to submit acceptable audited financial statements. Stip. 3. However, the

[1] The Government also filed a Motion for Summary Judgment on September 18, 2007, just prior to the hearing. However, the Motion is moot, as the hearing has been held. Furthermore, there were issues still remaining in dispute that were essential to resolution of this appeal and, reviewing the facts in the light most favorable to the non-moving party as required, summary judgment would not have been appropriate in this case. As the facts and law of the case will be fully discussed in this Decision, I will not repeat them herein for the purposes of also addressing the Motion for Summary Judgment as it is moot.

reason R&G did not submit its financial statements within the appropriate time, or since, is because the Federal Reserve and other federal governmental entities are requiring R&G Financial to restate its financial statements for 2000-2004 due to an accounting formula error by the top three banks in the area that ultimately affected all the lenders in Puerto Rico. Stip. 2; Tr. 54, 89. Until the restatement audit that is the final result of this process is completed, it is not possible to do audited financial statements for subsequent years because the beginning balances for those years would be off. Tr. 92. As a result, R&G has been unable to submit audited financial statements for the years after the restatement time period, including the 2006 statements at issue in this case. The restatement process can take a long time, even several years, because of the complexities involved and the other changes in the financial accounting that must be adjusted to reflect the restated amounts, particularly when five years of restatements are involved. Tr. 89. Intervening litigation can also drag out the process. Tr. 89-90.

Supervised lenders do not have to submit audited financial statements because of the federal oversight they receive from the supervisory agencies. Tr. 25-26. R&G is not classified by HUD as a supervised lender, despite receiving the same federal oversight as a supervised lender, so it does not get this credit and must submit audited financial statements. However, the federal oversight it receives is interfering with R&G's ability to comply with this non-supervised lender requirement of HUD's. R&G is therefore caught between these regulatory agencies.

The Office of the Commissioner of Financial Institutions ("OCFI") of the Commonwealth of Puerto Rico, with which entity HUD has an agreement to deal with regulatory issues on behalf of HUD, also receives interim quarterly reports from R&G, call reports, has discussions with management, conducts field work examinations, and incorporates its oversight and knowledge of the context within which Respondent is operating to ensure that it is fiscally sound. Tr. 60-61, 64. The Commissioner of Financial Institutions, Alfredo Padilla, testified stated that his oversight office also requires mortgagees to submit audited financial statements each year in order to be re-licensed. Tr. 68. The Commissioner expressed similar reasons for this requirement to those expressed by HUD. However, the Commissioner stated that R&G had not submitted those statements for 2006 to his office either, and that R&G could not receive those statements from the outside auditors until the restated financials due to the federal requirement had been completed. Tr. 67. The auditors had all of the necessary information and R&G could not submit audited financial statements until the auditor signed them. Tr. 60, 61-62, 67. Because his office knew that R&G could not comply with the financial statement requirement, R&G was licensed this year even without them, based upon other examinations and financial information the Commissioner had that assured his office that R&G was fiscally sound. Tr. 68.

The Commissioner also emphasized the adverse impact that withdrawing R&G's approved lender status would have on the Puerto Rican economy. Tr. 56, 59, 63, 68.

This, and further testimony from other witnesses about the state of the housing market and economy in Puerto Rico established that the Puerto Rican economy is in its worst slump since World War II, and that there is an urgent need for low-to-middle-income housing fulfilled by FHA-insured mortgages, particularly as the median income is $20,000. Tr. 38, 39, 40, 41-42, 45-48. Puerto Rico experienced a negative economic growth rate for fiscal year 2007, and removing a major source of FHA loans would create ripples of difficulties across the island, in addition to putting thousands of people out of work. *Id*. and Tr. 68. Although the Government testified that there are 39 FHA-approved lenders in Puerto Rico, R&G by itself has 10% of the market share. Tr. 104-05. R&G is the Island's top lender or close to top lender in several Puerto Rican housing programs and is one of the top three lenders in Puerto Rico. Tr. 49-50. If R&G loses its approved lender status, it will also lose its status in other federal mortgage programs, including Fannie Mae, creating an even greater negative impact.

