## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

### 24 CFR Parts 30 and 203

**[Docket No. FR–4553–F–03]**

**RIN 2501–AC66**

### Treble Damages for Failure To Engage in Loss Mitigation

**AGENCY:** Office of Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Final rule.

**SUMMARY:** This final rule amends HUD's civil money penalty regulations to reflect HUD's authorization to impose treble damages on a mortgagee for any mortgage for which the mortgagee had a duty but failed to engage in appropriate loss mitigation actions. The final rule follows publication of a proposed rule, takes into consideration the public comments received on the proposed rule, but makes no changes at this final rule stage.

**DATES:** *Effective Date:* May 26, 2005.

**FOR FURTHER INFORMATION CONTACT:** Michael Reyes, Office of the Deputy Assistant Secretary for Single Family Housing, Office of Housing, Department of Housing and Urban Development, 301 NW. Sixth Street, Oklahoma City, OK 73102–2807, telephone (405) 609–8475 (this is not a toll-free number). Persons with hearing or speech impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at 1–800–877–8339.

**SUPPLEMENTARY INFORMATION:**

## I. Background

On April 14, 2004 (69 FR 19906), HUD published a proposed rule that would amend HUD's civil money penalty regulations at 24 CFR part 30 and HUD's single family mortgage insurance regulations at 24 CFR part 203 to reflect HUD's authorization to impose treble damages on a mortgagee for any mortgage for which the mortgagee had a duty but failed to engage in appropriate loss mitigation actions.

Sections 601(f), (g), and (h) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (Pub. L. 105–276, approved October 21, 1998), amended sections 230, 536(a), and 536(b)(1) of the National Housing Act (NHA) (12 U.S.C. 1715u, 12 U.S.C. 1735f–14(a)(2), and 12 U.S.C. 1735f–14(b)(1), respectively) to add a triple penalty to the existing civil money penalty system for failure to engage in appropriate loss mitigation. Section 230(a) of title II of the NHA, as amended, makes it mandatory for the mortgagee, upon the default of a single family mortgage, to engage in loss mitigation actions (including, but not limited to, special forbearance, loan modification, and deeds in lieu of foreclosure) for the purpose of providing alternatives to foreclosure. Section 601(h) amended section 536(b) of title V of the NHA to authorize but not require HUD to impose a civil money penalty on mortgagees that fail to engage in loss mitigation activities as required in section 230(a) of the NHA. Section 601(g) amended section 536(a) of title V of the NHA to provide that the penalty shall be equal to three times the amount of any insurance benefits claimed by a mortgagee with respect to any mortgage for which the mortgagee had a duty to engage in loss mitigation and failed to do so.

On December 6, 2000 (65 FR 76520), HUD published in the **Federal Register** an advance notice of proposed rulemaking (ANPR) that advised the public of HUD's plan to issue a proposed rule to amend HUD's civil money penalties regulations to assess treble damages for a mortgagee that had a duty to engage in loss mitigation and failed to do so. HUD's ANPR also solicited comments on the use of a tier ranking system (TRS) that analyzes a mortgagee's loss mitigation efforts on a portfolio-wide basis, and ranks the mortgagee on performance ratios of loss mitigation actions to conveyance claims. The TRS is based on a system that HUD implemented through notice as a pilot.

HUD's TRS consists of four tiers (Tiers 1, 2, 3, and 4) and is designed to measure a mortgagee's loss mitigation performance. While any mortgagee that has a duty to engage in loss mitigation and fails to do so is subject to treble damages, this rule provides appropriate notification that HUD will focus on Tier 4 mortgagees. Information available to HUD indicates that Tier 4 mortgagees engage in little or no loss mitigation. The public will be apprised of any change to HUD's focus through **Federal Register** notice. In addition, for any mortgagee, regardless of ranking or absence of ranking, HUD is not prevented from pursuing HUD penalties or sanctions.

Failure to engage in loss mitigation is defined as a mortgagee's failure to evaluate a loan for loss mitigation before four full monthly mortgage installments are due and unpaid to determine which, if any, loss mitigation techniques are appropriate (*see* 24 CFR 203.605), or subsequent failure to take appropriate loss mitigation action(s). Offering plausible loss mitigation options (as defined in 24 CFR 203.501) to qualified borrowers is engaging in loss mitigation. Mortgagees must be able to provide documentation of their loss mitigation evaluations and actions. Should a claim for mortgage insurance benefits later be filed, this documentation must be maintained in the claim review file in accordance with 24 CFR 203.365(c). Failure to successfully engage in loss mitigation with a borrower that is uncooperative or otherwise ineligible is not considered ''failure to engage'' in loss mitigation for that mortgage.

## II. This Final Rule

This final rule follows publication of the April 14, 2004, proposed rule and takes into consideration the public comments received on the proposed rule. After careful consideration of the public comments, HUD has decided to adopt the April 14, 2004, proposed rule without change.

