

materially adversely affect the safety and soundness of the Enterprise.

**§ 1710.31 Prohibited indemnification payments.**

(a) *Prohibited indemnification payments.* An Enterprise or any affiliate of an Enterprise may not make, except as provided in paragraph (b) of this section, any payment to indemnify any board member or executive officer for any legal expense incurred in connection with an administrative proceeding initiated or undertaken by OFHEO that results in a final order or settlement pursuant to which the board member or executive officer is assessed a civil money penalty or is required to cease and desist from or take any affirmative action with respect to the Enterprise.

(b) *Exceptions.* An Enterprise may make a reasonable payment that:

(1) Is used to purchase any commercial insurance policy or similar coverage; provided, however, that such insurance policy or similar coverage shall not be used to indemnify a board member or executive officer for the cost of any civil money penalty assessed against him or her in an administrative proceeding initiated or undertaken by OFHEO, but may be used to pay other legal expenses incurred in connection with such administrative proceeding or to pay the amount of any restitution to the Enterprise; or

(2) Represents partial indemnification for legal expenses specifically attributable to particular charges for which there has been a formal and final adjudication or a finding in connection with a settlement that the board member or executive officer has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty.

Dated: September 4, 2001.

**Armando Falcon, Jr.,**

*Director, Office of Federal Housing Enterprise Oversight.*

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**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

**Office of Federal Housing Enterprise Oversight**

**12 CFR Part 1773**

**RIN 2550-AA21**

**Flood Insurance**

**AGENCY** Office of Federal Housing Enterprise Oversight, HUD.

**ACTION:** Proposed regulation.

**SUMMARY:** The Office of Federal Housing Enterprise Oversight (“OFHEO”) is proposing a regulation to codify the authority and responsibility of OFHEO to oversee and enforce the statutory requirements affecting the operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation under the National Flood Insurance Reform Act of 1994, and to effect congressionally mandated adjustments to the civil money penalties applicable to violations of that law.

**DATES:** Comments regarding this notice of proposed rulemaking must be received in writing on or before October 12, 2001.

**ADDRESSES:** Send written comments to Alfred M. Pollard, General Counsel, Office of General Counsel, Office of Federal Housing Enterprise Oversight, 1700 G Street, NW., Fourth Floor, Washington, DC 20552. Written comments may also be sent by electronic mail at [RegComments@ofheo.gov](mailto:RegComments@ofheo.gov). OFHEO requests that written comments submitted in hard copy also be accompanied by the electronic version in MS Word or in portable document format (pdf) on 3.5” disk.

**FOR FURTHER INFORMATION CONTACT:** David A. Felt, Associate General Counsel, Office of General Counsel, Office of Federal Housing Enterprise Oversight, 1700 G Street, NW., Fourth Floor, Washington, DC 20552, telephone (202) 414-3750 (not a toll-free number). The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

**SUPPLEMENTARY INFORMATION:**

**Comments**

OFHEO invites comments on all aspects of the proposed regulation, including legal and policy considerations, and will take all comments into consideration before issuing the final regulation. Copies of all comments will be posted on the OFHEO Internet web site at <http://www.ofheo.gov>. In addition, copies of all comments received will be available for examination by the public at the Office of Federal Housing Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

*I. Statutory Framework*

Title XIII of the Housing and Community Development Act of 1992, Pub. L. No. 102-550, entitled the “Federal Housing Enterprises Financial Safety and Soundness Act of 1992” (the

“Act”),<sup>1</sup> established the Office of Federal Housing Enterprise Oversight (“OFHEO”) as an independent office within the Department of Housing and Urban Development. OFHEO is the financial safety and soundness regulator of the nation’s two largest housing-related Government-sponsored enterprises: the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively, the “Enterprises”). In addition to establishing OFHEO, the Act made amendments to the Enterprises’ enabling statutes (collectively, “the Charter Acts”)<sup>2</sup> among other things, accommodate the restructured regulatory regime under the Act.

The National Flood Insurance Act of 1968 (“NFIA”)<sup>3</sup> and the Flood Disaster Protection Act of 1973 (“FDPA”),<sup>4</sup> as amended by the National Flood Insurance Reform Act of 1994 (“NFIRA”),<sup>5</sup> together create a comprehensive National Flood Insurance Program (“NFIP”) that includes various provisions designed to ensure that structures built in flood plains are covered by statutory minimum amounts of flood insurance. NFIRA added specific requirements explicitly applicable to the Enterprises,<sup>6</sup> designated OFHEO as the Federal agency responsible for determining compliance of the Enterprises’ flood insurance responsibilities, required OFHEO to report their compliance in the agency’s 1996, 1998 and 2000 annual reports,<sup>7</sup> and provided OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA.<sup>8</sup> NFIRA also authorized OFHEO to impose civil money penalties upon an Enterprise that fails to implement procedures reasonably designed to ensure that the loans it purchases comply with the mandatory flood insurance purchase requirements.<sup>9</sup>

More specifically, NFIRA requires that the Enterprises each implement procedures reasonably designed to ensure that any mortgage loan that is purchased and is secured by property located in a designated flood hazard

<sup>1</sup> 12 U.S.C. 4501 *et seq.*

<sup>2</sup> Federal National Mortgage Association Charter Act (12 U.S.C. 1716-1723i) and Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451-1459).