The Mortgagee Review Board ("MRB") of HUD, via September 25, 1992, Board meeting notes, "voted unanimously to redelegate its authority, pursuant to 24 CFR Section 25.2, to the Director, Office of Lender Activities and Land Sales Registration to withdraw the HUD-FHA approval of mortgagees and Title I lenders for a period of one year where they fail to submit an acceptable annual audit report within 90 days of the close of their fiscal year . . . ." R-Exh. 1-1. Cecilia Ross, current director of Lender Approval and Re-certification within HUD's Office of Lender Activities and Program Compliance ("OLA"), testified at the hearing that her office's system is set up in such a manner that it does not matter why a non-supervised lender does not submit the audited financial statements; the failure to submit such statements will result in an automatic Notice of Violation that is sent to the lender approximately 30 days after the due date for its audited financial statements. Tr. 19, 28-29, 31. R&G's deadline to submit was March 31, 2007, and the Notice of Violation was served on R&G on May 9, 2007. Stip. 4, 7; J-Exh. 1. Ms. Ross stated that all she does with regard to her delegated duty on this matter is carry out this prescribed process and follow the regulation. Tr. 20, 26, 29, 31.

R&G responded to the Notice of Violation on June 13, 2007, requesting an extension of the submission deadline until December 31, 2007. Stip. 8. R&G explained why it was unable to produce the audited financial statements, provided interim un-audited financial statements so that HUD could ascertain that R&G was in a sound financial status, and explained what steps R&G was taking to resolve the situation. J-Exh. 2; R-Exh. 3. R&G had between 20-50 full-time employees and consultants working on the restatement, incurring expenses of $80 million to that point, all of which was being borne by R&G Financial, the parent company. J-Exh. 2. The accounting issues had been addressed and resolved between R&G Financial/R&G and its auditors at PricewaterhouseCoopers, and the auditors were reviewing the draft new financial statements for 2004 at the time of R&G's letter to OLA. J-Exh. 2. R&G anticipated moving on to 2005 and then 2006 financial statements soon thereafter. J-Exh. 2. R&G

also had a net worth far exceeding the amounts required by HUD for non-supervised lenders. J-Exh. 2; R-Exh. 3.

HUD did not respond to R&G's request, but on June 29, 2007, HUD issued to R&G an automatic Notice of Withdrawal of R&G's HUD-FHA mortgagee approval, effective immediately. Stip. 9, 10, 13. R&G received a fax copy of the notice on July 3, 2007. Stip. 10. The Notice of Withdrawal stated that the basis for the withdrawal was R&G's failure to submit audited financial statements. Stip. 10. It was signed by Joy Hadley, Director, OLA. Stip. 11.

By letter dated July 5, 2007, the Honorable Jorge Rivera Jiménez, Secretary of the Department of Housing of the Commonwealth of Puerto Rico, wrote HUD requesting that it withdraw the termination of R&G as an FHA-approved mortgagee. Stip. 14. Secretary Jiménez stated in his letter that withdrawing R&G's approved mortgagee status would have a "severe adverse impact . . . on affordable housing in Puerto Rico . . . . its elimination from this field will mean that many lower-and moderate-income Puerto Ricans will not be able to obtain mortgage financing." R-Exh. 4, pp. 1-2.

The Honorable Alfredo Padilla, Commissioner of Financial Institutions of the Commonwealth of Puerto Rico, wrote HUD a letter on July 6, 2007, expressing opposition to the immediate withdrawal of R&G's HUD-FHA Title II approval. In that letter, Commissioner Padilla explained that his office has a formal agreement with HUD in which the two agencies exchange information, cooperate, and coordinate investigations, audits, and reviews to assist each other in carrying out their functions. R-Exh. 5, p. 1. Commissioner Padilla expressed his office's comfort, as a regulator of R&G, with the un-audited statements and numbers that R&G had previously submitted to HUD and noted that his office found R&G "to be in a financially sound condition . . . ." Stip. 15. Commissioner Padilla based his statement on financial and operational information his office had been regularly receiving from R&G, and his office's belief that the un-audited financial statements accurately represented the information that would be contained in the audited versions, once released. R-Exh. 5, p. 2.

