



MB Financial Bank, NA, Rosemont, IL

Single-Family Housing Mortgage Insurance Program



To: Gisele Roget, Deputy Assistant Secretary for Single Family Housing, HU

//SIGNED//

From: Kimberly S. Dahl, Regional Inspector General for Audit, 2AGA

Subject: MB Financial Bank, Rosemont, IL, Did Not Always Follow HUD's Underwriting Requirements but Generally Complied With Quality Control Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of MB Financial Bank's compliance with HUD's underwriting and quality control requirements for Federal Housing Administration-insured loans.

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 212-264-4174.



Audit Report Number: 2017-NY-1011

Date: September 20, 2017

MB Financial Bank, Rosemont, IL, Did Not Always Follow HUD's Underwriting Requirements but Generally Complied With Quality Control Requirements

Highlights

What We Audited and Why

We audited MB Financial Bank, a Federal Housing Administration (FHA)-approved direct endorsement lender, as part of our efforts to protect the integrity of the U.S. Department of Housing and Urban Development's (HUD) single-family housing mortgage insurance programs. We selected MB Financial for review based on an analysis of underwriting and default data maintained by HUD. Our objective was to determine whether MB Financial followed HUD and Federal requirements when underwriting loans and implementing its quality control plan.

What We Found

MB Financial did not always follow HUD's underwriting requirements when rejecting and approving loans. Specifically, it did not (1) ensure that five loan applications were manually underwritten before rejecting these loans and (2) follow underwriting requirements for four loans it approved. This condition occurred because MB Financial did not understand HUD requirements for approving and rejecting loans. Because MB Financial did not ensure that loan applications were manually underwritten before rejecting the loans, there was an increased risk of eligible applicants being rejected. Further, the significant underwriting deficiencies identified in the four loans approved by MB Financial placed the FHA insurance fund at an increased risk of loss of approximately \$179,000.

MB Financial generally complied with applicable requirements when implementing its quality control program. However, its written quality control plan did not include the specific procedures used to review rejected loan applications. This condition occurred because the lender was not aware of the requirement. As a result, HUD did not have assurance that MB Financial used a consistent practice when reviewing rejected loan applications.

What We Recommend

We recommend that HUD require MB Financial to (1) indemnify HUD for the four loans that did not comply with underwriting requirements, (2) provide training to its underwriters on HUD's underwriting requirements for approving and rejecting loans, (3) update its policies and procedures to ensure that its staff understands applicable underwriting requirements, and (4) update its quality control plan to include the specific procedures used to review rejected loan applications.

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Background and Objective

The Federal Housing Administration (FHA) is the largest insurer of mortgages in the world, insuring more than 34 million properties since its beginning in 1934. FHA provides mortgage insurance on loans made by approved lenders throughout the United States and its territories. Its mortgage insurance provides lenders with protection against losses because FHA will pay a claim to the lender in the event of a homeowner's default.

To qualify for FHA insurance, loans must meet certain requirements. For example, loans are generally required to be scored using a statistically derived algorithm through FHA's Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard to evaluate borrower credit history and application information. Lenders access TOTAL Mortgage Scorecard through an approved automated underwriting system and must verify the integrity of all data entered into the system to ensure that the approval decision is valid. If a loan receives a "refer" decision or is downgraded to manual underwriting, the lender must manually underwrite the loan using the U.S. Department of Housing and Urban Development's (HUD) detailed underwriting requirements.

MB Financial Bank, NA, is a HUD-approved supervised direct endorsement lender based in Rosemont, IL. MB Financial was created in 2001 after the merging of Mid-City National Bank, founded in 1911, and Manufacturers Bank, founded in 1913. MB Financial has more than 50 active branch offices located throughout the United States. During the period November 2014 through October 2016, MB Financial underwrote 2,023 FHA-insured loans in the State of New York. During this same period, MB Financial's compare ratio¹ for seriously delinquent loans was 311 percent for loans underwritten in the Buffalo, NY, HUD office jurisdiction and 117 percent for all loans in the State.

Our objective was to determine whether MB Financial followed HUD and Federal requirements when underwriting loans and implementing its quality control program.