## III. Discussion of Public Comments

The public comment period on the April 14, 2004, proposed rule closed on June 14, 2004. HUD received nine public comments on the proposed rule. Comments were received from a housing counseling agency, state housing and finance authorities, trade associations representing mortgage bankers and brokers, and a community development organization. This section of the preamble presents a summary of the significant issues raised by the public commenters and HUD's responses to these issues.

*Comment: The treble damages penalty is unfair and excessively high.* Two commenters stated that the treble damages penalty is unfair because it is not based on damages actually sustained by HUD. The commenters wrote that the penalties proposed are not treble damages but are actually numbers that are ten times HUD's actual losses on foreclosures. The commenters stated that the average losses incurred by HUD per foreclosure in 2003 were approximately $26,000, whereas an average penalty incurred per treble damages violation would be three times the average insurance claim, or approximately $276,000. One commenter explained the imposition of treble damages penalty is excessive in that the servicer ''risks losing'' three times the amount of the entire claim. Another commenter stated that treble damages should be limited to the amount of the borrower's current principal balance.

*HUD Response.* The statutory language that added this triple penalty to the existing civil money penalty

system states that the penalty shall be in the amount of three times the amount of any insurance benefits claimed for which the mortgagee failed to engage in loss mitigation. HUD, in determining the treble damages penalty amount, must abide by the statutory directive. Furthermore, the penalty is a punitive damage that would be assessed based on the lender's failure to follow HUD's policies and regulations. It is designed to remind mortgagees of the importance of complying with existing regulations and policies that require lenders to engage in loss mitigation, which minimizes the risk that borrowers unnecessarily lose their homes.

*Comment: The TRS has no bright-line test.* One commenter is concerned there is no ''bright-line test'' to determine a lender or mortgagee's placement in the TRS.

*HUD Response.* Lenders have had sufficient notice through 17 rounds of the Tier Ranking System to have a familiarity with the system. HUD published, by notice, with opportunity for comment, the benchmarks used in the Tier Ranking System.

*Comment: Loss mitigation efforts are highly subjective.* One commenter asked, ''How far is a lender expected to go to reach an uncooperative borrower [?]''

*HUD Response.* This final rule does not impose new servicing requirements on lenders, so the level of effort required to make contact and to attempt to gather and evaluate the borrower's financial situation remains unchanged. As stated in the proposed rule, if, despite documented attempts to evaluate or provide loss mitigation, implementation could not occur due to the borrower's refusal or failure to cooperate with the mortgagee, then generally, the mortgagee would be considered in compliance and not subject to treble damages for the particular loan.

An evaluation of the number of foreclosures by the 22 lenders earning a Tier 4 score in Round 17 shows that the median number of foreclosures was 32, the average was 63, the minimum was 11, and the maximum was 456. A comparison of these numbers to the corresponding level of loss mitigation used to calculate the TRS score supports HUD's contention that a Tier 4 ranking is evidence that a mortgagee has failed to engage in loss mitigation to such an extent that it is highly probable that the mortgagee has systematically denied loss mitigation to cooperative and qualified borrowers.

Lenders have had sufficient notice through 17 rounds of the Tier Ranking System. HUD's post-claim reviews can go back three years to establish a pattern of non-compliance with HUD policy. Treble damages will not be assessed on any claim where the date of default occurred before the final rule's effective date.

*Comment: It is unclear what claims are subject to the treble damages audit and penalty.* One commenter stated that HUD should provide a clearer statement of what claims, past and future, will be part of any treble damages audit and resulting penalty.

*HUD Response.* HUD will not pursue treble damages for failure to engage in loss mitigation where the date of default occurred before the final rule's effective date. Aside from that restriction, HUD may pursue treble damages as allowed by the operative statute of limitations.

*Comment: Tier 4 mortgagees should have a different standard of treble damages penalty than Tiers 1–3 mortgagees.* One commenter wrote that HUD must be very cautious in assessing the penalty and should only assess the penalty for Tier 4 mortgagees. Another commenter stated, ''HUD's apparent willingness to penalize any mortgagee for failure to engage properly in loss mitigation, 'regardless of [TRS] ranking or absence of ranking,' or historical context of excellent loss mitigation efforts, is disingenuous.'' One commenter wrote that it believes Tier 1–3 servicers should not have unlimited contingent liability for failure to engage in loss mitigation because minor infractions or other consumer complaints could trigger increased sampling and possible imposition of treble damages looking back to the previous servicing audit; thus, HUD should limit treble damages to only those servicers who fall into the Tier 4 category.

*HUD Response.* In the proposed rule, HUD stated that while any mortgagee that has a duty to engage in loss mitigation and fails to do so is subject to treble damages, this rule provides appropriate notification that HUD will focus on Tier 4 mortgagees for review purposes. Information available to HUD indicates that Tier 4 mortgagees engage in little or no loss mitigation. HUD continues to agree with this assessment.