<sup>3</sup> Codified at 42 U.S.C. 4001 *et seq.* and other scattered sections of 42 U.S.C.

<sup>4</sup> Codified at 42 U.S.C. 4002 *et seq.* and other scattered sections of 42 U.S.C.

<sup>5</sup> Pub. L. No. 103-325 (Sept. 23, 1994) (codified, as amended, at 42 U.S.C. 4001-4129).

<sup>6</sup> 42 U.S.C. 4012a(b)(3).

<sup>7</sup> 12 U.S.C. 4521(a)(4).

<sup>8</sup> 42 U.S.C. 4001 note.

<sup>9</sup> 42 U.S.C. 4012a(f)(c).

area is covered for the term of the loan by flood insurance in an amount at least equal to the lesser of (1) the outstanding principal balance of the loan or (2) the maximum limit of coverage made available for that type of property under the NFIP. OFHEO is authorized under NFIRA to levy a civil money penalty of \$350 per violation, not to exceed \$100,000 per year, against an Enterprise that it finds to have engaged in a pattern or practice of purchasing loans in violation of the procedures.<sup>10</sup>

## II. Background

The Enterprises have a key role in the implementation of the Federal Government's flood insurance program, particularly with regard to lenders that are not subject to direct supervision by a Federal regulatory agency. The Enterprises use their seller/servicer guidelines and other quality control review procedures to ensure that lenders with whom they contract comply with the applicable flood insurance laws. The Enterprises are required to establish procedures designed to prevent their purchase of loans that do not comply with these laws. NFIRA tasks OFHEO with reviewing the adequacy of such procedures as well as the Enterprises' compliance with them.

A primary purpose of the proposed regulation is to reiterate the relevant statutory provisions specifically applicable to the Enterprises and to OFHEO and to codify them in OFHEO's regulations. The proposed regulation is intended to provide guidance as to the procedures to be applied if an enforcement action were to be required, to add statutory civil money penalty amounts for infractions of the flood insurance requirements to the schedule of penalties in OFHEO's regulations and to adjust such penalty amounts as contemplated by law for inflation.

### The Inflation Adjustment Act

The Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996 (the Inflation Adjustment Act),<sup>11</sup> requires Federal agencies with the authority to issue civil money penalties, to adopt regulations to adjust each civil money penalty authorized by law that the agency has jurisdiction to administer. The purpose of these adjustments is to maintain the deterrent effect of civil money penalties and promote compliance with the law. The Inflation Adjustment Act requires agencies to make an initial adjustment

of their civil money penalties upon the statute's enactment, and to make additional adjustments on an ongoing basis, at least once every four years following the initial adjustment.

Under the Inflation Adjustment Act, the inflation adjustment for each applicable civil money penalty is determined by increasing the maximum civil money penalty amount by a cost-of-living adjustment. As is described in detail below, the Inflation Adjustment Act provides that this cost-of-living adjustment is to reflect the percentage increase in the Consumer Price Index since the civil money penalties were last adjusted or established.

NFIRA sets forth the procedures under which the Director of OFHEO could impose civil money penalties against an Enterprise and the amounts of these civil money penalties. In this rulemaking, the amounts of these civil money penalties are being adjusted in accordance with the requirements of the Inflation Adjustment Act. The increases in maximum civil money penalty amounts contained in this proposed rule do not mandate the amount of any civil money penalty that OFHEO may seek for a particular violation; OFHEO would determine each civil money penalty on a case-by-case basis in light of the circumstances of the case.