¹ The compare ratio is the percentage of the lender's loans that are seriously delinquent or were claim terminated divided by the percentage of loans that are seriously delinquent or were claim terminated for the selected geographic area.

Results of Audit

Finding 1: MB Financial Bank Did Not Always Follow HUD's Underwriting Requirements

MB Financial did not always follow HUD's underwriting requirements when rejecting and approving loans. Specifically, it did not (1) ensure that five loan applications were manually underwritten before rejecting these loans and (2) follow underwriting requirements for four loans it approved. This condition occurred because MB Financial did not fully understand HUD requirements for approving and rejecting loans. Because MB Financial did not ensure that loan applications were manually underwritten before rejecting the loans, there was an increased risk of eligible applicants being rejected, which could affect home-ownership opportunities. Further, the significant underwriting deficiencies identified in the four loans approved by MB Financial placed the FHA insurance fund at an increased risk of loss of approximately \$179,000.

Rejected Loans Were Not Always Manually Underwritten

MB Financial did not always follow HUD requirements when rejecting loan applications. Specifically, it did not ensure that five loan applications were manually underwritten before rejecting the loans. HUD Handbook 4000.1, paragraph II.A.5, requires lenders to manually underwrite loan applications that received a refer decision from the automated underwriting system and applications that were downgraded to a manual underwrite. Of 44 rejected loan applications reviewed, MB Financial's files showed that five of the loan applications were not manually underwritten before MB Financial rejected the loans. This condition occurred because MB Financial had a policy of not manually underwriting loans for purchases, which was contrary to HUD requirements, and because its staff did not understand HUD requirements for rejecting loans. While MB Financial issued letters to the borrowers, stating that their loans were denied because of issues with their qualifying ratios and credit history, its underwriter notes stated that the five loans were rejected because of an MB Financial policy of not manually underwriting loans. MB Financial staff confirmed that its policy was not to manually underwrite purchase loans, and its written procedures stated that loans must receive an automated underwriting system approval. Officials stated that they believed their staff was allowed to reject loans based on the decisions received from automated underwriting systems.

Approved Loans Were Not Always Underwritten Properly

MB Financial did not always follow HUD's underwriting requirements when approving loans. While it complied with HUD requirements when approving 18 of the 22 loans reviewed, MB Financial did not follow HUD's detailed underwriting requirements when approving the remaining 4 loans, which had individual underwriter IDs in HUD's systems.²

² While MB Financial had a policy of not manually underwriting loans for purchases, a small number of loans had individual underwriter IDs in HUD's systems, which indicated manual underwriting. These loans represented

The following table summarizes the material underwriting deficiencies identified.

Deficiency	Number of loans
Housing obligation payment history not documented	3
Employment history not sufficient	3
Income not adequately verified	2
Underwriter certification not complete or accurate	2
Excessive ratios without compensating factors	1
Credit history not sufficient	1

For example,

- MB Financial did not properly document the borrower’s payment history on housing obligations for three of the loans reviewed. Reviewing a borrower’s housing obligation history helps the lender determine the creditworthiness of the borrower. In cases in which the borrowers indicated that they had a monthly housing payment, MB Financial should have verified and documented the previous 12-month housing history through credit reports, verifications from landlords or mortgage servicers, or a review of canceled checks. In cases in which the borrowers indicated that they were living rent free, MB Financial should have obtained verification from the property owner.
- MB Financial did not ensure that the borrower complied with HUD’s qualifying ratio benchmarks and significant compensating factor requirements for one loan reviewed. Ensuring that a borrower meets HUD’s requirements for qualifying ratios and compensating factors helps ensure that the borrower will be able to afford the mortgage payments for the new loan. In one case, the borrower’s back ratio³ was 89.89 percent, and the file did not document compensating factors, such as significant cash reserves or residual income. The maximum qualifying back ratio allowed by HUD was 50 percent with two compensating factors documented. Based on the guidelines in place at the time the loan was approved, MB Financial should not have approved the loan.
- MB Financial also did not ensure that required forms documenting the approval of the loan were properly completed by the underwriter and were accurate. HUD relies on the direct endorsement approval portion of form HUD-92900-A to document lender certifications about the underwriting process. These forms should indicate whether the loan was underwritten by an automated underwriting system or manually underwritten by an approved underwriter. When loans are manually underwritten, the form should

less than 1 percent of the loans that it closed between August 2014 and March 2017. See the Scope and Methodology section for additional details.