By letter dated July 11, 2007, R&G requested suspension of the withdrawal of approval. Stip. 16. It received no reply to this request either. Stip. 16. In the same letter, R&G also requested a hearing to appeal the withdrawal. Stip. 16. The Chairman of the Mortgagee Review Board thereafter designated a Hearing Official and this proceeding ensued. Stip. 17, 18.

DISCUSSION AND CONCLUSIONS OF LAW

The MRB was established in the Office of the Secretary of HUD to exercise the Secretary's authority to administratively sanction mortgagees for violations of HUD agreements, rules, regulations, handbooks, or other requirements. 24 C.F.R. §§ 25.2,

25.3(a). The regulations governing the MRB are contained in 24 C.F.R. Part 25. These regulations establish the procedure by which the Board may determine and impose administrative sanctions on mortgagees.

The Board is permitted to impose sanctions, or take administrative "actions," that include letters of reprimand, probation, suspension, withdrawal, and settlement agreements. 24 C.F.R. § 25.5. However, first, the Board must issue a written notice of violation at least thirty days prior to taking any such action, and must provide the mortgagee with thirty days in which to submit a response. 24 C.F.R. § 25.6(a). If the mortgagee fails to reply within that time, the Board may then "make a determination without considering any comments of the mortgagee." *Id*. There is only one exception permitted to this thirty-day due process requirement. If the Board determines that "there is adequate evidence that immediate action is required to protect the financial interests of the Department or the public," the Board may take a suspension action without having issued a notice of violation. 24 C.F.R. § 25.6(c). This does not permit the Board to take a withdrawal action without first providing a mortgagee with thirty days' notice and an opportunity to respond.

In the instant case, Respondent was served with a Notice of Violation by the OLA, the Board's delegatee, and was given thirty days in which to respond, which it did. However, there is no indication that R&G's response was considered, by either the Board or by OLA, prior to issuing the Notice of Withdrawal. In fact, according to Ms. Ross' testimony, the reasons why a lender does not submit its financial statements do not matter and are not taken into consideration prior to her office issuing the Notice of Withdrawal. In addition, she also indicated that she has no discretion as to whether or not to issue a Notice of Withdrawal in every case in which financial statements are not submitted. The Notice is automatic. This process therefore fails to fulfill all of the requirements of 24 C.F.R. § 25.6(a).

Once the Board has made a determination to impose a specific sanction, the Board must promptly notify the mortgagee in writing of that determination. 24 C.F.R. § 25.7. This notice must include the nature and duration of the administrative action, must specifically state the violations, "shall set forth the findings of the Board," and must inform the mortgagee of its right to a hearing and how to request such a hearing. *Id*. The only exception to these content requirements is in the case of a letter of reprimand. The Notice of Withdrawal fulfills this requirement in that it notifies the mortgagee in writing of the Board's (through OLA) determination to impose a specific sanction. It also states the violation and informs the mortgagee of its right to a hearing. However, because neither the Board nor OLA make any findings, indeed, apparently do not consider any factors prior to issuing the Notice, the Notice of Withdrawal does not fulfill all the requirements of 24 C.F.R. § 25.7.

Section 25.9 lists violations by a mortgagee that "may result in an administrative action by the Board under § 25.5." It states that any administrative action imposed under § 25.5 must be based upon one or more of the listed violations, and includes within that list a mortgagee's failure to submit acceptable audited financial reports "within 90 days of the close of its fiscal year, or such longer period as the [Government] may authorize in writing prior to the expiration of the 90 days." 24 C.F.R. § 25.9(e). Failure to submit acceptable audited financial reports is also a violation of the approval requirements listed in 24 C.F.R. §§ 202.5 and 202.7.

Section 25.9 further states that, "Except in cases where the Board's authority has been delegated in accordance with § 25.2, the Board will consider, among other factors, the seriousness and extent of the violations, the degree of mortgagee responsibility for the occurrences and any mitigating factors, in determining which administrative action, if any, is appropriate" (emphasis added). By including the term "will" this regulation establishes that the Board's consideration of factors is required prior to making a determination to impose a sanction. The phrase "except in cases" indicates that the Board must consider these factors on a case-by-case basis, with a specific exception for certain cases.