*Comment: A ''safe harbor'' should be established where mortgagees demonstrating overall compliance will not be subjected to treble damage penalties.* One commenter wrote that a safe harbor should be provided to those who demonstrate a ''systematic overall compliance'' with the loss mitigation rules. The commenter explained that due to the ''extreme nature of the penalty,'' treble damages should not be imposed where a servicer is materially complying with the loss mitigation regulations and only ''isolated incidents'' of non-compliance have occurred. Another commenter stated that servicers that have generally good loss mitigation records may be subjected to treble damages for ''relatively isolated compliance failures.'' This commenter stated that a safe harbor should be included for those mortgagees with ''good rankings'' and that treble damages should be reserved for only those who have ''repeatedly failed to comply'' with loss mitigation requirements; otherwise, the ''inability to avoid treble damages'' may make ''GNMA servicing less attractive.'' Another commenter wrote that HUD should reconsider a treble damages penalty exemption for servicers who have demonstrated overall compliance with HUD's loss mitigation rules through the Tier rankings.

*HUD Response.* As stated previously, the civil money penalty statute does not allow HUD to exempt any group of lenders; therefore, HUD is prohibited from exempting Tier 1–3 lenders from potential treble damages. Also, as stated previously, this rule provides appropriate notification that HUD will focus on Tier 4 mortgagees for review purposes. Finally, while there is a case-by-case liability stemming from failure to evaluate a loan for loss mitigation and/or failure to then take the appropriate action, treble damage penalties are more likely where there is a pattern of non-compliance as opposed to an isolated servicing mistake. Thus, HUD continues to emphasize that HUD will primarily concentrate on those mortgagees that engage in little or no loss mitigation.

*Comment: Mortgagees should be allowed flexibility to challenge its findings of non-compliance.* One commenter wrote that the appeals process must be more broad in allowing servicers to refute substantive findings of ''failure to engage in loss mitigation'' regardless of the Tier ranking. The commenter explained that overly aggressive auditors who have misapplied Federal Housing Administration (FHA) requirements in the past will have the final decision on which companies will appear before the Mortgagee Review Board (MRB) for possible treble penalties; thus, servicers deserve an opportunity to refute an auditor's findings with HUD staff that are knowledgeable about loss mitigation policies before reaching the MRB. Another commenter stated that an appeals process is critical to ensure that the imposition of the treble damages penalty is justified.

*HUD Response.* HUD believes the commenters' concerns are misplaced,

and characterization of some Quality Assurance Division (QAD) monitors as ''overly aggressive'' is incorrect. HUD takes its duties to protect the public very seriously, and will continue current vigorous efforts to ensure the stability and viability of Departmental programs. Mortgagees have opportunities throughout the monitoring and Mortgagee Review Board process to contest proposed findings, and ultimately, to appeal any findings actually made. Generally, mortgagees have the ability to discuss potential findings with monitors on-site at the end of a review. If a mortgagee is referred to the Mortgagee Review Board and a Notice of Violation is issued, the mortgagee has an opportunity to submit a comprehensive response to the Notice. The mortgagee's response is considered by the Mortgagee Review Board in determining whether an administrative action or civil money penalty is appropriate. Upon being notified of the Board's determination to impose a sanction, a mortgagee has appeal rights as provided by statute and regulations.

*Comment: Servicers should have sufficient lead times before tier scoring standards are changed and implemented.* One commenter wrote that because HUD reserves the right to change the tier scoring benchmarks via **Federal Register** notice, any changes to the tier scoring system should allow the servicer necessary time (12 months) to make necessary revisions to their processes to meet new performance standards set out by HUD. Another commenter wrote that HUD should provide an advance warning system to allow servicers to improve their scores before enforcement actions can be taken. The commenter stated that servicers, like borrowers seeking loss mitigation, should be given a chance to cure. Moreover, although HUD has claimed it will adjust thresholds based on negative market conditions, an early warning system is still needed. Another commenter suggested that servicers be provided 12 months' advance warning of an increase in TRS thresholds or a change in TRS calculation so that servicers can publicly comment; also, 12 months allows for an evaluation of the change on a morgagee's tier ranking and an opportunity to adjust business models to raise scores. This alone may require hiring additional staff, a change of business plans, etc. This same commenter wrote that 12 months is consistent with other HUD timelines when other mortgagee policies have been changed. The commenter used the Round 14 Tier 4 threshold change from ''less than 15%'' to ''less than 40%'' as an example of how a more advanced warning could result in affected companies taking steps to avoid the new category.

*HUD Response.* A lender's business model should not be based on HUD's Tier Ranking System or its benchmarks; rather, it should be based on meeting the requirements that lenders evaluate all defaulted loans for loss mitigation and then take the appropriate action. As stated in the proposed rule, HUD may from time to time propose changes to the benchmarks. The changes will be proposed by a **Federal Register** notice, and offer the opportunity for comment before the changes take effect. Although the benchmarks are not part of the codified regulations, HUD nevertheless recognizes that changes to the benchmarks should undergo the opportunity for comment before becoming final and taking effect. Changes to evaluation thresholds are done periodically within the industry as performance changes. Under the TRS, Tier 4 will always be the lowest ranking possible. While the benchmarks were adjusted in Round 14, this was the only benchmark change since the workout ratio was adopted in Round 6. Advance notice, with opportunity to comment, will be given should HUD decide to change the TRS formula.