³ The back ratio is the total fixed payment divided by effective income. The total fixed payment includes the total mortgage payment and monthly obligations on all debts and liabilities. Effective income refers to income that may be used to qualify a borrower for a mortgage and is likely to continue through at least the first 3 years of the mortgage.

include the underwriter's ID and signature certifying that the underwriter approved the loan and fulfilled his or her responsibilities when reviewing the borrower's credit and debt, income, qualifying ratios, and compensating factors. For two loans, the forms were not signed by the underwriter as required, and the underwriter IDs were not accurate.

These deficiencies occurred because MB Financial's staff did not fully understand HUD's requirements for underwriting loans.

MB Financial Had Begun To Take Action To Resolve Underwriting Deficiencies

After we notified MB Financial that we had identified a small number of purchase loans with manual underwriting IDs in HUD's systems and explained that we would review these loans, it reviewed the files and acknowledged that it did not comply with underwriting requirements for the four loans discussed above. MB Financial self-reported these four loans to HUD as required by HUD Handbook 4000.1, and HUD then executed indemnification agreements with MB Financial for each loan. Further, to ensure that MB Financial follows HUD's underwriting requirements, we recommend that it provide training to its underwriters and update its policies and procedures.

Conclusion

MB Financial did not always follow HUD's underwriting requirements when rejecting and approving loans. This condition occurred because of MB Financial's policy of not manually underwriting loans for purchases, which was contrary to HUD requirements, and because its staff did not fully understand HUD requirements for approving and rejecting loans. Because MB Financial did not ensure that loan applications were manually underwritten before rejecting the loans, there was an increased risk of eligible applicants being rejected, which could affect home-ownership opportunities. Further, as a result of its failure to follow underwriting requirements when approving loans, there was an increased risk to the FHA insurance fund. As of June 29, 2017, the total unpaid principal balance for the four loans with significant underwriting deficiencies was \$364,920 with an estimated potential loss to HUD of \$179,000.⁴

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require MB Financial to

- 1A. Indemnify HUD against potential losses of \$178,811 for the four loans that did not comply with underwriting requirements (appendix C). HUD provided us copies of the four executed indemnification agreements in August and September 2017. Therefore, upon issuance of this report, we will enter a management decision into HUD's Audit Resolution and Corrective Action Tracking System, along with copies of the indemnification agreements, and close this recommendation.

⁴ HUD calculates that FHA loses an average of 49 percent of the claim amount when it sells a foreclosed-upon property. The 49 percent loss rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2017 as of June 30, 2017.

- 1B. Provide training to its underwriters on HUD's underwriting requirements for approving and rejecting loans.
- 1C. Update its policies and procedures to ensure that its staff understands underwriting requirements and the requirement that loans be manually underwritten when a refer decision is received from automated underwriting systems or when a loan is downgraded to a manual underwrite.

Finding 2: MB Financial Bank Generally Complied With HUD's Quality Control Requirements

MB Financial generally complied with applicable requirements when implementing its quality control program. However, its written quality control plan did not include the specific procedures used to review rejected loan applications. This condition occurred because the lender was not aware of the requirement. As a result, HUD did not have assurance that MB Financial used a consistent practice when performing reviews of rejected loan applications.

The Quality Control Program Generally Complied With Requirements

MB Financial generally followed applicable requirements when implementing its quality control program. For example, its plan had requirements to perform the proper amount of reviews of closed loans, early payment default loans, and rejected loan applications as required by HUD Handbook 4000.1, and MB Financial followed its plan. However, MB Financial's written quality control plan did not include the specific procedures used to review rejected loan applications. HUD Handbook 4000.1, paragraph V.A.2.b.iii(A)(2), requires lenders to include the procedures used to review rejected applications in their quality control plans. MB Financial's written plan stated that it would review the required percentage of rejected loans within the proper timeframe to ensure that the rejection was valid and indicated that two levels of review would be performed as required. However, it did not detail the procedures to be used for the rejected loan reviews. This condition occurred because MB Financial officials were unaware that the detailed procedures needed to be included in the written plan.

