



Issue Date April 8, 2011

Audit Report Number 2011-FW-0001

TO: Ivery Himes, Acting Director, Office of Single Family Asset Management, HUF

//signed//

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The National Servicing Center Implemented the FHA-HAMP Loss Mitigation Option in Accordance With Rules and Regulations

HIGHLIGHTS

What We Audited and Why

We audited the U. S. Department of Housing and Urban Development's (HUD) National Servicing Center's (NSC) Federal Housing Administration (FHA)-Home Affordable Modification Program (HAMP) as a part of our annual audit plan. Our objective was to determine whether NSC implemented and operated FHA-HAMP in accordance with rules and regulations.

What We Found

Overall, NSC implemented and operated FHA-HAMP in accordance with the necessary rules and regulations. However, since this was a recently developed program, new situations arose that NSC had not addressed or corrected. We identified three areas that NSC needed to improve. These three areas were identifying failed FHA-HAMP trial plans, identifying duplicate FHA-HAMP payments, and improving the timeliness of trial payments.

What We Recommend

We recommend that the Acting Director of the Office of Single Family Asset Management require NSC to (1) develop a default status code for failed FHA-HAMP trial plans and (2) clarify its timeliness of trial payments.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft report to HUD on March 18, 2011, with a request for written comments by March 31, 2011. We held an exit conference with the Office of Single Family Asset Management and NSC on March 24, 2011. HUD requested an extension to provide comments and we agreed to extend the date to April 5, 2011. We received written comments on April 6, 2011. The Office of Single Family Asset Management agreed with our recommendations.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

TABLE OF CONTENTS

Background and Objective	4
Results of Audit	
Finding: NSC Implemented and Operated FHA-HAMP in Accordance With Rules and Regulations	5
Scope and Methodology	9
Internal Controls	12
Appendixes	
A. Auditee Comments and OIG's Evaluation	14

BACKGROUND AND OBJECTIVE

The U. S. Department of Housing and Urban Development (HUD) created the Federal Housing Administration (FHA)-Home Affordable Modification Program (HAMP) loss mitigation home retention option in response to the Helping Families Save Their Homes Act of 2009 (Act). The National Servicing Center¹ (NSC) was responsible for implementing FHA-HAMP and providing guidance on the program. Effective August 15, 2009, FHA-HAMP provided homeowners who defaulted on their mortgage loan a greater opportunity to reduce their mortgage payments to a sustainable level.² On January 22, 2010, HUD issued guidance³ allowing homeowners facing imminent default to participate in FHA-HAMP.

FHA-HAMP combined two of the current home retention loss mitigation options: loan modification and partial claim. The loan modification must reduce the unmodified monthly principal and interest payment, and the servicer must reamortize the loan for 30 years. The partial claim amount can be up to 30 percent of the unmodified unpaid principal balance. No interest accrues on the partial claim. The FHA-HAMP partial claim is due at the maturity of the FHA-HAMP mortgage, the sale of the property, or payoff or refinancing of the FHA-HAMP mortgage.

To participate in the FHA-HAMP loss mitigation option, at least 12 months must have passed since the homeowner's first payment due date for the unmodified FHA-insured mortgage, and the homeowner must have made at least four full mortgage payments. Also, the loan servicer must consider each homeowner for special forbearance, regular loan modification, or regular partial claim before considering the homeowner for FHA-HAMP.

If the homeowner does not qualify for the three home retention loss mitigation options and the servicer determines that the homeowner qualifies for FHA-HAMP, the servicer may put the homeowner in a 3-month trial plan for loans in default or a 4-month trial plan for homeowners facing imminent default. If the homeowner completes the trial plan, the servicer may file for a partial claim and loan modification to reduce the amount owed on the mortgage and modify the monthly mortgage payments. If the homeowner does not complete the trial plan, the homeowner no longer qualifies for FHA-HAMP for the life of the FHA-insured mortgage.

