Bank of America
Plano, TX

Loss Mitigation Requirements for Distressed Asset Stabilization Program

Office of Audit, Region 8
Denver, CO

Audit Report Number: 2019-DE-1001
April 9, 2019

To:	Gisele G. Roget Deputy Assistant Secretary for Single Family Housing, HU
	//**signed**//
From:	Ronald J. Hosking Regional Inspector General for Audit, 7AGA
Subject:	Bank of America, Plano, TX, Followed the Loss Mitigation Requirements for All of the Loans Reviewed

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Bank of America's loss mitigation for loans released into the Distressed Asset Stabilization Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.

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Bank of America Followed the Loss Mitigation Requirements for All of the Loans Reviewed

Highlights

What We Audited and Why

We audited Bank of America because it has released more than 47,000 Federal Housing Administration (FHA)-insured loans into the Distressed Asset Stabilization Program (DASP) note sales program. Since its inception, DASP has facilitated the sale of more than 108,000 FHA loans, which means that Bank of America accounts for nearly half of the entire program. This is the fourth in a series of audits on DASP. The first three audits (2017-KC-0006, 2017-KC-0010, and 2018-KC-0003) examined the U.S. Department of Housing and Urban Development and focused on the program's requirements, processes, controls, and oversight. Our audit objective for this audit was to determine whether Bank of America properly followed all loss mitigation requirements for loans released into DASP.

What We Found

Bank of America followed the loss mitigation requirements for all of the loans reviewed. For those loans without a completed loss mitigation process, the main reasons loss mitigation was not performed related to a lack of homeowner participation or homeowner documentation.

What We Recommend

This report contains no recommendations.

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Background and Objective

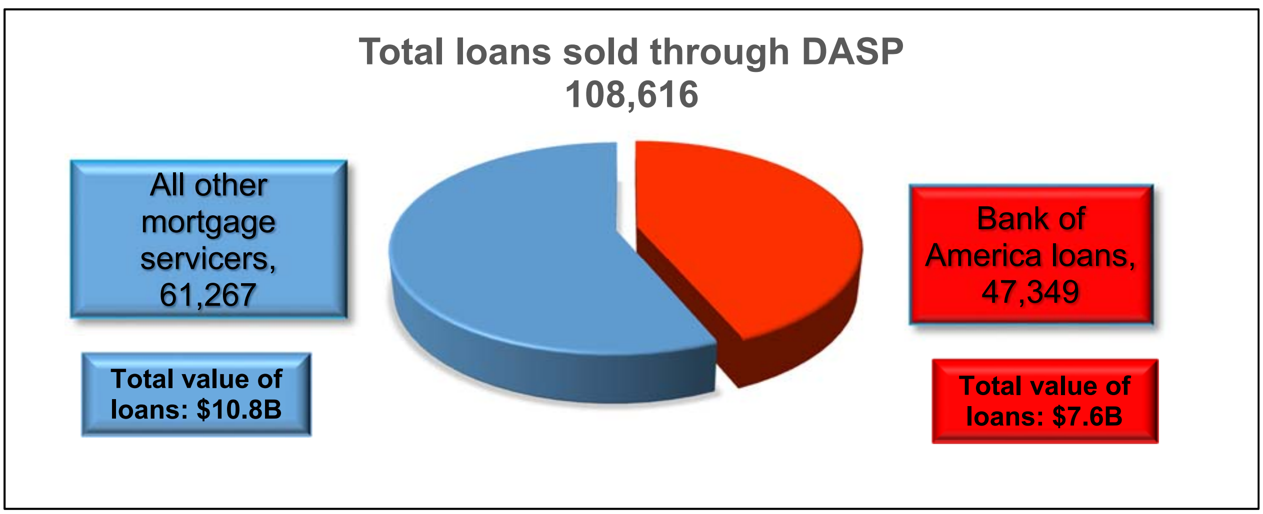
Distressed Asset Stabilization Program

The U.S. Department of Housing and Urban Development's (HUD) Office of Housing began selling defaulted Federal Housing Administration (FHA)-insured single-family mortgages through its Distressed Asset Stabilization Program (DASP) in 2012. Since then, it has facilitated the sale of 108,616 loans totaling $18 billion and insulated the FHA insurance fund from greater loses.