*Comment: Only claims from the last quarter should be considered in HUD's TRS analysis.* One commenter wrote that if HUD is willing to impose treble damages for failure to engage in loss mitigation on one loan, regardless of a mortgagee's loss mitigation performance, then HUD is being ''capricious and excessive.'' Both commenters stated that only claims filed during the last quarter comprising the ranking should be subject to treble damages and that claims in following quarters should not be subject to treble damages if the score improves to a higher ranking. The two commenters wrote that a preferred policy would be to subject servicers to the treble damage penalty only after servicers have been ranked Tier 4 for four consecutive quarters because this provides a reasonable opportunity to correct deficiencies or adjust business plans. In other words, this would allow sufficient time for an opportunity to cure. One of the commenters wrote that it previously supported quarterly rankings, but if the scope of servicers' liability is not limited to one quarter, then it is critical to reduce the frequency with which companies are evaluated for treble damages.

*HUD Response.* As stated above, lenders have had sufficient notice through 17 rounds of the Tier Ranking System to evaluate and improve their rankings. The statute does not permit HUD to exempt lenders from possible penalty based upon the approach proposed by the commenter, but treble damages will not be assessed on any loan where the date of default occurred before the effective date of this final rule.

As stated previously, this rule provides appropriate notification that HUD will focus on Tier 4 mortgagees for review purposes. HUD believes that looking at four quarters of data in TRS is in the lender's best interest, as it provides a better indication of performance. HUD will continue to provide quarterly feedback via the TRS. Given HUD's limited resources, HUD will focus on as many Tier 4 lenders as HUD can; however, the TRS is only one of several tools used by HUD for targeting lenders for review.

*Comment: Tiers 1–3 liability should only extend for one quarter.* Two commenters wrote that the window for Tiers 1–3 liability should extend for only one quarter. One commenter suggested providing quarterly reports for the servicers' benefit (''early warning system'') but that only one ''compliance'' ranking issued per year would trigger any enforcement action. The other commenter wrote that servicers ranked Tier 4 should only be subject to treble damages for those claims made during the last quarter comprising the ranking.

*HUD Response.* There is no ''tier liability.'' A mortgagee is not determined liable or not liable simply due to what Tier ranking a mortgagee occupies. As stated previously, HUD is focusing on Tier 4 mortgagees for review purposes. Also, as stated above, all Lenders have had sufficient notice through 17 rounds of the Tier Ranking System. HUD's post claim reviews can go back three years to establish a pattern of non-compliance with HUD policy. Treble damages will not be assessed on any loan where the date of default occurred before the final rule's effective date.

*Comment: Only certain loan origination issue dates and Round dates should be used in determining TRS rankings.* One commenter stated that it assumes HUD will not use dates from Round 14 through Round 17 in future scores if the data causes a servicer to be ranked Tier 4. The commenter explained that it assumes also that any findings of failure to engage in loss mitigation from October 1, 2002 through June 30, 2004 will not be subject to treble damages, because servicers did not have an advance warning of the increase in the threshold. Also, a

commenter stated that any application of the treble damages penalty should only apply to loans originated on or after the issue date of the final treble damages rule.

*HUD Response.* HUD believes there is no reason to delay application of TRS beyond issuance of the final rule. All tier rankings are based on one year's data, so mortgagees have sufficient information and notice of their performance to gauge their compliance. As a part of the pilot testing of TRS, 17 Rounds of TRS scores have been issued since December 2000. HUD's observation is that changes from Round to Round have been minimal based on the data's rolling 12 months. Treble damages will not be assessed on any loan where the date of default occurred before this final rule's effective date.

*Comment: Implementation of the treble damages hurts FHA.* One commenter stated ''We are concerned that the inability to completely avoid treble damages may make FHA servicing less attractive.''

*HUD Response.* HUD partially agrees with this comment. The inability to completely avoid treble damages may make FHA servicing less attractive to those lenders who systematically fail to engage in loss mitigation, which is a violation of existing regulations. However, this final rule adds no new servicing requirements; rather, it increases the penalty to those lenders who do not follow these requirements. When lenders do not service FHA loans in accordance with FHA regulations, this failure to perform loss mitigation results in greater losses to HUD. Lenders who do not service FHA loans in accordance with FHA regulations also harm the insurance fund by precluding ways by which a homeowner could recover financially and make mortgage payments. Additionally, lenders who do not service FHA loans in accordance with FHA regulations also deprive servicers of servicing income. The MRB has assessed and will continue to assess substantial fines to those lenders who demonstrate a pattern of non-compliance with HUD regulations.