As of June 7, 2010, servicers had completed 731 FHA-HAMP loss mitigation options. The top 5 servicers accounted for 91 percent of the 731 completed FHA-HAMP claims.

Our objective was to determine whether NSC implemented and operated FHA-HAMP in accordance with rules and regulations.

¹ NSC oversees all loss mitigation options to help FHA borrowers cure defaults to avoid foreclosure. FHA approved lenders must use the loss mitigation options to cure defaults and, if possible, avoid foreclosure.

² Mortgagee Letter 2009-23

³ In Mortgagee Letter 2010-04, "FHA defines an 'FHA borrower facing imminent default' to be an FHA borrower that is current or less than 30 days past due on the mortgage obligation and is experiencing a significant reduction in income or some other hardship that will prevent him or her from making the next required payment on the mortgage during the month that it is due."

RESULTS OF AUDIT

Finding: NSC Implemented and Operated FHA-HAMP in Accordance With Rules and Regulations

With a few exceptions, NSC implemented and operated FHA-HAMP in accordance with rules and regulations. However, it could improve its operations by improving its monitoring of and controls over FHA-HAMP. Specifically, NSC should (1) establish a default status code for a failed FHA-HAMP trial plan and (2) clarify contradictory requirements concerning the FHA-HAMP trial plan payments. Since this was a recently developed program, new situations arose that NSC had not addressed or corrected. Implementing and incorporating these changes should contribute to the effectiveness and efficiency of FHA-HAMP.

HUD Did Not Have a Default Status Code for Failed FHA-HAMP Trial Plans

NSC did not assign a specific default code within its system⁴ for a failed FHA-HAMP trial plan. This omission prohibited NSC from tracking and thus measuring failed FHA-HAMP trial plans. When an FHA-insured loan went into default, regulations required servicers to report the status of the default. In October 2009, HUD assigned two default status codes for FHA-HAMP:⁵ (1) default status code 39 to show that the servicer had approved the participant for an FHA-HAMP trial period and (2) default status code 41 to show that the participant had successfully completed the trial plan and the servicer was starting the process to complete the FHA-HAMP loan modification and partial claim.

NSC considered an FHA-HAMP loss mitigation option failed when the servicer reported only a default status code 39 without a subsequent default status code 41. However, this was not always a reliable conclusion, as lenders reported loans in default status code 39 without a subsequent recording of default status code 41 for a variety of reasons. These reasons could include

- The loan was under an ongoing FHA-HAMP trial plan,
- The borrower did not qualify for the FHA-HAMP trial plan,
- The borrower became current on the mortgage loan,
- The borrower did not qualify for FHA-HAMP after the servicer recorded the default status 39 but qualified for another loss mitigation option, or
- The borrower did not complete the FHA-HAMP trial plan paperwork.

⁴ HUD's system, Single Family Data Warehouse, requires lenders to enter a default code reflecting the status of the default (Mortgagee Letter 2006-15).

⁵ Mortgagee Letter 2009-39

Of 10 loans that were reviewed that had a default status code 39, only 1 failed the FHA-HAMP trial plan. Analysis of original default history data showed 8,848 loans that had a default status code 39 reported without a default status code 41. Analysis of updated data approximately 7 months later⁶ showed that 7,672 of the 8,848 loans still did not have a default status code of 41 reported. One servicer had 4,754 of the 7,672 loans with a default status code 39 without a default status code 41, although the particular servicer may have had a computer issue with reported default status codes.

FHA-HAMP is limited to one trial plan per FHA loan. If the borrower under that loan failed the trial plan, the servicer was no longer allowed to consider that loan for the FHA-HAMP loss mitigation option. NSC's implementation of a default status code to identify failed FHA-HAMP trial plans would benefit NSC and the servicers. This measure would also help servicers who acquire the loans to identify loans that are no longer eligible for the FHA-HAMP loss mitigation option.