The Inflation Adjustment Act directs Federal agencies to calculate each civil money penalty adjustment as the percentage by which the CPI-U for June of the calendar year preceding the adjustment exceeds the CPI-U for June of the calendar year in which the amount of such civil money penalty was last set or adjusted pursuant to law. OFHEO has not previously adjusted these CMP amounts, so the base period is 1994, the year in which the CMPs were enacted into law by NFIRA. Because OFHEO is making these adjustments in calendar year 2001, and NFIRA was enacted in 1994, the inflation adjustment amount for each civil money penalty was calculated by comparing the CPI-U for June 1994 (148.0) with the CPI-U for June 2000 (172.4), resulting in an inflation adjustment of 16.5 percent. For each civil money penalty, the product of this inflation adjustment and the previous maximum penalty amount was then rounded in accordance with the specific requirements of the Inflation Adjustment Act,<sup>12</sup> then added to the

previous maximum penalty amount to determine the new adjusted maximum penalty amount. However, the Inflation Adjustment Act further specifies that the first adjustment of any CMP pursuant to such Act may not exceed ten percent of the penalty. Accordingly, the original civil money penalty maximum of \$350 under NFIRA is increased to \$385 for each violation and the civil money penalty maximum of \$100,000 is increased to \$110,000 for the total assessed penalties against any Enterprise during any calendar year.

## Section-By-Section Analysis

### Section 1773.1 Authority and Scope

Section 1773.1 sets forth the authority upon which this proposed regulation is based, namely the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended by the National Flood Insurance Reform Act of 1994. The National Flood Insurance Reform Act of 1994 requires OFHEO to examine the Enterprises to ascertain their compliance with these statutes and to report to Congress on their compliance, and provides OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA. OFHEO is authorized to impose civil money penalties on an Enterprise for violation of procedures established pursuant to the National Flood Insurance Act of 1968, as amended, or rules or regulations adopted pursuant thereto.<sup>13</sup>

### Section 1773.2 Requirements

Section 1773.2(a) sets forth the requirement that each Enterprise is to implement procedures reasonably designed to ensure that the properties securing particular loans described in paragraph (a) are properly insured in accordance with the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended by the National Flood Insurance Reform Act of 1994. This requirement applies to any loan purchased by an Enterprise that is secured by improved real estate or a mobile home located in an area that has been identified, at the time of the origination of the loan or at any time during the term of the loan, by the Director of the Federal Emergency Management Agency as an area having special flood hazards and in which

penalties greater than \$10,000 but less than or equal to \$100,000; \$10,000 in the case of penalties greater than \$100,000 but less than or equal to \$200,000; and \$5,000 in the case of penalties greater than \$200,000.

<sup>13</sup> 42 U.S.C. 4012a(f)(3).

<sup>12</sup> The statute's rounding rules require that each increase be rounded to the nearest multiple as follows: \$10 in the case of penalties less than or equal to \$100; \$100 in the case of penalties greater than \$100 but less than or equal to \$1,000; \$1,000 in the case of penalties greater than \$1,000 but less than or equal to \$10,000; \$5,000 in the case of

<sup>10</sup> 42 U.S.C. 4012a(f)(3)(5).

<sup>11</sup> 28 U.S.C. 2461 note.

flood insurance is available under the National Flood Insurance Program. As explained in paragraph (a), the Enterprise is required to ensure that a building or mobile home, and any personal property securing such loan are covered for the term of the loan by flood insurance in an amount at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage made available with respect to the particular type of property under the National Flood Insurance Program.

Section 1773.2(b) proposes that the procedures in paragraph (a) need apply only to loans made, increased, extended, or renewed after September 22, 1995. It further provides that paragraph (a) does not apply to any loan having an original outstanding principal balance of \$5,000 or less and a repayment term of one year or less.

#### *Section 1773.3 Civil Money Penalties*

Section 1773.3 sets forth procedures under this proposed section under which the Director of OFHEO may impose civil money penalties against an Enterprise. Section 1773.3(a) sets forth that the Director of OFHEO may assess a civil money penalty against an Enterprise determined by the Director to have engaged in a pattern or practice of purchasing loans in violation of the procedures established pursuant to § 1773.2.

Section 1773.3(b) sets forth notice and hearing requirements prior to the imposition of civil money penalties under this section. A civil money penalty may be issued only after notice and an opportunity for a hearing on the record has been provided under 12 CFR part 1780.

Section 1773.3(c) sets forth the maximum amount of civil money penalties that may be imposed on an Enterprise under this section. A civil money penalty under this section may not exceed the adjusted statutory amount of \$385 for each violation and the total amount of penalties assessed under this section against an Enterprise during any calendar year may not exceed the adjusted statutory cap of \$110,000 for such total penalties.

Section 1773.3(d) sets forth procedures for the deposit of civil money penalties. Any civil money penalties collected under this section shall be paid into the National Flood Mitigation Fund in accordance with 42 U.S.C. 4104d.

Section 1773.3(e) provides that any civil money penalty under this section shall be in addition to any civil remedy or criminal penalty otherwise available.

Section 1773.3(f) provides that no penalty may be imposed under this section after the expiration of the four-year period beginning on the date of the occurrence of the violation for which the penalty is authorized.