*Comment: Ranking servicers by legal identity is a positive step.* One commenter expressed support that the proposed rule provides that servicers will be ranked by legal entity rather than separate mortgagee identification numbers. The commenter stated that servicers that have acquired other servicers will not be disadvantaged with regard to treble damages merely because they possess multiple mortgagee identification numbers and transact different activities under those numbers.

*HUD Response.* HUD has been providing a single, aggregate score only to those lenders with multiple HUD identification numbers who have legally become a single entity, and who have provided this notification to and met other requirements of HUD's Lender Approval and Recertification Division.

*Comment: Question regarding proposed damages cap.* One commenter asked whether the maximum money penalty, currently $1,250,000, applies to the treble damages penalty. The commenter would like HUD to make an express statement explaining the cap to treble damages.

*HUD Response.* HUD does not believe the annual limitation to the amount of civil money penalties applies to treble damages imposed for failure to engage in loss mitigation. The original enactment of a civil money penalty in 1988 was capped at the per violation level and the per violation cap was further modified by an annual cap. The 1998 legislation enacting a civil money penalty for failure to engage in loss mitigation provided for a penalty that substantially exceeds the original per violation maximum enacted by the initial 1988 civil money penalty legislation, and makes no mention of an annual cap on loss mitigation penalties. Indeed, a loss mitigation penalty for a single loss mitigation failure will likely be assessed at hundreds of thousands of dollars as the average claim to HUD is roughly $98,500. The legislative history for the 1998 enactment emphasizes Congress' intent that the loss mitigation program be ''aggressive and effective.'' Finally, as codified, the annual cap only modifies penalties previously capped on a per violation basis. Given the foregoing, HUD believes that an annual maximum civil money penalty amount does not apply to loss mitigation penalties.

*Comment: HUD should make loan-level information more easily available to servicers.* One commenter requested that HUD make available information used to calculate Tier Rankings in a downloadable batch format through FHA Connection. The commenter states that often the HUD data and the servicers' data do not match; also, a servicer must cut and paste tens of thousands of fields of information in order to perform reconciliation, which is very time-consuming. Servicers must be able to validate and reconcile their internal records to ensure all parties are operating off the same records.

*HUD Response.* In HUD's experience, the primary reason for failure to reconcile data stems from failure of the lender to accurately report to HUD's Single Family Default Monitoring System (SFDMS). The lender provides data to HUD, so the lender should be able to recreate in their own systems the data sent to HUD's SFDMS and data regarding paid loss mitigation and foreclosure claims. HUD has always responded to individual inquiries requesting loan level information. HUD is studying providing loan level data through a system accessible to lenders, but at this time does not have adequate funding for necessary system enhancements.

*Comment: HUD should provide timely TRS reports when used to trigger liability or incentives.* One commenter stated that because not all servicers can accurately monitor their Tier Rankings internally due to the difficulty in reconciliation and verification, HUD should provide timely TRS reports to ensure that the servicers have enough time to correct deficiencies before the next Tier Rankings are released.

*HUD Response.* There has always been at least a one-quarter lag from the end of the ranking period until the scores are released. This allows adequate time to ensure data integrity within the HUD systems from which the TRS counts are obtained. The TRS scoring methodology was designed so that lenders could calculate their own scores for self-monitoring, at any interval desired, using data from their own internal systems.

*Comment: Round 6's calculation change negatively affects rankings.* One commenter stated that the change in TRS calculation in Round 6, which requires servicers to back out multiple loss mitigation actions reported, makes the internal calculation of the score more difficult and less reliable. This results in discrepancies between servicer-generated rankings and the official Tier rankings.

*HUD Response.* The TRS calculation, including the maximum of one credit for multiple cases, was developed by HUD using widely available database software. The TRS scoring methodology was designed so that lenders could calculate their own scores for self-monitoring, at any interval desired, using data from their own internal systems.

*Comment: Question regarding sampling to determine Tier 4 reviews.* One commenter asked if HUD plans to conduct a 100 percent review of Tier 4 servicers or if HUD will limit the review to a smaller percentage or random sample.

*HUD Response.* Since 2001, soon after the first TRS scores were released, HUD incorporated TRS scores into the methodology used to target servicing lenders for review. This methodology

takes into account variables which include, but are not limited to, TRS scores, servicing portfolio size, length of time since last HUD review, default rates, default reporting, foreclosure claims, and previous findings. This methodology ensures that servicing lenders are reviewed with appropriate frequency, and effectively ensures that all Tier 4 servicing lenders will be reviewed at some time based on the variables in the targeting methodology. Furthermore, HUD may review any claim at any time for compliance with HUD's regulations regardless of tier ranking.