NSC Did Not Test for Potential Duplicate FHA-HAMP Claims

Analysis of HUD data indicated that one FHA-HAMP lender incorrectly submitted two FHA-HAMP claims on the same loan. HUD rules and regulations allow one FHA-HAMP loss mitigation option per FHA-insured mortgage.⁷ If a homeowner goes into default after successfully completing the FHA-HAMP process, the homeowner must use a loss mitigation option other than FHA-HAMP to cure the default.

While NSC performed several tests to determine the progress and use of the FHA-HAMP loss mitigation option, it did not have one to identify potential duplicate FHA-HAMP claims. When notified of the potential duplicate FHA-HAMP claims, NSC created a similar test to identify potential duplicate FHA-HAMP claims. NSC also contacted the servicer to obtain an explanation to determine why it filed the duplicate claim. In this instance, the servicer had accidentally filed the two FHA-HAMP loan modifications under the same mortgage number when it was for two different mortgages. The servicer took corrective action to ensure that the loans reflected the correct FHA-HAMP loan modifications.

When NSC used this test for its June 2010 reporting period, it identified an additional three mortgages with potential duplicate FHA-HAMP claims. Identifying

⁶ Trial plans are for either 3 or 4 months. Therefore, if the participants had completed the FHA-HAMP trial plan, the servicer more than likely would have started filing the partial claim and loan modification documentation (default status code 41) to complete the process.

⁷ Mortgage Letter 2009-23 guideline attachment

the duplicates early in the process will help NSC to quickly correct errors and prevent fraud.

After NSC developed the test to identify duplicates, it developed another test to determine whether the new unpaid principal balance was lower than the unmodified unpaid principal balance. By performing this test, NSC could determine whether the partial claim met the intent of the program. NSC developed this test for its July 2010 reporting period and found one instance of noncompliance. By incorporating these tests into its routine monitoring, NSC has sufficiently addressed the issue, and no further recommendation will be made.

HUD Provided Conflicting Trial Plan Payment Guidance

HUD provided contradictory guidance on FHA-HAMP trial payments. In two mortgagee letters,⁸ HUD required FHA-HAMP lenders to complete a 3- or 4-month trial plan to determine whether the participant could afford the modified monthly mortgage payments. The trial payments should be made on time. The mortgagee letter also required the servicing of the FHA-HAMP trial plan in the same manner as a special forbearance.⁹ Under the special forbearance requirements, participants were considered successful as long as they were no more than 60 days delinquent on trial plan payments.¹⁰ It appears HUD may have been unaware that the requirements were contradictory.

The intent of the FHA-HAMP loss mitigation option is to ensure that the participant can afford the modified monthly mortgage payment and make those payments on time. With the amount of the FHA-HAMP partial claim potentially being much larger than the regular partial claim¹¹ and the legal position of the partial claim not having a required priority, it is imperative that the participants show the ability to make the modified monthly mortgage payments on time. Otherwise, the negative impact to the FHA insurance fund could be significant. HUD should clarify its guidance to ensure that borrowers make their FHA-HAMP trial payments on time.

⁸ Mortgagee Letters 2009-23 and 2010-04

⁹ Mortgagee Letter 2009-23

¹⁰ Mortgagee Letter 2002-17

¹¹ The FHA-HAMP partial claim can be up to 30 percent of the unpaid principal balance. The regular partial claim is limited to 12 months of principal, interest, taxes, and insurance.

Conclusion

With a few exceptions, NSC implemented and operated FHA-HAMP in accordance with the necessary rules and regulations. HUD should implement a default status code for those loans that fail the FHA-HAMP loss mitigation option. NSC has prudently taken corrective action to identify and add tests to its routine monitoring program. Lastly, HUD should clarify its regulations to ensure that FHA-HAMP participants make the trial plan payments on time every month and not allow delinquencies during the trial plan.