#### **Regulatory Impact**

##### *Executive Order 12866, Regulatory Planning and Review*

This proposed rule is not deemed to be a significant rule under Executive Order 12866 because it will not result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or foreign markets. Accordingly, no regulatory impact assessment is required and this proposed rule has not been submitted to the Office of Management and Budget for review.

##### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a rule that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). OFHEO has considered the impact of this proposed rule under the Regulatory Flexibility Act. The General Counsel certifies that this proposed rule will not have a significant economic impact on a substantial number of small business entities.

##### *Paperwork Reduction Act*

This proposed rule does not contain any information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

##### *Unfunded Mandates Reform Act of 1995*

This proposed rule does not require the preparation of an assessment statement in accordance with the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1531. Assessment statements are not required for regulations that incorporate

requirements specifically set forth in law. As explained in the preamble, this rule implements specific statutory requirements. In addition, this rule does not include a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year.

#### **List of Subjects in 12 CFR Part 1773**

Administrative practice and procedure, Flood insurance, Penalties, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, OFHEO proposes to add 12 CFR part 1773 to subchapter C of chapter XVII as follows:

#### **PART 1773—FLOOD INSURANCE**

Sec.

1773.1 Authority and scope.

1773.2 Requirements.

1773.3 Civil money penalties.

**Authority:** 12 U.S.C. 4521(a)(4); 42 U.S.C. 4001 note; 28 U.S.C. 2461 note; 42 U.S.C. 4012a(f)(3), (4), (8), (9), (10).

##### **§ 1773.1 Authority and scope.**

(a) *Authority.* The National Flood Insurance Act of 1968, title XII of Pub. L. No. 90-448, Aug. 1, 1968, 42 U.S.C. 4002 *et seq.*, and the Flood Disaster Protection Act of 1973, 42 U.S.C. 4002 *et seq.*, as amended by the National Flood Insurance Reform Act of 1994 ("NFIRA"), Pub. L. No. 103-325, Sept. 23, 1994, 42 U.S.C. 4001-4129, together create the National Flood Insurance Program ("NFIP") which established specific requirements applicable to the Enterprises. NFIRA designates OFHEO as the Federal agency responsible for determining compliance by the Enterprises with these statutes and with reporting to Congress biannually for six years on the Enterprises' compliance. OFHEO with the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA. OFHEO is also charged with enforcing the requirements of NFIRA as to the Enterprises and provides for the assessment of civil money penalties for violations of the procedures established by the Enterprises pursuant to the law or implementing regulations.

(b) *Scope.* This part sets forth the responsibilities of the Enterprises under NFIRA and the procedures to be used in any proceeding to assess civil money penalties against an Enterprise under NFIRA.

##### **§ 1773.2 Requirements.**

(a) *Procedures.* Each Enterprise shall implement procedures reasonably

designed to ensure for any loan that is secured by improved real estate or a mobile home located in an area that has been identified, at the time of the origination of the loan or at any time during the term of the loan, by the Director of the Federal Emergency Management Agency as an area having special flood hazards and in which flood insurance is available under the NFIP, and purchased by such entity, the building or mobile home and any personal property securing the loan is covered for the term of the loan by flood insurance in an amount at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage made available with respect to the particular type of property under the NFIP.

(b) *Applicability.* (1) Paragraph (a) of this section shall apply only with respect to any loan made, increased, extended, or renewed after September 22, 1995.

(2) Paragraph (a) of this section shall not apply to any loan having an original

outstanding balance of \$5,000 or less and a repayment term of one year or less.

#### **§ 1773.3 Civil money penalties.**

(a) *In general.* If an Enterprise is determined by the Director of OFHEO to have engaged in a pattern or practice of purchasing loans in violation of the procedures established pursuant to the NFIA, as amended, or to § 1773.2, the Director may assess civil money penalties against such Enterprise in such amount or amounts as deemed to be appropriate under paragraph (c) of this section.

(b) *Notice and hearing.* A civil money penalty under this section may be assessed only after notice and an opportunity for a hearing on the record has been provided under 12 CFR part 1780.

(c) *Amount.* A civil money penalty under this section may not exceed \$385 for each violation. The total amount of penalties assessed under this section

against an Enterprise during any calendar year may not exceed \$110,000.

(d) *Deposit of penalties.* Any penalties collected under this section shall be paid into the National Flood Mitigation Fund in accordance with 42 U.S.C. 4104d.

(e) *Additional penalties.* Any penalty under this section shall be in addition to, and shall not preclude, any civil remedy or criminal penalty otherwise available.

(f) *Statute of limitations.* No civil money penalty may be imposed under this section after the expiration of the four-year period beginning on the date of the occurrence of the violation for which the penalty is authorized under this section.

Dated: September 4, 2001.

**Armando Falcon, Jr.,**

*Director, Office of Federal Housing Enterprise Oversight.*

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