Section 25.2 states that the Board may "redelegate its authority to *impose* administrative sanctions on the grounds specified in §§ 25.9 (e), (h), and (u), and to *take all other* nondiscretionary acts" (emphasis added). It is clear from the structure of this provision that the authority to impose a sanction is considered a non-discretionary act, parallel to the "other" non-discretionary acts that may also be delegated. Similarly, § 25.2 also states that the Board may redelegate its authority to "take administrative actions for failure to remain in compliance with the requirements for approval in 24 CFR 202.5(i), 202.5(n), 202.7(b)(4), 202.8(b)(1) and 202.8(b)(3)." Both the plain meaning of the regulation and its parallel structure make it clear that only non-discretionary authority may be delegated by the Board.

However, neither provision within § 25.2 permits the Board to delegate its authority to *determine* which sanction, if any, is warranted in a given case. Such determinations by the Board are required by the Board's regulations prior to taking or imposing any sanction, and clearly constitute discretionary authority: they require the Board to make choices, decisions, or determinations. The Board must not only consider specific factors when making a determination to impose a sanction, but must also inform the mortgagee in writing of its findings on these matters, pursuant to the notice of determination requirements set forth in 24 C.F.R. § 25.7. There is no provision within Part 25 that permits the Board to delegate this discretionary "determination" authority or to impose a sanction on a mortgagee without notifying the mortgagee of its findings, except in cases in which the Board has made a determination that there is sufficient evidence that an immediate suspension is in the best interests of the public or HUD. Because this determination must be made on the basis of the evidence in each given case,

it is also a discretionary act by the Board and is one that must be made on a case-by-case basis and cannot, therefore, be delegated.

Section 25.5, which lists and explains the sanctions the Board may impose, includes provisions specifically addressing the effective date of each sanction. Letters of reprimand, probations, and suspensions shall be effective upon receipt of the Board's notice of action. However, the provision addressing the effective date of withdrawals differs. It states, "If the *Board determines* that immediate action is in the public interest or in the best interests of [HUD], *then* withdrawal shall be effective upon receipt of the Board's notice of withdrawal," or immediately, as the parties have referred to it. 24 C.F.R. § 25.5(e)(2)(i) (emphasis added). If the Board does not determine that immediate action is necessary, "then withdrawal shall be effective . . . [u]pon receipt of the Board's decision under § 25.8, if the mortgagee requests a hearing." 24 C.F.R. § 25.5(e)(2)(ii).

This provision is consistent with the approach taken in the rest of Part 25's regulatory scheme. This provision does not waive the Board's requirement (24 C.F.R. § 25.6(a)) to issue a notice of violation and provide the mortgagee with thirty days in which to respond. The Board must still consider the mortgagee's response, if any, prior to making its determination that withdrawal is appropriate in a given case, and to then, and only then, issue its notice of withdrawal. This provision simply permits the Board the discretion to also determine that a withdrawal should be immediately effective upon receipt of the Board's notice of withdrawal. Therefore, this authority to make a determination that withdrawal shall be immediately effective, like the Board's other discretionary determinations, is not delegable. Once such a determination has been made, the Board may delegate the authority to impose the sanction and to impose it immediately.

The Government asserts, however, that the Board has made a determination that an immediate withdrawal is the appropriate sanction in *every* case in which a mortgagee has failed to submit acceptable audited financial reports within the 90-day time requirement; that all such cases harm the public interest and HUD's interests. The Government also asserts that the Board has made a determination that such a sanction will be imposed in every one of these cases and has therefore issued blanket, non-discretionary, authority to the Director of OLA to automatically impose such immediate withdrawals in every case of late or unacceptable financial reports.

Assuming for the moment that the Government's assertions in this regard are accurate, this indicates (although it has not been spelled out this way by the Government) that, in all such cases: 1) the Board does not even see or consider the case until after the appeal hearing occurs because it has pre-determined that all cases involving a violation of this type will automatically result in the same sanction; 2) the Board does not read or consider any reply submitted by a mortgagee during the 30-day response time granted by

24 C.F.R. § 25.6(a); 3) the Board does not make a determination that there is or is not sufficient evidence to warrant an immediate suspension instead, in accord with 24 C.F.R. § 25.6(c); 4) the Board does not make findings on the violation, and thus does not set forth those findings in the notice of withdrawal, as required by 24 C.F.R. § 25.7; and 5) the Board does not consider the factors in extenuation and mitigation as set forth in 24 C.F.R. § 25.9 before determining to impose this sanction for these cases. In other words, if such a blanket delegation has in fact occurred, the Board has not only required the Director of OLA to automatically impose such a sanction in all these cases, but has (for this type of violation) effectively rendered itself and its other regulations moot, and erased all due process provisions built into its regulations, until the end of the appeal process.