Recommendations

We recommend that the Acting Director of the Office of Single Family Asset Management require NSC to

- 1A. Develop and issue a default status code for a failed FHA-HAMP trial plan.
- 1B. Revise and/or clarify the FHA-HAMP regulations to require the participants to make the trial plan payments on time and not allow delinquencies.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Reviewed relevant criteria,
- Visited two servicers to review FHA-HAMP files,
- Interviewed NSC staff and staff from the two servicers, and
- Analyzed HUD's Single Family Data Warehouse's¹² (HUD data) loss mitigation table and default history table as discussed in detail below.

HUD Data - Loss Mitigation Table

To obtain an understanding of the program, we analyzed HUD data. Through analysis of the loss mitigation table, we determined that it contained more than 1.1 million records as of June 7, 2010. Using ACL software, we “filtered” these records to show paid claims for loan modifications and partial claims with or without an FHA-HAMP indicator. Further, we tested for duplicate claims to determine whether HUD paid any claims twice on the same loan that had a loan modification or partial claim with an FHA-HAMP indicator. One loan had a duplicate claim for a loan modification with an FHA-HAMP indicator. Further, we “joined” these filtered records to determine the number of

- Completed FHA-HAMP claims (731),
- Paid claims for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim (14),
- Paid claims for an FHA-HAMP partial claim without a corresponding FHA-HAMP loan modification (131),
- Paid claims for an FHA-HAMP partial claim that had a previous partial claim without an FHA-HAMP indicator (41), and
- Instances in which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date (7).

As of June 7, 2010, Midland Mortgage and Wells Fargo had the most completed FHA-HAMP claims with 337 and 181, respectively. Therefore, we chose those two servicers to visit.

For Midland Mortgage,¹³ we chose a total of 10 files to review from 5 different tables. The number, universe, and method of selection follow:

- Two loans from the completed FHA-HAMP data – one with the oldest endorsement date and one with the highest FHA-HAMP partial claim amount;

¹² HUD data is composed of a variety of “tables” based upon the status of the mortgage. For our purposes, we primarily used the loss mitigation and default history tables.

¹³ See audit report 2011-FW-1008, dated April 8, 2011, “Midland Mortgage Company, Oklahoma City, OK, Generally Complied With FHA-HAMP Rules and Regulations” for the results of the review.

- Two loans from the paid claim data for an FHA-HAMP partial claim without a corresponding FHA-HAMP loan modification – one with the highest FHA-HAMP partial claim amount and one with the oldest process date with the highest FHA-HAMP partial claim amount;
- Two loans from the paid claim data for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim – the first two listed;
- Two loans from the paid claim data for an FHA-HAMP partial claim that had a previous partial claim without an FHA-HAMP indicator – one with the highest FHA-HAMP partial claim amount and one with the highest regular partial claim amount; and
- Two loans for which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date – Midland Mortgage only had two of these loans.

For Wells Fargo, we chose a total of 10 files to review from 5 different tables. The number, universe, and method, of selection follow:

- Two loans from the completed FHA-HAMP data – one with the oldest endorsement date and one with the highest FHA-HAMP partial claim amount;
- Two loans from the paid claim data for an FHA-HAMP partial claim without a corresponding FHA-HAMP loan modification – one with the highest FHA-HAMP partial claim amount and one with the oldest process date with the highest FHA-HAMP partial claim amount;
- Three loans from the paid claim data for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim – the first three listed;
- One loan from the paid claim data for a FHA-HAMP partial claim that had a previous partial claim without an FHA-HAMP indicator – Wells Fargo only had one loan with a previous partial claim; and
- Two loans for which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date – Wells Fargo only had two of these loans.

HUD Data - Default History Table

As of June 10, 2010, HUD's data for the default history table for default status codes 39 and 41 had more than 18,800 records. Using ACL software, we "filtered" the records to isolate the default status codes into individual tables: default status codes 39 had 16,662 records, and default status code 41 had 2,139 records. We then "joined" the default status code tables to determine how many loans had a default status code 39 that matched and did not match default status code 41. After eliminating any duplicate case numbers,¹⁴ our analysis showed that 746 loans had both a default status code of 39 and 41. Additionally, 8,848 loans had a default status code of 39 but not a 41.