Conclusion

While MB Financial generally complied with HUD requirements when implementing its quality control program, its written plan did not include the specific procedures used to review rejected loan applications as required. As a result, HUD did not have assurance that MB Financial used a consistent practice when reviewing rejected loan applications. In addition, there was an increased risk that eligible applicants for FHA-insured mortgages could be rejected.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require MB Financial to

- 2A. Update its quality control plan to include the specific procedures to be used when reviewing rejected loan applications.

Scope and Methodology

We performed our audit work from December 2016 through July 2017. We conducted onsite work at MB Financial's office located at 2350 Green Road, Ann Arbor, MI. The audit covered the period September 1, 2014, through December 31, 2016, and was expanded as determined necessary.

To accomplish our objective, we reviewed applicable HUD and Federal requirements; MB Financial's policies and procedures, electronic loan files, and quality control files; and loan file reviews performed by HUD's Quality Assurance Division. We also interviewed MB Financial's employees.

To determine whether MB Financial followed HUD's underwriting requirements, we selected four samples of approved and rejected loans for review as follows:

- **Loans underwritten by automated underwriting systems:** Using data maintained in HUD's Single Family Data Warehouse,⁵ we determined that MB Financial closed 5,621 loans between August 2014 and December 2015,⁶ including 86 loans that had a serious delinquency occurrence (90 days or more) during the first year. From the 86 loans, we narrowed our selection to 30 loans, including 5 loans from branches that had a higher rate of loan defaults and 25 loans from the remaining branches. The unpaid principal balance for these 30 loans totaled more than \$4.2 million. Of the 30 loans, we selected for review 8 loans that were seriously delinquent and had the fewest payments before first becoming seriously delinquent. The unpaid principal balance for these eight loans totaled more than \$1 million, and each of the eight loans was underwritten by an automated underwriting system. We reviewed the case files for these eight loans for compliance with HUD's requirements for loans approved by automated underwriting systems. We found that MB Financial generally complied with HUD's underwriting requirements for these eight loans.
- **Manually underwritten loans:** After MB Financial indicated that its policy was not to manually underwrite loans for the purchase of properties, we performed additional analysis of data maintained in HUD's Single Family Data Warehouse to confirm whether it had manually underwritten purchase loans. Of the 10,134 loans that it closed between August 2014 and March 2017, there were 16 loans (0.15 percent) for the purchase of properties that had an individual underwriter ID indicating manual underwriting. The unpaid principal balance for these 16 loans was more than \$1.9 million. Of the 16 loans, 1 loan was terminated, and 1 loan was indemnified; therefore, we did not review these 2 loans. We reviewed the case files for the remaining 14 loans, with unpaid principal balances totaling more than \$1.3 million, for compliance with HUD's underwriting

⁵ Single Family Data Warehouse is an internal HUD database that has information regarding FHA-insured borrowers, such as names, addresses, Social Security numbers, and other personal financial data.

⁶ We selected this period so that our sample of loans had at least a 1-year of payment history.

requirements.⁷ We found that MB Financial did not comply with HUD's underwriting requirements for 4 of the 14 loans.

- Loan applications that received automated underwriting system refer decisions: HUD's Single Family Data Warehouse contained 7,389 TOTAL Scorecard records in which MB Financial was listed as the lender that submitted the data to the system. The dates for these records ranged from July 22, 2009, to May 13, 2017. We identified 316 unique FHA case numbers in which the last automated underwriting system decision for the loan was "refer." The proposed loan amounts related to these 316 loan applications totaled more than \$47.5 million. We selected the five cases with the highest loan amount and five cases with the lowest loan amount. The total proposed loan amount for these 10 cases was more than \$3.2 million. We reviewed MB Financial's files for these loan applications to determine whether MB Financial referred the cases to underwriters before a final decision was made on the loan application. We found that MB Financial generally complied with HUD requirements to refer these cases to an underwriter when a refer decision was made by the automated underwriting system.
- Rejected loan applications: MB Financial provided us with a listing of 2,615 rejected loan applications for the period September 2014 through December 2016. Using the reason for denial codes, credit scores, and the debt-to-income ratios listed in the data, we selected a sample of 44 rejected loan applications for review to determine whether MB Financial complied with FHA regulations when rejecting these loans. We found that MB Financial did not always follow FHA regulations when rejecting 5 of the 44 rejected loan applications reviewed.