The Government asserts that the Board has authority to delegate non-discretionary imposition of sanctions for this type of violation and that, because the Director of OLA does not have the discretion to impose this sanction in only some cases, the Board has not delegated discretionary authority and is thus not in violation of its own regulations. Given the plain meaning of the regulatory language set forth previously, this argument is disingenuous. While it is true that the Board, if it issued such a blanket delegation, would not have delegated discretionary authority to the Director of OLA, it would have nonetheless taken that discretionary authority away from itself and set up a situation in which that discretionary authority would not be acted upon by anyone until a hearing had been held and the appeal process was almost complete. The regulations clearly do not contemplate such an occurrence or they would not contain the several due process and discretionary determination provisions at each step in the procedure, as noted above.

The regulations do not contain a provision permitting the Board to issue a blanket determination to be applied in all future cases of a certain type of violation. There is also no provision that expressly prohibits such a blanket determination. However, the regulations, read as a whole, clearly establish a system in which it is expected that the Board will render determinations on a case-by-case basis and that due process will be built in to the system at each stage of the process. For example, the fact that mortgagees are provided with notice and an opportunity to respond before the Board decides which sanction to impose, and that the Board is required to consider any such response from a mortgagee prior to determining a sanction, clearly constitute due process and case-by-case provisions. Even the Board's authority to determine not to permit such a response time must be made on a case-by-case basis when the Board "determines that there exists adequate evidence . . . ." It would be impossible to make a prior blanket determination that all cases of a certain type of violation will always have adequate evidence justifying an immediate suspension. Similarly, it would be impossible to make a prior blanket determination that all cases involving a particular type of violation would result in the same findings by the Board in its notice of action, or would include the same level of egregiousness or mitigating factors and would thus warrant the same type of sanction.

Permitting a blanket pre-determination in a certain class of cases would render these provisions meaningless.

This is supported by the Government's discussions in 1983 and 1992 when it published these regulations and changes thereto in the Federal Register. In 1983, the Government stated, "*Each case* considered by the Board involves a different set of circumstances and may also present mitigating factors. . . . a general introduction to the grounds [§ 25.9] has been adopted which states that the Board will consider, among other factors . . . any mitigating factors, in *determining which sanction*, if any, is appropriate." 48 FR 40705-01, 1983 WL 104640, *40706 (September 9, 1983) (emphasis added). The Government later added, "One commentator suggested the inclusion of a materiality and willfulness test, as well as a showing of specific harm or damage . . . . These concerns have essentially been dealt with in the introduction to the section [§ 25.9], which is generally applicable to all of the grounds. The Board will consider several factors . . . ." *Id*. The Government made similar responses in response to other comments to the rule, recognizing both the individuality of given cases and the need for due process consideration *before* imposing a sanction.

In 1992, after revision of some of the regulatory provisions within Part 25, the Government further discussed the regulatory provisions at issue in this case. One commentator suggested that the provision allowing the Board to delegate imposition of administrative sanctions in specific cases should be removed. To this, the Government responded, "Since §§ 25.9(e), (h) and (u) relate to non-waivable lender approval requirements, *if the Board determines* that a violation of any one or more of these requirements *warrants withdrawal* of approval, the taking of this action is nondiscretionary." 57 FR 31048-01, 1992 WL 159675, *31048 (July 13, 1992) (emphasis added). This statement supports the interpretation of the regulation's plain meaning above; the Board must make a determination that withdrawal is warranted, and if it does so, it may then delegate authority to impose that sanction on the mortgagee, and the person to whom this delegation is made does not have the discretion to choose not to impose that sanction in that case. This does not give the Board the authority to issue a blanket determination affecting all future cases of a certain type without considering whether withdrawal is warranted in a given case.