¹⁴ Servicers would report a default status code 39 for the 3- or 4-month period the participant was in the trial plan.

We chose 10 loans to review (5 from Midland Mortgage and 5 from Wells Fargo) that had a default status code of 39 but not a 41. We assigned a random number to each loan and sorted in ascending order. Before selecting the loan to review, we reviewed Neighborhood Watch to ensure that the loan did not already have a completed FHA-HAMP claim. If the loan did have a completed FHA-HAMP claim, we discarded that loan and chose the next loan until we had five loans for each servicer.

HUD Data - Updated Default History Table

As of January 6, 2011, the default history table for default status codes 39 and 41 contained more than 58,800 records. We filtered the records to isolate default status code 41, which had 5,010 records after eliminating duplicate case numbers. We compared this information with the 8,848 records from the original default history table. Of the 8,848 records that had a default status code 39 but not a default status code 41 reported in June 2010, 7,672 records still did not have a default status code 41 reported in January 2011. One servicer (Wells Fargo) was responsible for 4,754 of those records.

We relied on the above data to select a sample of loans to review for our objective. We reviewed the underlying documentation to form our conclusions. We do not express an opinion on the overall reliability of the data.

We performed audit work at NSC's office and Midland Mortgage's office, both in Oklahoma City, OK. We also performed audit work at Wells Fargo's office in Fort Mill, South Carolina. We performed this work from May 2010 through March 2011.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Program operations – Local policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that it obtains, maintains, and fairly discloses valid and reliable data in reports.

We assessed the relevant controls identified above.

A deficiency in internal controls exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency


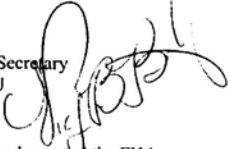
We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of NSC's internal controls.

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

 OFFICE OF HOUSING	U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT WASHINGTON, DC 20410-8000 APR 06 2011
MEMORANDUM FOR:	Gerald R. Kirkland, Regional Inspector General for Audit, Fort Worth Region, 6AGA
FROM:	Vicki B. Bott, Deputy Assistant Secretary for Single Family Housing, HU 
SUBJECT:	The National Servicing Center Implemented the FHA- HAMP Loss Mitigation Option in Accordance With Rules and Regulations Audit 2011-FW-000X Issue Date: TBD
<p>The Office of Inspector General (OIG) performed an audit of the Department of Housing and Urban Development's National Servicing Center's (NSC) Federal Housing Administration's (FHA) Home Affordable Modification Program (FHA-HAMP) as part of its annual audit plan. The OIG's audit objective was to determine whether NSC implemented and operated FHA-HAMP in accordance with rules and regulations.</p> <p>The Office of Single Family Housing's response to the audit recommendations are as follows:</p>	
<p><u>OIG's Recommendation 1A:</u></p> <p>Develop and issue a default status code for a failed FHA-HAMP trial plan.</p>	
Comment 1	<p><u>Single Family's Response:</u> Single Family Housing agrees with the recommendation. Once the codes are activated, Single Family Housing will issue a Mortgagee Letter instructing mortgagees on how to use the code and the effective date of implementation.</p>
<p><u>OIG's Recommendation 1B:</u></p> <p>Revise and/or clarify the FHA-HAMP regulations to require the participants to make the trial plan payments on time and not allow delinquencies.</p>	
Comment 1	<p><u>Single Family's Response:</u> Single Family Housing agrees with the recommendation. Single Family Housing intends to re-emphasize the existing requirements for participants to make timely trial plan payments to avoid delinquencies. The "Frequently Asked Questions" page for FHA-HAMP will be updated to define timely payments on NSC's web page located at http://www.hud.gov/offices/hsg/slh/nsc/ml0923qa.pdf</p>
<p>www.hud.gov espanol.hud.gov</p>	

OIG Evaluation of Auditee Comments

Comment 1 We commend the Office of Single Family Asset Management for taking appropriate action regarding the recommendations.