*Comment: Small mortgagees will be negatively affected by a treble damages penalty.* One commenter states it is concerned that HUD has retained the possibility to assess treble damages on any mortgagee HUD determines has failed to engage in loss mitigation. This commenter writes that such action would be very damaging to small mortgagees and that a good way to encourage mortgagees to engage in loss mitigation would be to use a tiered level of fines and penalties based on the size of the mortgagee. The commenter states that if a small mortgagee determines that it may be subject to an FHA penalty due to a failure to engage in required loss mitigation actions, it can simply push for foreclosure rather than offer loss mitigation to the mortgagor, purchase the property at foreclosure sale and make no claim (i.e., do not convey the property to the FHA).

*HUD Response.* The civil money penalty statute does not allow HUD to assess the penalty on any factor other than three times the amount of any insurance benefits claimed by the mortgagee with respect to any mortgage for which the mortgagee failed to engage in such loss mitigation actions. As stated in the proposed rule, all mortgagees have an obligation to ensure that all borrowers are afforded the opportunity for loss mitigation where loss mitigation is appropriate, and HUD has an obligation to enforce the loss mitigation requirements, regardless of the mortgagee's portfolio size.

HUD notes that pushing for a foreclosure without attempting loss mitigation as identified in the comment violates HUD's servicing regulations even in the absence of a filed claim. Implementation of a rush to foreclosure policy could subject the mortgagee and individuals involved in the violation to monetary penalties and program exclusions. A mortgagee that realizes that it has not done loss mitigation, and is fearful of a treble damages penalty, should, rather than push for foreclosure, stop or stay the foreclosure, perform the loss mitigation evaluation and then take the appropriate action, and potentially avoid a treble damages penalty altogether.

*Comment: Small mortgagees are unable to handle the financial and organizational costs associated with additional regulations.* A commenter wrote that small mortgagees such as state housing agencies are on the verge of suffering because of a variety of FHA policies and servicing FHA-insured loans is becoming almost as costly as servicing sub-prime loans. The potential fines and treble damages that the new mortgagee may encounter after taking on the service of new portfolios must be considered. The commenter stated that the ''myriad of rules, regulations, complexities, penalties and fines that are part of the current FHA insurance environment are detrimental to the achievement of the mission of state housing agencies and in turn detrimental to the achievement of HUD's stated mission and strategic goals.'' The commenter offered suggestions to lessen what the commenter states is a significant economic impact on small entities. The commenter suggests that: (1) A new definition of ''small'' be implemented; (2) more penalty categories be created where the penalties and fees are lower for smaller organizations; and (3) classifications are based on portfolio size and not the number of claims.

*HUD Response.* As stated previously, Section 230(a) of the NHA requires lenders to engage in loss mitigation actions. Again, this final rule adds no new servicing requirements; rather, it provides for imposition of a penalty on mortgagees that do not follow loss mitigation requirements. The intent of treble damages is to encourage mortgagees to comply with existing HUD policies, regulations, and statutes.

*Comment: HUD should address the unique needs of specialty servicers, especially small-to mid-sized servicers and subservicers, which have unique business models.* The commenter wrote that when subservicers are contractually required to finalize any foreclosure actions and process claims on behalf of the primary servicer, the subservicer must identify itself as the ''mortgagee of record'' and that foreclosure claim payment will be assigned to the subservicer for Tier Ranking purposes, thus negatively affecting the subservicer's TRS ranking. Also, buyers that acquire servicing for severely delinquent loans will have limited opportunity to perform loss mitigation. The commenter wrote that HUD should expressly state that a servicer's business model and/or the practical inability to perform certain loss mitigation functions will be considered a compensating factor for a Tier 4 ranking and HUD's imposition of treble damages. HUD should review servicers and the impact those servicers' different business models have on a case-by-case basis. Another commenter stated that ''mistakes happen.'' The commenter noted that one mistake on a loan file, thus resulting in a treble damages penalty, could put a small mortgagee out of business.

*HUD Response.* As stated previously, section 230(a) of the NHA requires mortgagees to engage in loss mitigation actions. Again, this final rule adds no new servicing requirements; rather, it provides for imposition of a penalty on mortgagees that do not follow loss mitigation requirements. The intent of treble damages is to encourage mortgagees to comply with existing HUD policies, regulations, and statutes. HUD is not a party to contractual agreements between servicers and subservicers. Servicers and subservicers are cautioned, however, to ensure that the parties to the contract have followed HUD regulations regarding approved servicers, mortgage record changes and servicing requirements, including loss mitigation evaluation and the management decision to foreclose.

HUD disagrees with the comment that a servicer's business model and/or the practical inability to perform certain loss mitigation functions should be considered a compensating factor for a Tier 4 ranking and HUD's imposition of treble damages. To allow such a compensating factor undermines the effectiveness of the regulatory scheme as neither the buyer nor the seller would accept responsibility for appropriate servicing, including the loss mitigation evaluation. HUD cannot allow ''sale of a mortgage'' to be an acceptable reason to not evaluate a loan for loss mitigation. While it may be true that servicing mortgagees who acquire servicing of severely delinquent loans could have limited opportunity to perform loss mitigation, the solution lies in the servicing mortgagees's due diligence prior to acquiring loans. Due diligence provides the servicing mortgagee the opportunity to measure the risks inherent in the portfolio, including, but not limited to, inadequate servicing or other factors that may ultimately lead to findings, civil money penalties, or indemnification of HUD (Please see Mortgagee Letter 2002–21, dated September 26, 2002, Due Diligence in Acquiring Loans, and HUD Handbook 4330.1, Rev-5, Chapter 6, for more guidance).