In two further comments in 1992, it was suggested that a suspension or probation of a mortgagee should not become effective until 30 days after the mortgagee receives notice and fails to contest the action, or in the alternative, if the mortgagee requests a hearing, until the appeal process is completed. *Id*. at *31049. In both cases, the Government responded, ". . . . the Department has amended these regulation so that the placing of a mortgagee on [probation or suspension] shall be effective upon receipt of notice by the mortgagee . . . ." *Id*. However, in contrast, in response to a comment suggesting that withdrawals should automatically incorporate a suspension of the mortgagee upon receipt of notice, the Government responded, "These regulations provide

that the Board may *at its option* withdraw a mortgagee's approval immediately upon receipt of notice." *Id*. (emphasis added). In the case of withdrawals, unlike suspensions and probation, the Board must exercise its discretion whether or not to make the sanction effective immediately; it cannot delegate this authority and make it automatic.

Furthermore, although suspensions and probation may be made effective upon determination by the Board to impose such a sanction in a given case, this does not remove the Board's discretionary authority to make such determinations in each case, to receive and consider each mortgagee's response to the notice of violation, or to consider factors in extenuation and mitigation in each case. Neither would a similar provision in the regulation that made withdrawals effective immediately upon receipt of the notice of action. However, what the Government asserts in this case is not that withdrawals are always effective upon receipt of notice of action, after due consideration and appropriate determinations by the Board on a case-by-case basis, but that for a certain type of alleged violation, the sanction of withdrawal is automatic and immediate, without any consideration or determination by the Board as to the appropriateness in a given case. This is clearly in violation of the Board's regulations.

In addition, the Government has not provided any evidence of such a blanket determination by the Board. The record contains a copy of minutes from a Board meeting, in which it states, "At its September 25, 1992 meeting, the Board voted unanimously to redelegate its authority, pursuant to 24 CFR Section 25.2, to the Director, Office of Lender Activities and Land Sales Registration to withdraw the HUD-FHA approval of mortgagees and Title I lenders for a period of one year where they fail to submit an acceptable annual audit report within 90 days . . . ."

This statement does delegate the Board's discretionary authority to determine what sanction will apply in each case, creating a blanket pre-determination that, in all cases involving such violations, withdrawal is the appropriate sanction and the Director of OLA will impose that sanction without discretion. It does not, however, purport to make imposition of these withdrawals effective immediately upon a mortgagee's receipt of the notice of withdrawal. This document does not address when such withdrawals will become effective. The Government has provided no other documentation in support of its argument that the Board intends for all withdrawals involving the failure to timely file audited financial statements to become effective immediately. Furthermore, the Board's delegation, as it were, delegates authority to impose withdrawals of only one year in duration. However, the Notice of Withdrawal sent to R&G does not honor this restriction and sets forth no limitation to the length of time of the withdrawal, making it appear to be indefinite.

Assuming, for the sake of argument, that the regulations permit the Board to render such a blanket pre-determination in a certain class of violations, the Board has not issued a determination that such withdrawals will take effect immediately. We must

therefore return to the regulation to resolve this issue. The regulation clearly states that the Board must make a determination that immediate withdrawal is in the best interests of HUD or the public before a withdrawal may become immediately effective. 24 C.F.R. § 25.5(e)(2)(i). There is no evidence that such a determination has been made in this case. The regulation clearly states that if no such determination is made by the Board, then, if the mortgagee has requested a hearing as in the instant case, the withdrawal will become effective only upon receipt of the Board's decision at the end of the hearing and appeal process set forth in § 25.8. 24 C.F.R. § 25.5(e)(2)(ii)(B).

If the Board had believed it in the beast interest of the public or HUD to withdraw Respondent's mortgagee approval status immediately upon receipt of the Notice of Withdrawal, it would have made such a determination. However, it did not. I cannot assume that the Board intended to make such withdrawals effective immediately absent a determination by the Board to that effect. The Board's own regulations mandate this conclusion.

However, Respondents' status as an approved lender was reinstated pending the outcome of this proceeding, so the issue of immediate effectiveness of the Notice of Withdrawal in this case has been dealt with. In future, however, to avoid similar problems, the OLA might consider issuing a Notice of Withdrawal that either sets forth findings as to why immediate withdrawal is necessary in a particular case, or that at least does not impose an immediate withdrawal when the mortgagee requests a hearing to appeal the sanction.

