



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

September 28, 2018

MEMORANDUM NO:
2018-CF-0802

Memorandum

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

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FROM: Christeen Thomas
Director, Joint Civil Fraud Division, GAW

SUBJECT: HUD Failed To Enforce the Terms of a Settlement Agreement With Fifth Third Bank Because It Did Not Record Indemnified Loans in Its Tracking System

INTRODUCTION

The U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), worked with HUD's Office of Lender Activities and Program Compliance, Office of Single Family Housing, to resolve outstanding matters related to two September 2015 agreements with Fifth Third Bank (FTB) and its principal subsidiary, Fifth Third Bancorp, an Ohio-based bank holding company.

FTB entered into a stipulation agreement with the Federal Government in September 2015 and agreed to indemnify¹ HUD for all losses sustained at any time for 920 Federal Housing Administration (FHA)-insured mortgage loans. FTB then entered into an indemnification agreement with HUD in the same month for the 920 loans. FTB is an FHA-approved mortgage lender with its principal place of business located in Cincinnati, OH.

BACKGROUND

FHA is a component of HUD. It provides mortgage insurance for a person to purchase or refinance a principal residence. The mortgage loan is funded by a lending institution, such as a mortgage company or bank, and the mortgage is insured by FHA. HUD's direct endorsement program authorizes private-sector mortgage lenders to approve mortgage loans for FHA

¹ Indemnification is when the lender agrees to either abstain from filing an insurance claim or reimburse FHA if a future holder of the mortgage files an insurance claim and FHA suffers a financial loss.

insurance. Lenders approved for the program must follow various FHA requirements, including providing annual and per loan certifications that the lender complied with these requirements when underwriting and approving loans for FHA insurance. FTB has participated in the FHA program since 1935 and became a direct endorsement lender in 1989.

FTB made a voluntary disclosure to the Government and identified residential mortgage loans that FTB had originated and certified to HUD as eligible for FHA insurance, but the loans were materially defective.² A finding is deemed material if disclosure of the finding would have altered the lender's decision to approve the loan or to seek endorsement from FHA for insurance of the mortgage loan. FTB disclosed 1,439 materially defective loans that were originated between 2003 and 2013. HUD had paid claims on 519 of those loans. The Government was awarded more than \$84.9 million for these ineligible claims. Also, FTB agreed to indemnify HUD for all losses for the remaining 920 FHA-insured mortgage loans.

In January 2017, FTB voluntarily disclosed an additional 381 loans that were materially defective. HUD's Quality Assurance Division conducted a review of those loans, which resulted in an additional indemnification agreement. The Quality Assurance Division evaluates lenders' portfolios to identify compliance and performance issues that may put the mortgage insurance fund at risk. FTB agreed to indemnify HUD for all losses sustained through and up to 5 years from the date of the agreement for the 381 FHA-insured loans. We compared the 381 loans from the 2017 agreement to the 920 FHA-insured loans identified in the September 2015 stipulation agreement. The 381 loans from the 2017 indemnification agreement were all included in the 2015 stipulation agreement; therefore, FTB voluntarily disclosed a group of materially defective loans that it had disclosed 2 years earlier.

HUD officials provided us with a 2015 settlement agreement between FTB and HUD, which included the indemnification of the 920 loans. Office of Lender Activities and Program Compliance officials informed us that in October 2015, HUD staff attempted to upload the 920 life-of-loan indemnifications into the FHA Connection³ system, which is used to originate and service FHA loans. However, HUD was unsuccessful because FTB voluntarily terminated FHA insurance on many of the loans, causing them to be noncompliant with FHA Connection's indemnification processing function. Therefore, HUD's Quality Assurance Division reviewed the same loans that were in the stipulation agreement from 2015, resulting in the indemnification agreement of 2017. Additionally, HUD would not have billed FTB for losses on the loans because the loans were not properly identified in HUD's systems as having been indemnified by FTB.

RESULTS OF INVESTIGATION

HUD failed to properly record the required indemnifications in its FHA Connection system; therefore, it did not hold FTB accountable to the terms of the settlement agreement. FTB and HUD entered into a settlement agreement on September 28, 2015. FTB agreed to indemnify

² A loan has a material defect if HUD would not have endorsed the loan for FHA insurance had it been aware of the defect.

³ FHA Connection is an interactive system on the internet that gives approved FHA lenders and other HUD-approved business partners real-time access to data residing in a number of HUD FHA systems.

HUD for all losses and expenses sustained by HUD at any time related to the 920 FHA-insured loans in the stipulation agreement. However, two of the FHA-insured loans were conveyed to HUD with losses totaling \$123,922. FTB had not paid the amount of HUD's loss on these loans as required. In addition, FTB was paid loss mitigation claims for 15 loans for which the FHA insurance had been terminated. FTB needs to repay HUD \$187,777 for these claims. HUD's failure to record the indemnifications in FHA Connection exposed the FHA insurance fund to potential losses of more than \$47.4 million.⁴ HUD officials worked with us to quantify FTB's ineligible claims and explained the measures it would take to ensure enforcement of the 2015 settlement agreement. The following recommendations include the measures HUD agreed to take.

RECOMMENDATIONS

We recommend that HUD's Office of Single Family Housing

- 1A. Require FTB to reimburse HUD \$311,699 for 2 loans for which HUD incurred losses when it sold the properties and 15 loans for which FHA insurance had been terminated and HUD had paid loss mitigation claims to FTB.
- 1B. Record in FHA Connection the remaining indemnified loans, avoiding \$47,433,895 in estimated losses. The estimated loss is based on the loss severity rate of 46 percent of the total unpaid principal balance of \$103,117,164.
- 1C. Develop and implement controls to ensure that indemnification agreements that result from U.S. Department of Justice settlements have been properly recorded in FHA Connection.
- 1D. Take appropriate administrative action against FTB for violations of the settlement agreement.

⁴ HUD calculated that FHA loses an average of 46 percent of the unpaid principal balance when it sells a foreclosed-upon property. The 46 percent loss rate is based on HUD's Single Family Acquired Asset Management System's computation as of June 30, 2018.