To determine whether MB Financial followed HUD's requirements when implementing its quality control program, we reviewed its quality control records. MB Financial performed 1,090 random quality control reviews during our audit period. We reviewed all 44 random quality control reviews performed in December 2016. MB Financial conducted quality control reviews on 177 early payment defaults during our audit period. We reviewed the early payment default reviews performed on the eight automated underwriting system loans that were previously selected for review. Based on the listing of 2,615 rejected loan applications for the period September 2014 through December 2016, we determined that MB Financial should have performed 262 rejected loan application reviews. We reviewed records provided by MB Financial showing that it conducted 351 rejected application reviews.

Although our sampling approaches in reviewing MB Financial's compliance with underwriting and quality control requirements did not allow us to make projections to the universes from which our samples were drawn, they were sufficient to meet our objective.

⁷ We reviewed 8 of these 14 loans against manual underwriting requirements. We reviewed the remaining six loans against automated underwriting requirements because the underwriter certification indicated that the loans had been approved through an automated underwriting system and the loan files did not contain information indicating that the loans had been manually underwritten.

We relied on information maintained in HUD's Neighborhood Watch and Single Family Data Warehouse systems for information and sampling purposes. Further, we relied on data maintained in MB Financial's system, such as electronic loan files and quality control review results. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes. The testing consisted of comparing data in the electronic files to information in HUD's systems. The audit results were based on our review of electronic documentation maintained by MB Financial.

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:

- Policies and procedures to ensure that FHA loans are underwritten in accordance with HUD requirements.
- Policies and procedures to ensure that FHA loan applications are rejected in accordance with HUD requirements.
- Policies and procedures to ensure that a quality control program is implemented in accordance with HUD requirements.

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.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- MB Financial did not have adequate controls to ensure that HUD requirements were followed when underwriting loans and to ensure that loan applications were manually underwritten before being rejected (finding 1).

Appendixes

Appendix A

Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
1A	\$178,811
Total	178,811

- 1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. Because HUD implemented our recommendation to indemnify the loans not underwritten in accordance with requirements, it reduced FHA's risk of loss to the insurance fund. The projected loss is equal to 49 percent of the unpaid principal balance of loans containing significant underwriting deficiencies. It is based on HUD's calculation that FHA loses an average of 49 percent of the claim amount when it sells a foreclosed-upon property. The 49 percent loss rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2017 as of June 30, 2017. See appendix C for additional details regarding the calculation of funds to be put to better use.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments



Via Email and Overnight Delivery

August 30, 2017

Kimberly Dahl, Regional Inspector General
for Audit, New York Region
U.S. Department of Housing and
Urban Development
Office of Inspector General
Office of Audit, Region 2
Jacob K. Javits Federal Building
26 Federal Plaza, Room 3430
New York, NY 10278-0068
KDahl@hudoig.gov

**Re: Response to Audit Report
Audit Period November 2014 through October 2016 ("Audit Period")**

Dear Ms. Dahl:

This letter serves as the response of MB Financial Bank, N.A. ("MB Financial") to the draft audit report ("Audit Report") containing the findings of the completed audit of MB Financial, for the above-referenced period, that was conducted by the Office of the Inspector General ("OIG"). The Audit Report resulted from a review regarding MB Financial's compliance with HUD's underwriting and quality control requirements for single-family Federal Housing Administration (FHA) loan production. We appreciate the opportunity to respond to the findings raised in the Audit Report.