We now address the sanction itself. The Board's or OLA's failure to exercise its discretion to assess the imposition of a sanction in this case before now affects only the immediacy issue because review before a hearing officer is *de novo*. 24 C.F.R. § 25.8(b). *See also, In the Matter of Puller Associates, Inc.*, HUDALJ 89-112-MR (October 17, 1990). The hearing officer must consider the same regulatory factors the Board was required to consider in all cases except those in which its authority was delegated in accord with 24 C.F.R. § 25.2. In this case, the Board's authority was not delegated in accord with 24 C.F.R. § 25.2, or, if, as HUD asserts, it was delegated properly, then OLA was obligated to consider these factors, and to consider Respondent's letter, prior to issuing the Notice of Withdrawal. It did not. The regulatory scheme does not include provision for mortgagees to be deprived of basic due process rights spelled out repeatedly in the regulations when a determination is being made as to whether or not a sanction is warranted.

Therefore, the factors listed in 24 C.F.R. § 25.9 must be addressed in this Recommended Decision. First, the regulation states that one of the listed violations (including the one at issue in this case) *may* result in an administrative action by the Board (emphasis added). To determine whether a sanction should be imposed, we must

consider the following factors: 1) the seriousness and extent of the violations; 2) the degree of mortgagee responsibility for the occurrences; and 3) any mitigating factors.

Based upon the testimony from the Government and the Board's indications in its delegation letter and the regulations, it is clear that failure to submit acceptable audited financial statements is a very serious infraction. As Ms. Ross testified, the financial statements are necessary for HUD to be able to determine the financial soundness of a mortgagee whose loans HUD is insuring; they permit HUD to ascertain a mortgagee's net worth, liquidity, internal controls, compliance with HUD programs, whether there is fraud, and whether there are lawsuits against the mortgagee. Tr. 24. If a lender is financially unstable, engaging in risky behavior, or any number of other financial misadventures, it could endanger not only the FHA fund and HUD's program, but the low-medium housing market as a whole. The financial statements are one of the few means by which HUD may ascertain the financial health and stability of lenders and minimize the program's financial risks. Auditing of the financial statements ensure that the financial statements are true and reliable.

However, the degree of R&G's responsibility for its failure to submit appropriate financial statements is very low, if not almost non-existent. R&G is prevented from submitting its audited financial statements due to a requirement from the federal oversight agencies. As a result of this requirement, R&G's auditors will not certify R&G's financial statements as audited until the federally-required changes are completed. R&G has no choice in this matter. It is a requirement dictated by the federal oversight agency and standard accounting practices, and neither the federal agencies nor the auditors will change this requirement at R&G's request or at HUD's insistence on having audited financial statements by a certain time. R&G has provided HUD with un-audited statements in an effort to comply with HUD's requirement to the best of its ability in the interim. R&G and its parent company have also devoted significant time and resources to resolving the situation and have indicated an expected completion date that is not far in the future. Not only is R&G prevented from complying with HUD's requirement by outside agencies, but it is diligently working to bring itself into compliance as fast as it can under the circumstances. J-Exh. 2.

The foregoing might still not be enough to offset the seriousness of the infraction in another case. However, in this case there are additional mitigating factors. The underlying principle for taking administrative actions, as espoused throughout the regulations, is the public interest or the interests of the Department. In this case, withdrawing R&G's approved status as an FHA lender for failure to submit audited financial statements on time would not be in the public interest in the Commonwealth of Puerto Rico. In fact, the testimony from high-level government officials in Puerto Rico indicates that removal of R&G'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. Tr. 38, 39, 40, 41-42, 45-48, 49-50.