For each DASP sale, HUD's Office of Asset Sales would publish specific criteria outlining which loans could be included, but all sales were limited to loans already in default and for which loss mitigation attempts had failed. FHA-approved loan servicers would submit their loans to be sold, and HUD would package the eligible loans together in pools. Some of these were large national pools, while others were limited to specific geographic areas in an attempt to stabilize certain neighborhoods. Interested buyers of these pools would submit competitive bids to HUD, and the highest bidder would receive the entire pool of loans. Once sold, FHA would no longer insure these loans, and the buyers would be prohibited from immediately reselling them.

Bank of America

Bank of America services FHA-insured mortgages and sells defaulted loans through DASP. We audited Bank of America because it has provided 43 percent of all loans sold through the program worth an estimated $7.6 billion, by far the largest share of any servicer. To participate, Bank of America entered into a participating servicer agreement with HUD, certifying that all of the loans it released into DASP met the requirements for an eligible mortgage loan. See appendix C for the specific eligible mortgage loan requirements.



Our audit objective was to determine whether Bank of America properly followed all loss mitigation requirements for loans released into DASP.

Results of Audit

Results: Bank of America Followed the Loss Mitigation Requirements for All of the Loans Reviewed

Bank of America followed the loss mitigation requirements for all of the loans reviewed. For those loans without a completed loss mitigation process, the main reasons loss mitigation was not performed related to a lack of homeowner participation or homeowner documentation.

Bank of America Was Required To Follow Loss Mitigation Requirements

Before submitting delinquent loans to HUD for a DASP note sale, Bank of America must certify that the loans meet all of the participating servicer agreement requirements. The agreements require servicers to offer loss mitigation to help borrowers bring their loans out of delinquency and keep them in their homes. Loss mitigation options include temporarily waving monthly payments or modifying the terms of the loan to reduce the amount due each month. Another option is the FHA Home Affordable Modification Program (HAMP), which permanently reduces a borrower's monthly mortgage payments through the use of an FHA mortgage insurance partial claim. The partial claim defers the repayment of mortgage principal through an interest-free subordinate mortgage that is not due until the first mortgage is paid off.

To accomplish successful loan modification and loss mitigation, the agreement requires Bank of America to follow various mortgagee letters that identify the loss mitigation waterfall, and these rules have remained largely unchanged during DASP. The full loss mitigation waterfall from Mortgagee Letter 2012-22 is included in appendix B of this report and includes the following decision points, stated as questions:

> **Step 1**: "The household or mortgagor [borrower] has experienced a verifiable loss of income or increase in living expenses?" This is step 1 of every loss mitigation waterfall. If the servicer cannot verify this information, the homeowner is unable to receive loss mitigation.
>
> **Step 2**: "One or more mortgagors are currently employed?" If the homeowner is employed, he or she might qualify for FHA-HAMP. If not, the borrower may offer special forbearance.

Importantly, these waterfall steps show that loss mitigation works only when the homeowner responds to the servicer's requests for the required documentation. It is the homeowner's responsibility to provide current financial information, a signed request for modification, and any other supporting documentation to help him or her stay in the home.

Loss mitigation requires homeowner participation.

Bank of America Followed Loss Mitigation Requirements

As required, Bank of America attempted to provide loss mitigation to all 10 homeowners reviewed.

- Six of the homeowners did not submit all of the financial information necessary for Bank of America to verify their eligibility. Additionally, of those six, two homeowners also refused loss mitigation, and one declared bankruptcy while Bank of America was processing their initial information.
- Bank of America could not contact two homeowners to offer loss mitigation after many attempts to reach them.
- Two of the homeowners had already failed recent loss mitigation attempts and both filed for bankruptcy during the process.

Recommendations

We have no recommendations.

Scope and Methodology

We performed our audit work between August and December 2018. We conducted our onsite fieldwork at Bank of America's office in Plano, TX, and our work covered Bank of America's loss mitigation records from 2010 to 2016.

To accomplish our objective, we

- conducted interviews with Bank of America officials in the loss mitigation program,
- determined the total number of loans Bank of America released into DASP,
- selected a sample of loans to review,
- studied HUD regulations and mortgagee letters related to loss mitigation,
- reviewed Bank of America's policies and procedures related to loss mitigation, and
- analyzed individual loan files to determine whether Bank of America provided loss mitigation.

Sample Selection

We used a non-statistical sample of 10 loans to identify a relatively small number of loans that were likely to be high risk due to the nature of their complexity with regards to the waterfall rules. We determined that 10 loans were enough to demonstrate Bank of America's approach to loss mitigation. HUD paid $1.5 million in claims for these 10 loans, and the following are highlights from the universe of loans:

- The audit universe contained 47,349 loans that were eventually sold through DASP.
- The total loan amount contained an estimated $7.6 billion in FHA form A mortgage insurance claims.