Finally, while there is a case-by-case liability stemming from failure to evaluate a loan for loss mitigation and/or failure to then take the appropriate action, treble damage penalties are more likely where there is a pattern of non-compliance as opposed to an isolated servicing mistake.

## IV. Small Business Concerns Related to Treble Damages

With respect to imposing treble damages on a mortgagee for failure to engage in loss mitigation, or taking other appropriate enforcement action against a mortgagee, HUD is cognizant that section 222 of the Small Business Regulatory Enforcement Fairness Act of 1996 (Public Law 104–121) (SBREFA) requires the Small Business and Agriculture Regulatory Enforcement Ombudsman to ''work with each agency with regulatory authority over small businesses to ensure that small business concerns that receive or are subject to an audit, on-site inspection, compliance assistance effort, or other enforcement related communication or contact by agency personnel are provided with a means to comment on the enforcement activity conducted by this personnel.'' To implement this statutory provision, the Small Business Administration has requested that agencies include the following language on agency publications and notices that are provided to small business concerns at the time the enforcement action is undertaken. The language is as follows:

Your Comments Are Important

The Small Business and Agriculture Regulatory Enforcement Ombudsman and 10 Regional Fairness Boards were established to receive comments from small businesses about Federal agency enforcement actions. The Ombudsman will annually evaluate the enforcement activities and rate each agency's responsiveness to small business. If you wish to comment on the enforcement actions of [insert agency name], you will find the necessary comment forms at *http://www.sba.gov.ombudsman* or call 1–888–REG–FAIR (1–888–734–3247).

In accordance with its notice describing HUD's actions on the implementation of SBREFA, which was published on May 21, 1998 (63 FR 28214), HUD will work with the Small Business Administration to provide small entities with information on the Fairness Boards and National Ombudsman program, at the time enforcement actions are taken, to ensure that small entities have the full means to comment on the enforcement activity conducted by HUD.

## V. Findings and Certifications

*Public Reporting Burden*

The information collection requirements contained in this rule have been approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35) and assigned OMB control number 2502–0523. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

*Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. All entities, small or large, will be subject to the same penalties for failure to engage in loss mitigation as established by statute and implemented by this rule. The statute does not provide an exemption for small entities. To the extent that the treble damages penalty would impose a significant economic impact on small entities, an impact will only occur due to a mortgagee's own inaction—since the only entities that will be affected will be poorly performing mortgagees that fail to engage in loss mitigation. Therefore, the undersigned certifies that this final rule will not have a significant economic impact on a substantial number of small entities.

*Environmental Impact*

In accordance with 24 CFR 50.19(c)(6) of HUD's regulations, this rule involves establishment of treble damages for lenders who fail to perform the loss mitigation evaluation and actions under 24 CFR 203.605. In accordance with 24 CFR 50.19(c)(1) of HUD's regulations, this final rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. Therefore, this rule is categorically excluded from the requirements of the National Environmental Policy Act (42 U.S.C. 4321 *et seq.*).

*Executive Order 13132, Federalism*

Executive Order 13132 (entitled ''Federalism'') prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the relevant requirements of Section 6 of the Executive Order are met. This rule affects only mortgagees and does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

*Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1531–1538) establishes requirements for Federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This final rule does not impose any Federal mandates on any state, local, or tribal government or the private sector within the meaning of UMRA.

*Regulatory Planning and Review*

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, Regulatory Planning and Review. OMB determined that this rule is a ''significant regulatory action'' as defined in section 3(f) of the Order (although not an economically significant regulatory action under the Order). Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection in the office of the Regulations Division, Office of General Counsel, Room 10276, 451 Seventh Street, SW., Washington, DC 20410–5000.

*Catalog of Federal Domestic Assistance Number*

The Catalog of Federal Domestic Assistance number applicable to the program affected by this rule is 14.117.

**List of Subjects**

*24 CFR Part 30*

Administrative practice and procedure, Grant programs—housing and community development, Loan programs—housing and community development, Mortgages, Penalties.

*24 CFR Part 203*

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community

development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

■ For the reasons discussed in the preamble, HUD amends 24 CFR parts 30 and 203 to read as follows:

## PART 30—CIVIL MONEY PENALTIES: CERTAIN PROHIBITED CONDUCT

■ 1. The authority citation for 24 CFR part 30 continues to read as follows:

**Authority:** 12 U.S.C. 1701q–1, 1703, 1723i, 1735f–14, 1735f–15; 15 U.S.C. 1717a; 28 U.S.C. 2641 note; 42 U.S.C. 3535(d).