At the outset, MB Financial desires to state that it is committed to following all HUD established guidelines, and is also committed to providing lending opportunities that support sustainable homeownership.

Summary of MB Financial's Response

During the Audit Period, MB Financial underwrote, as a HUD-approved supervised direct endorsement lender, 2,023 FHA-insured loans in the State of New York. The OIG stated in the Audit Report that MB Financial had a higher compare ratio for delinquent loans in the Buffalo HUD office jurisdiction than the compare ratio percent for all loans in the State of New York. Therefore, the OIG's objective was to determine whether MB Financial followed HUD and Federal requirements when underwriting loans and implementing its quality control program.

MB Financial welcomes the feedback from the OIG on MB Financial's adherence to HUD's underwriting requirements and, based on the OIG's review of the sampled files, MB Financial has agreed to indemnify

Comment 1

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 2



HUD on the identified four (4) loans with stated deficiencies. MB Financial has further agreed to implement the related underwriter training and enhanced underwriting procedure recommendations. Indeed, MB Financial has already indemnified HUD on the four (4) loans and is in the process of making the related recommendations to its underwriting processes.

Comment 3

While MB Financial believes its quality control plan and program substantially complies with HUD's applicable requirements, MB Financial agrees to update its quality control plan to include specific procedures used to deny loan applications. MB Financial appreciates HUD's statement in the Audit Report of its general compliance with applicable requirements in the implementation of MB Financial's quality control program.

With respect to the two (2) findings and four (4) recommendations raised in the Audit Report, MB Financial responds as follows:

Finding #1: MB Financial Did Not Always Follow HUD's Underwriting Requirements

MB Financial did not always follow HUD's underwriting requirements when rejecting and approving loans. Specifically, it did not (1) ensure that five loan applications were manually underwritten before rejecting these loans, and (2) follow underwriting requirements for four loans it approved. This occurred because MB Financial did not fully understand HUD requirements for approving and rejecting loans. Because MB Financial did not ensure that loan applications were manually underwritten before rejecting the loans, there was an increased risk of eligible applicants being rejected, which affects homeownership opportunities. Further, the significant underwriting deficiencies identified in the four loans approved by MB Financial placed the FHA insurance fund at an increased risk of loss of approximately \$179,000.

MB Financial Response to Certain Approved Loans Not Being Underwritten Properly

First, MB Financial agrees that it must follow all applicable HUD underwriting requirements in order to obtain FHA mortgage insurance on a loan. As to the four (4) loans it approved as stated above, MB Financial has reviewed these loans, found deficiencies, self-reported the loans, and has signed indemnification agreements.

Comment 1

MB Financial appreciates the OIG's statement in the Audit Report that, during the audit, MB Financial had already begun to take action to resolve the underwriting deficiencies in the four (4) loans.

Comment 2

Additionally, MB Financial agrees to provide credit training to its underwriters on key components of HUD's and MB Financial's underwriting standards and requirements (such as, a review for sufficiency and documentation of housing obligation payment, employment and credit histories; adequate verification of income; meeting and documenting requirements for qualifying ratios and compensating factors; and complete and accurate underwriter certifications). MB Financial conducts regular underwriter training sessions and will ensure that comprehensive underwriting training is provided to address the noted areas. Finally, MB Financial will update its underwriting procedures accordingly.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 4



MB Financial Response to Certain Rejected Loans Not Being Manually Underwritten

The Audit Report states that five (5) loans were not manually underwritten before MB Financial rejected the loans. The Audit Report references Handbook 4000.1, Section II, A., 5. In order to obtain FHA insurance on a loan, Handbook 4000.1 requires a lender to manually underwrite loan applications that receive a "refer" decision from the automated underwriting system (referred to as "TOTAL Mortgage Scorecard") and applications that are downgraded to a manual underwrite.

It is MB Financial's response and agreement that when the TOTAL Mortgage Scorecard returns a "refer" risk score or when a loan is downgraded to a manual underwrite, MB Financial will require its underwriter to review the loan to determine whether the loan can be approved, in accordance with both HUD's requirements as provided for in the FHA Single Family Housing Policy Handbook 4000.1 and MB Financial's credit underwriting standards and requirements, before making a final credit decision on the loan application.