We analyzed the 10 sample loans to determine whether Bank of America followed HUD's guidelines for loss mitigation. We determined that Bank of America followed HUD's guidelines for the sample loans and, therefore, decided not to conduct further audit work. We used this sample selection because it was sufficient to accomplish our objective. Our results relate only to the loans reviewed and cannot be used to represent the entire universe.

To help identify the universe of loans, we relied on data obtained from HUD's Office of Asset Sales' individual note sales bidder data and Bank of America's loan data. We used these data to develop an individual sales breakout, to provide contextual information in the report, and to establish the total number of loans. We performed sufficient work to determine that the data were reliable for the purposes of this report, but our conclusions are based on supporting documentation in the individual loan files.

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(s). 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 objective:

- Controls to ensure that Bank of America properly offered homeowners HUD loss mitigation for its FHA loans entering into DASP.

We assessed the relevant controls identified above.

A deficiency in internal control 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.

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 Bank of America's internal controls.

Appendixes

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

March 22, 2019

Ronald J. Hosking
Regional Inspector General for Audit
U.S. HUD – Office of the Inspector General
1670 Broadway
23rd Floor
Denver, CO 80202

Dear Mr. Hosking,

Comment 1

Bank of America, N.A. (Bank) has received and reviewed the U.S. Department of Housing and Urban Development's Office of Inspector General (HUD OIG) draft report regarding the Bank's participation in the Distressed Asset Stabilization Program (DASP) note sale program. We appreciate the opportunity to work with the HUD OIG during its review, and are in agreement with the draft report's findings.

Sincerely,

//signed//
Mark Ramsey
Senior Vice President
Applied Decision Support Executive
Strategic Portfolio Management
Bank of America, N.A.

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Bank of America

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OIG Evaluation of Auditee Comments

Comment 1 We appreciate Bank of America's assistance throughout the audit process.

Appendix B

Loss Mitigation Waterfall

Initial Assistance Screens			
Step	Decision Point	Yes	No
1	Household or mortgagor(s) has experienced a verifiable loss of income or increase in living expenses?	Step 2	Informal or Formal forbearance/repayment plan.
2	One or more mortgagors are currently employed?	Step 3	Special Forbearance
3	Surplus income is at least the greater of $300 or greater than 15% of net income?	Step 4	**FHA-HAMP** (Step 6)
4	85% of surplus income is sufficient to cure arrears within 6 months?	Formal forbearance/ repayment plan for 6 months	**Modification** (Step 5)

Modification *(Requires Successful Completion of Trial Payment Plan)*			
Step	Decision Point	Yes	No
5	Modification would reduce monthly payment by at least the greater of 10% or $100?	• Modified interest rate must not exceed 50 bps above Freddie Mac average, rounded to the nearest 1/8th, at time trial payment plan is offered to mortgagor. • Term of modified loan must be 30 years	**FHA-HAMP** (Step 6)

Step 6	**FHA-HAMP** *(Requires Successful Completion of Trial Payment Plan)*

- Use of FHA-HAMP is to both alleviate the burden of immediate repayment of arrears and to adjust monthly payments to a level sustainable by the household with current income. FHA-HAMP permits combining a Partial Claim and a Loan Modification.
- Partial Claim: Total amount available is the lesser of: 1) 30% of the outstanding unpaid principal balance less any previous Partial Claims paid on this mortgage; and 2) the sum of:
    1. Arrearages;
    2. Legal fees and foreclosure costs related to a canceled foreclosure action; and
    3. Principal deferment (per below calculation).
- Modification
    1. Calculate the target monthly payment:
        - A. Calculate 31% of gross income.
        - B. Calculate 80% of current mortgage payment
        - C. Calculate 25% of gross income
        - D. Take the greater of B and C
        - E. Take the lesser of A and D
    2. Calculate monthly payment on current loan balance at the market interest rate (not including arrears) and 360 months term.
    3. If result of Step 2 is lower than result from Step 1.E. then the mortgagor is eligible for a standard modification at the market interest rate and if necessary a Partial Claim for arrearages, legal fees, and foreclosure costs ONLY, but may not receive principal deferment; else go to Step 4.
    4. Calculate allowable principal deferment amount
        - A. Reduce loan balance used in Step 2 until calculated mortgage payment reaches target amount from Step 1 or else the maximum allowable principal deferment is reached per amount available as calculated above under Partial Claim.
        - B. If the final mortgage payment is greater than 40% of current income, and there is verifiable unemployment status, then mortgagor is eligible for reduced payment option under Special Forbearance. If there is no verifiable unemployment status, then mortgagor is eligible for Informal or Formal Forbearance or non-retention options.