### Subpart B—Violations

■ 2. In § 30.35, add a new paragraph (a)(15) and revise paragraph (c) to read as follows:

**§ 30.35 Mortgagees and lenders.**

* * * * *

(a) * * *

(15) Fails to engage in loss mitigation as provided in § 203.605 of this title.

* * *

(c) *Amount of penalty. (1) Maximum penalty.* Except as provided in paragraph (c)(2) of this section, the maximum penalty is $6,500 for each violation, up to a limit of $1,250,000 for all violations committed during any one-year period. Each violation shall constitute a separate violation as to each mortgage or loan application.

*(2) Maximum penalty for failing to engage in loss mitigation.* The penalty for a violation of paragraph (a)(15) of this section shall be three times the amount of the total mortgage insurance benefits claimed by the mortgagee with respect to any mortgage for which the mortgagee failed to engage in such loss mitigation actions.

### Subpart C—Procedures

■ 3. Add § 30.80 (l) to read as follows:

**§ 30.80 Factors in determining the appropriateness and amount of civil money penalty.**

* * * * *

(l) HUD may consider the factors listed in paragraphs (a) through (k) of this section to determine the appropriateness of imposing a penalty under § 30.35(c)(2); however, HUD cannot change the amount of the penalty under § 30.35(c)(2).

## PART 203—SINGLE FAMILY MORTGAGE INSURANCE

■ 4. The authority citation for 24 CFR part 203 continues to read as follows:

**Authority:** 12 U.S.C. 1709, 1710, 1715b, and 1715u; 42 U.S.C. 3535(d).

### Subpart C—Servicing Responsibilities

■ 5. Revise § 203.500 to read as follows:

**§ 203.500 Mortgage servicing generally.**

This subpart identifies servicing practices of lending institutions that HUD considers acceptable for mortgages insured by HUD. Failure to comply with this subpart shall not be a basis for denial of insurance benefits, but failure to comply will be cause for imposition of a civil money penalty, including a penalty under § 30.35(c)(2), or withdrawal of HUD's approval of a mortgagee. It is the intent of the Department that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed.

■ 6. Revise § 203.605 to read as follows:

**§ 203.605 Loss mitigation performance.**

*(a) Duty to mitigate.* Before four full monthly installments due on the mortgage have become unpaid, the mortgagee shall evaluate on a monthly basis all of the loss mitigation techniques provided at § 203.501 to determine which is appropriate. Based upon such evaluations, the mortgagee shall take the appropriate loss mitigation action. Documentation must be maintained for the initial and all subsequent evaluations and resulting loss mitigation actions. Should a claim for mortgage insurance benefits later be filed, the mortgagee shall maintain this documentation in the claim review file under the requirements of § 203.365(c).

*(b) Assessment of mortgagee's loss mitigation performance.* (1) HUD will measure and advise mortgagees of their loss mitigation performance through the Tier Ranking System (TRS). Under the TRS, HUD will analyze each mortgagee's loss mitigation efforts portfolio-wide on a quarterly basis, based on 12 months of performance, by computing ratios involving loss mitigation attempts, defaults, and claims. Based on the ratios, HUD will group mortgagees in four tiers (Tiers 1, 2, 3, and 4), with Tier 1 representing the highest or best ranking mortgagees and Tier 4 representing the lowest or least satisfactory ranking mortgagees. The precise methodology for calculating the TRS ratios and for determining the tier stratification (or cutoff points) will be provided through **Federal Register** notice. Notice of future TRS methodology or stratification changes will be published in the **Federal Register** and will provide a 30-day public comment period.

(2) Before HUD issues each quarterly TRS notice, HUD will review the number of claims paid to the mortgagee. If HUD determines that the lender's low TRS score is the result of a small number of defaults or a small number of foreclosure claims, or both, as defined by notice, HUD may determine not to designate the mortgagee as Tier 3 or Tier 4, and the mortgagee will remain unranked.

(3) Within 30 calendar days after the date of the TRS notice, a mortgagee that scored in Tier 4 may appeal its ranking to the Deputy Assistant Secretary for Single Family or the Deputy Assistant Secretary's designee and request an informal HUD conference. The only basis for appeal by the Tier 4 mortgagee is disagreement with the data used by HUD to calculate the mortgagee's ranking. If HUD determines that the mortgagee's Tier 4 ranking was based on incorrect or incomplete data, the mortgagee's performance will be recalculated and the mortgagee will receive a corrected tier ranking score.

*(c) Assessment of civil money penalty.* A mortgagee that is found to have failed to engage in loss mitigation as required under paragraph (a) of this section shall be liable for a civil money penalty as provided in § 30.35(c) of this title.

Dated: April 15, 2005.

**John C. Weicher,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

[FR Doc. 05–8334 Filed 4–25–05; 8:45 am]

**BILLING CODE 4210–27–P**