MB Financial believes it has a responsibility to make loans where borrowers are financially capable of meeting their loan obligations, and therefore, based on past loan performance, MB Financial will also apply its credit underwriting standards and requirements to the underwrite of an FHA loan application that returns a "refer" risk score or that is downgraded to a manual underwrite.

MB Financial has chosen not to manually underwrite a loan unless the loan also meets our credit standards and requirements. MB Financial understands HUD's mission to provide homeownership opportunities to FHA loan applicants, but we also believe that sustainable homeownership is essential to a healthy and well-functioning housing market and that MB Financial's response and approach strikes an appropriate balance between fulfilling HUD's mission of homeownership, preserving the financial health of the FHA insurance fund and making loans within the credit risk appetite of MB Financial.

Finding #2: MB Financial Generally Complied with HUD's Quality Control Requirements

MB Financial generally complied with applicable requirements when implementing its quality control program. However, its written quality control plan did not include the specific procedures used to review rejected loan applications. As a result, HUD does not have assurance that MB Financial is using a consistent practice when performing reviews of rejected loan applications.

MB Response

MB appreciates the statement in the Audit Report that its quality control plan had requirements to perform the proper amount of reviews of closed loans, early payment default loans and rejected loan applications as required by HUD Handbook 4000.1, and that MB Financial followed its plan.

As recommended by the OIG, MB Financial agrees to update its quality control plan to include the specific procedures to be used when reviewing rejected loan applications.

Comment 3

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 5



Conclusion


First, as a point of clarification, in the "Background and Objectives" section of the Audit Report, there is a statement that MB Financial was founded in 2001. Please be advised that since 1911, MB Financial has had deep roots in Chicago banking history. Starting out, Mid-City National Bank was founded in 1911 by a group of Chicago businessmen. Two years later, Manufacturers Bank opened its doors in Chicago. Both banks thrived over the years and, in 2001, two of Chicago's oldest middle-market community-focused banking institutions merged to create MB Financial Bank, N.A.

In conclusion, MB Financial appreciates the opportunity to submit this response to the Audit Report, and remains committed to complying with all requirements set forth by HUD for an FHA-insured loan, as demonstrated by the actions MB Financial has already taken and actions MB Financial has agreed to take in response to the Audit Report.

Auditee Comments and OIG's Evaluation


Ref to OIG Evaluation

Auditee Comments



Signature Page

Sincerely,



Phillip Miller,
President of the Mortgage Division
of MB Financial Bank, N.A.

Cc:
Rebecca Bussineau,
Senior Vice President
Mortgage Division,
Director of Credit

U.S. Department of Housing and
Urban Development
Office of Inspector General
Buffalo Field Office
LaFayette Court
465 Main Street
Second Floor
Buffalo, NY 14203-1780

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OIG Evaluation of Auditee Comments

- Comment 1 MB Financial agreed to indemnify HUD on the four loans that did not comply with underwriting requirements. HUD provided us copies of the executed indemnification agreements in August and September 2017. Therefore, we will close recommendation 1A upon issuance of this report.
- Comment 2 MB Financial agreed to implement underwriter training and enhanced underwriting procedures. These planned actions are responsive to recommendations 1B and 1C.
- Comment 3 MB Financial agreed to update its quality control plan to include the specific procedures used to deny loan applications. This is responsive to recommendation 2A.
- Comment 4 MB Financial agreed that when the TOTAL Mortgage Scorecard returns a “refer” risk score or when a loan is downgraded to a manual underwrite, it will require its underwriter to review the loan to determine whether the loan can be approved in accordance with both HUD’s requirements and its credit underwriting standards and requirements. This is responsive to recommendations 1B and 1C.
- Comment 5 MB Financial provided additional information about its organizational background. We updated the background section of our report with this information.