Appendix C

Participating Servicer Agreement Requirements

The following text is from the agreement Bank of America signed related specifically to the loans sold in DASP sale 2016-2. However, the text below is similar if not identical to the wording of the agreements Bank of America signed for the other DASP sales it participated in.

"**Eligible Mortgage Loan**" means a single-family mortgage loan which meets all of the following Claim Eligibility Criteria and Sale Eligibility Criteria as of the date of SFLS [Single Family Loan Sale] Claim Submission Report (unless explicitly excepted), and continues to meet all such requirements as of the Claim Date (or such date as otherwise expressly set forth).

(a) Claim Eligibility Criteria:

(i) the related Mortgaged Property has no more than four (4) dwelling units;

(ii) it is a FHA-Insured Loan;

(iii) it is at least eight (8) full payments past due under the terms of the Mortgage Note, or at least four (4) full payments past due under the terms of the Mortgage Note and the Participating Servicer has determined that the Mortgaged Property has been vacant or abandoned for the last sixty (60) consecutive days. If the Mortgage Note was permanently modified in connection with a Loss Mitigation Option, the Mortgage Loan as modified must meet the delinquency requirements of the preceding sentence;

(iv) with respect to the current default, Participating Servicer (or a Prior Servicer) has evaluated all FHA Loss Mitigation Home Retention Options (Special Forbearance, FHA-HAMP and Loan Modification) and Non-Retention Options (Pre-Foreclosure Sale, and Deed-in-Lieu of Foreclosure) in accordance with regulations at 24 C.F.R. §§ 203.501 and 203.605 and all applicable FHA Handbooks and Mortgagee Letters, and has determined the Mortgagor to be presently ineligible for any Loss Mitigation or such appropriate Loss Mitigation Options have been attempted and failed;

(v) the related Mortgaged Property is not a condemned property; or has not been seized by the United States Department of Justice; or is not otherwise the subject of a seizure order;

(vi) it is not subject to an Indemnification Agreement, or other settlement agreement setting forth specific obligations with respect to Mortgage Loan unless such obligations have been fully satisfied;

(vii) the related Mortgaged Property has not sustained any Surchargeable Damage; and

(viii) it is not a Bankruptcy Loan, except for any Bankruptcy Loan that is:

i. a Bankruptcy Loan under Chapter 11, 12 or 13 of the United States Bankruptcy Code where the Mortgagor is not current under the terms of a confirmed repayment plan, or

ii. a Bankruptcy Loan under Chapter 7 of the United States Bankruptcy Code, where the Mortgagor is not current on the Mortgage Loan debt after it has been reaffirmed.

(b) Sale Eligibility Criteria:

(i) as of the Claim Date only, no foreclosure sale has been scheduled for a date prior to the No FS [foreclosure sale] Date and there has been no foreclosure sale or preforeclosure sale, and no deed-in-lieu of foreclosure has been accepted;

(ii) it has an Unpaid Principal Balance of not less than twenty thousand dollars ($20,000);

(iii) it is not subject to pending litigation related either to the origination of the Mortgage Loan or the related Mortgaged Property securing the Mortgage Loan. For purposes of this subsection (b)(iii) the term "pending litigation" does not include any active litigation in which the only counts, claims, or causes of action are (i) asserted by the mortgagee or secured lender and (ii) necessary for the foreclosure of the mortgage;

(iv) it has not been previously offered for sale as part of an FHA SFLS, unless the reason for non-delivery as part of the previous sale was the result of additional loss mitigation actions offered by Participating Servicer, Surchargeable Damage (that has been subsequently repaired), a bankruptcy action, or litigation (that has been subsequently resolved), a Lien (that has been subsequently satisfied), no hazard and/or flood insurance (that has been subsequently reinstated), an inaccurate Unpaid Principal Balance (that has subsequently been corrected), or an incomplete Collateral File (that has been subsequently completed to contain all of the items required);

(v) as of the SFLS Claim Submission Report Date only, the Mortgage Loan has a Loan-to-Value Ratio greater than or equal to the Loan-to-Value Ratio listed in Exhibit G for the state in which the Mortgaged Property is located; and

(vi) as of the SFLS Claim Submission Report Date only, as identified in the SFLS Claim Submission Report, the Mortgage Loan, the Mortgage Loan is not past due by more than the maximum missed payments listed in Exhibit G for the state in which the Mortgaged Property is located.