Furthermore, R&G is a large lender, and both it and its parent company have been determined to be financially sound by not only the Puerto Rico governmental oversight agencies, but also the federal ones. The Federal Reserve inspects and examines Respondent's financial statements, the underwriting practices, its secondary market policies and procedures, its servicing practices, its delinquency management, and more. Tr. 82-83. The Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico, with which entity HUD has an agreement to deal with regulatory issues on behalf of HUD, also receives interim quarterly reports from R&G, call reports, has discussions with management, conducts field work examinations, and incorporates its oversight and knowledge of the context within which Respondent is operating to ensure that it is fiscally sound. Tr. 60-61, 64. Clearly, R&G is closely examined and the types of concerns HUD has are addressed by Commonwealth and federal regulators. Although the accounting restatement will alter their financial reports, there is no indication that the companies are not financially sound or stable, that there are any fiscal problems, or that Respondent's financial well-being is in question. Respondent's net worth is much higher than that required by HUD's standards for non-supervised mortgagees. There is no indication that R&G is lacking in internal controls, and the lawsuits relating to the accounting formula are known to HUD. There is also no indication from HUD that there has ever been a problem with R&G in the past or that R&G has ever failed to comply with the financial statement requirement until the federal oversight issue resulting in the need to restate its financial statements occurred.

In addition, Respondent is apparently also regulated in other ways by HUD itself, although there was no testimony to this fact. Respondent's post-hearing brief asserts on page 7 that FHA regularly audits, reviews, analyzes, and investigates mortgagees, including R&G, to determine compliance with FHA requirements such as underwriting, and the Government does not dispute this. Respondent also asserts that it ranked by the FHA as a Tier 1 mortgagee, which, according to the notice letter R&G states it received, is reserved for the best-performing FHA mortgagees. Because these facts were not admitted into evidence, but instead asserted in Respondent's brief, I do not weigh them as sworn testimony or other reliable evidence. However, other portions of 24 C.F.R., such as § 202.12(a)(8) (requiring mortgagees to maintain records on pricing information for reasonable inspection by HUD for two years) and § 202.12(c) (indicating that HUD tracks a mortgagee's rate of defaults, will notify a mortgagee if the rate is above normal, and require a report from the mortgagee), do indicate that FHA/HUD engages in other methods of regular oversight and scrutiny of approved lenders beyond just the audited financial statements. Although this is not evidence, it merely is an additional indicator, in general terms, that the FHA fund and HUD have other possible means by which to ascertain R&G's financial soundness, and that waiting to receive the audited financial statements in this case will not leave HUD in a position of unknown risk and danger.

In addition, this situation is not one in which the financial statements will never come or will be extended indefinitely. R&G, as a well-established mortgagee, has every indication that it will continue to operate in a fiscally-sound manner in the future as it did in the past. It has also indicated a time frame in which it expects to have complete, audited financial statements that satisfy HUD's requirements, without excessive delay. Respondent requested in June that it be granted an extension through the end of December 2007, a little more than one month from now. Even if the restated financial statements take longer than originally anticipated before they are complete and audited, given the circumstances of this case, a few more months is not an unreasonable extension of time.

As a result, in this rare instance, the seriousness of Respondent's infraction is outweighed by a combination of Respondent's low level of responsibility for the infraction, its good-faith efforts to resolve the problem, its history of compliance with HUD requirements, its financial soundness and net worth indicated by other means, the fact that it is regulated by federal and Puerto Rican oversight agencies who consider it financially sound, and the importance to the public interest for Respondent to be able to continue to provide FHA-insured mortgages in Puerto Rico. If any scenario was envisioned when HUD drafted regulations requiring due process and a discretionary assessment of the merits of an administrative sanction prior to imposing one, this case is it. It may well be that the vast majority of lenders who fail to submit audited financial statements do so in an effort to hide their fiscal unworthiness to be FHA-approved lenders. However, in a situation such as Respondent's, automatic imposition of an administrative sanction without any consideration of mitigating and extenuating factors would be an abuse of discretion. It is precisely for this type of rare occurrence that such discretion is built into the Board's sanction system at every step in the process.

CONCLUSION AND ORDER

A preponderance of the evidence supports Respondent's request that the Notice of Withdrawal and imposition of the sanction of withdrawal of its HUD FHA-approved mortgagee status be rescinded. Accordingly, the withdrawal action is overturned.

So **ORDERED.**

_____
ARTHUR A. LIBERTY
Chief Administrative Law Judge

Dated: November 20, 2007.

J:\FINAL\MR.R&GMortgage.dec.11-20-07.wpd