Appendix C

Schedule of Loans With Significant Deficiencies

FHA case no.	Unpaid mortgage balance	Estimated loss to HUD (49%)
105-8826176	\$118,041	\$57,840
264-1805505	65,886	32,284
372-4729720	71,196	34,886
544-1056136	109,797	53,801
Totals	364,920	178,811

Appendix D

Criteria

HUD Handbook 4000.1, Paragraph II.A.5

The Mortgagee [lender] must manually underwrite those applications where the AUS [automated underwriting system] issues a Refer or applications that were downgraded to a manual underwrite.

HUD Handbook 4000.1, Paragraph II.A.4.vii

The Mortgagee must rescore a Mortgage when any data element of the Mortgage change and/or new Borrower information becomes available.

Mortgage Letter 2014-02, Manual Underwriting

Definition of Manually Underwritten Loans

Manually underwritten loans include:

- loans involving borrowers without a credit score which were not scored against FHA's TOTAL Scorecard;
- loans receiving a *Refer* scoring recommendation from FHA's TOTAL Scorecard; and
- loans receiving an *Accept* scoring recommendation from FHA's TOTAL Scorecard but which have been downgraded to a *Refer* by the underwriter.

When a loan receiving an Accept scoring recommendation [through FHA's TOTAL Scorecard] is downgraded to a Refer, the loan must be underwritten in accordance with all provisions of this Mortgage Letter.

Borrowers With Minimum Decision Credit Scores of 580 or More and One Compensating Factor

The maximum allowable qualifying ratios for borrowers with minimum decision credit scores of 580 or more provided they meet two of the compensating factors specified below are as follows:

- total monthly mortgage payment may not exceed 40% of gross effective monthly income; and
- total monthly fixed payment may not exceed 50% of gross effective monthly income.

HUD Handbook 4155.1, Paragraph 4.D.1.a

Income may not be used to qualify the borrower if it comes from a source that cannot be verified, is not stable, or will not continue into the future.

HUD Handbook 4155.1, Paragraph 4.D.1.b

The lender must verify the borrower's employment for the most recent two full years, and the borrower must explain any gaps in employment that span one or more months.

HUD Handbook 4155.1, Paragraph 1.B.2.a

The lender must obtain a verification of rent or payment history on past mortgages for manually underwritten loans.

HUD Handbook 4155.1, Paragraph 1.B.3.c

The underwriter must sign the HUD-92900-A for manually underwritten loans.

HUD Handbook 4155.1, Paragraph 4.C.3.b

When evaluating a borrower with no credit references, or only Group II references as outlined in HUD 4155.1 1.C.5.f, a satisfactory credit history, at least 12 months in duration, must include

- no more than one 30-day delinquency on payments due to any Group II reference, and
- no collection accounts/court records reporting (other than medical) filed within the past 12 months

HUD Handbook 4155.1, Paragraph 1.C.5.f

In order for the underwriter to determine that a borrower has sufficient credit references to help evaluate bill paying habits, the credit history must

- include three credit references, including at least one from Group I (below), and
- exhaust all Group I references prior to considering Group II for eligibility purposes, as Group I is considered more indicative of a borrower’s future payment performance.

The table below lists the Group I and Group II categories of credit references the underwriter can use to determine if a borrower has a sufficient credit history.

Group Number	Types of Credit References
Group I	<ul style="list-style-type: none"> • Rental housing payments (subject to independent verification if the borrower is a renter) • Utility company reference (if not included in the rental housing payment), including <ul style="list-style-type: none"> – gas – electricity – water – land-line home telephone service, and – cable TV. <p>Note: If the borrower is renting from a family member, the lender should request independent documents to prove regularity of payments, such as cancelled checks.</p>
Group II	<ul style="list-style-type: none"> • Insurance premiums not payroll deducted (for example, medical, auto, life, renter’s insurance) • Payment to child care providers made to businesses that provide such services • School tuition • Retail stores credit cards (for example, from department, furniture, appliance stores, or specialty stores) • Rent-to-own (for example, furniture, appliances) • Payment of that part of medical bills not covered by insurance • Internet/cell phone services • A documented 12 month history of savings evidenced by regular deposits resulting in an increased balance to the account that <ul style="list-style-type: none"> – were made at least quarterly – were not payroll deducted, and – caused no insufficient funds (NSF) checks • Automobile leases • A personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments