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TO: Brian Montgomery, Assistant Secretary for Housing-Federal Housing Commissioner, H

FROM: 
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: HUD Did Not Always Ensure That FHA Lenders Complied with Federal Requirements Regarding Home Equity Conversion Mortgages

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) oversight of the Federal Housing Administration (FHA)-insured home equity conversion mortgages (HECM) program. We initiated the audit as part of the activities in our 2008 annual audit plan. Our audit objective was to assess elements of HUD's oversight of the HECM program. This is the first of two audit reports regarding the HECM program and focuses on lender notification of borrower deaths and payment of debenture interest.

What We Found

HUD did not ensure that FHA lenders reported borrowers' death in accordance with federal requirements. For the 31 loans reviewed, HUD's contractor failed to provide documentation to support that FHA lenders notified HUD of borrowers' deaths in writing. Further, the lenders failed to notify the contractor of borrowers' deaths for 11 of the 31 loans and for 13 loans, did not report in a timely manner the dates of borrowers' death.

HUD failed to pay debenture interest on HECM loans. For 13 of the 30 loans in which HUD paid claims during the period March 1, 2006, through February 29, 2008, it did not pay debenture interest to the lenders in accordance with federal requirements.

As a result, HUD could not be assured that FHA lenders appropriately met HUD's time requirements for initiating the foreclosure process or for recording the deeds-in-lieu to take possession of the property, which impacts the amount of the lenders' insurance claims. Additionally, as a result of HUD's failure to pay lenders debenture interest on HECM loans from the loans' due date to the claim payment date, it owes lenders debenture interest on HECM loans.

What We Recommend

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require that HUD's Office of Single Family Housing improve its existing procedures and controls to ensure that lenders follow HUD's requirements for servicing HECM loans and implement adequate procedures and controls to ensure that the Office of Single Family Housing complies with federal requirements in the administration of the HECM program, including the proper payment of claims, and curtail interest payments to the appropriate lenders for the loans identified in this audit report that HUD determines failed to meet all of its time requirements.

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 the results of the servicing deficiencies to HUD's Office of Single Family Housing's staff during the audit. We also provided the discussion draft audit report to HUD's staff during the audit. We conducted an exit conference with HUD's Office of Single Family Housing on September 16, 2008.

We asked HUD to provide written comments on our discussion draft audit report by September 26, 2008. As of noon Eastern Time on September 29, 2008, HUD's Office of Single Family Housing had not provided written comments to the discussion draft report.

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BACKGROUND AND OBJECTIVE

The Housing and Community Development Act of 1987 (1987 Act) established a federal mortgage insurance program (Section 255 of the National Housing Act) to insure home equity conversion mortgages (HECM) or reverse mortgages. Pursuant to the 1987 Act, the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) was authorized to insure 2,500 HECM loans and allocate them among the 10 regional offices in proportion to each region's share of the nation's elderly homeowners. In 1990, the Omnibus Budget Reconciliation Act increased HUD's insurance authority to 25,000 mortgages and terminated the reservation system, allowing all FHA-approved lenders to participate in the HECM program.

The purpose of HUD's HECM program is to enable elderly homeowners to stay in their homes while using some of their accumulated equity. The program allows borrowers that are 62 years of age or older to obtain an insured reverse mortgage (a mortgage that converts equity into income). Because elderly homeowners can be vulnerable to fraudulent practices, the program requires that participants receive counseling from a HUD-approved mortgage counseling agency before applying for a HECM. FHA insures the HECM loans to protect lenders against a loss if amounts withdrawn under the loan exceed the value of the property when the property is sold.

Our audit objective was to assess elements of HUD's oversight of the HECM program. This is the first of two audit reports regarding the HECM program and focuses on lender notification of borrower deaths and payment of debenture interest.

RESULTS OF AUDIT

Finding 1: HUD's Contractor Did Not Always Ensure That FHA Lenders Reported Borrowers' Deaths in Accordance with HUD's Requirements

HUD's HECM servicing contractor did not always ensure that lenders reported borrowers' deaths in accordance with HUD's requirements. For the 31 loans reviewed, the contractor lacked documentation to support that lenders notified HUD of borrowers' deaths in writing for all 31 loans. Further, the FHA lenders failed to notify the contractor of borrowers' deaths for 11 of the 31 loans and for 13 loans, did not report in a timely manner the dates of borrowers' deaths. The problems occurred because HUD's procedures and controls for monitoring its contractor did not ensure that FHA lenders complied with HUD's requirements. As a result, HUD could not be assured that FHA lenders appropriately met HUD's time requirements for initiating the foreclosure process or for recording the deeds-in-lieu to take possession of the property, which impacts the amount of the lenders' insurance claims.

FHA Lenders Did Not Comply with HUD's Requirements Regarding the Reporting of Borrowers' Deaths

Using the universe of 203,232 HECM loans endorsed by HUD between March 1, 2006, and February 29, 2008, 3,967 loans were identified as having borrowers as who were potentially deceased. Of the 3,967 loans, we statistically selected 35 to review for compliance with HUD's requirements. Of the 35 loans, we verified the borrowers' deaths for 31 loans and determined that the borrowers for the remaining four loans were not deceased; therefore, we excluded the four loans from our review.

For the 31 loans reviewed, HUD's contractor did not provide documentation to show that FHA lenders notified HUD in writing of the dates of death for the borrowers. When we contacted the FHA lenders to try to obtain the notification documentation, we obtained notification letters for 9 of the 31 borrowers. In reviewing the notification letters provided, we identified discrepancies between the dates of the notification letters, which were usually faxed from the lenders and the dates that HUD's contractor stated that it received notification letters for 5 of 9 borrowers.

Further, the lenders failed to notify the contractor of borrowers' deaths for 11 of the 31 loans and for 13 loans, did not report the dates of borrowers' deaths within 60-days as required by HUD. The number of days that elapsed before the FHA

lenders notified the contractor ranged from 30 to 174 days beyond HUD's 60-day requirement. One lender disbursed a line of credit drawdown in the amount of \$1,000 to a borrower (FHA loan # 093-6071405) after his date of death (see appendix D).

HUD Needs to Improve Its Existing Procedures and Controls

HUD's Office of Single Family Housing needs to improve its existing procedures and controls for monitoring its contractor to ensure that FHA lenders comply with HUD's requirements. According to the Director of HUD's Servicing Division, the contractor relied on the FHA lenders to notify it via letter or telephone when borrowers died. She said that her office was not aware that it should keep up with this information since it had no effect on the loan. Therefore, if a lender informed the contractor of a borrower's death, the contractor sometimes entered this information into the comments section in its computer system. However, there was no specific field in the database in which to record the information. The Director also said that she would look into changing this process.

As a result of HUD's contractor's failure to ensure that FHA lenders reported borrowers' deaths, HUD could not be assured that the lenders appropriately met their time requirements for initiating the foreclosure process or recording the deeds-in-lieu to take possession of the property, which impacts the amount of the lenders' insurance claims (see finding 2) and results in HUD either underpaying or overpaying claims. These loans had not yet been sent to claims, if warranted.

Recommendation

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require the Office of Single Family Housing to

- 1A. Improve its existing procedures and controls for monitoring its contractor to ensure that FHA lenders comply with HUD's time requirements.

Finding 2: HUD Did Not Pay Debenture Interest on HECM Loans

HUD failed pay to debenture interest on HECM loans. For 13 of the 30 loans for which HUD paid claims between March 1, 2006, and February 29, 2008, it did not pay debenture interest to the FHA lenders from the due date, date of mortgagors' deaths, or extended property vacancy to the date the claim was paid as required by HUD's regulations or from the date the lender obtains good marketable title of the property as required by federal requirements. This problem occurred because HUD lacked adequate procedures and controls to ensure that it complied with its own requirements and federal regulations in the proper administration of its HECM program. As a result of HUD's failure to pay lenders debenture interest on HECM loans from the loans' due date to the claim payment date, it owes lenders debenture interest on HECM loans.

HUD Failed to Pay Debenture Interest on HECM Loans

Using the universe of 203,232 HECM loans endorsed by HUD between March 1, 2006, and February 29, 2008, we identified 30 loans for which HUD paid claims. We reviewed all 30 loans for compliance with HUD's requirements. As of September 26, 2008, 17 of the 30 loans were assigned to HUD, and the remaining 13 were not. Lenders have the option of assigning loans to HUD when they reach 98 percent of the maximum claim amount.

HUD did not always pay debenture interest on HECM loans. For all 13 loans that were not assigned to HUD, it did not pay debenture interest from the due date to the date the claim was paid in accordance with Mortgagee Letter 2003-22 or in accordance with federal requirements, the date the lender obtains good marketable title to the property.

HUD Lacked Adequate Procedures and Controls

HUD lacked adequate procedures and controls to ensure that it complied with its own and other federal requirements in the proper administration of its HECM program. According to the Chief of HUD's Single Family Claims Branch, the payment of debenture interest had not been curtailed on any of the loans for which HUD paid claims for the untimely reporting of borrowers' deaths or for not initiating foreclosure in a timely manner because HUD had not paid lenders debenture interest for those items. It had only paid debenture interest from the date the claims were submitted to HUD to the date the claims were paid. The Chief of the Single Family Claims Branch said that HUD had always underpaid the lenders. She further stated that she had recently participated in several meetings with various HUD management staff to discuss how they would handle this situation and create policies.

As a result of HUD's failure to pay lenders debenture interest on HECM loans from the loans' due date to the claim payment date, it owes lenders debenture interest on HECM loans. Further, the contractor's failure to ensure that lenders reported borrowers' deaths (see finding 1) diminished HUD's ability to curtail lenders' debenture interest payments due to noncompliance if the lenders were to seek repayment.

Since HUD had not fully developed procedures as of August 2008 for calculating debenture interest and recording and validating borrowers' dates of death, and other pertinent dates such as determinations of extended property vacancies or other circumstances that would make the loans due, we could not determine the amount of debenture interest owed to the lenders.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require of the Office of Single Family Housing to

- 2A. Implement adequate procedures and controls to ensure that it complies with federal regulations in the administration of its HECM program, including the proper payment of claims.
- 2B. Curtail interest payments to the appropriate lenders for the loans identified in this audit report that HUD determines failed to meet all of its time requirements.

SCOPE AND METHODOLOGY

Our audit work was performed at HUD's headquarters, the Chicago regional office, and the Columbus and Detroit field offices. The review covered the period March 1, 2006, through February 29, 2008. We expanded the review as necessary.

To accomplish our audit, we researched and reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to the program. We also conducted interviews with HUD's staff and its contractor.

Using HUD's system, we identified 203,232 HECM loans that were endorsed by HUD during the period March 1, 2006, through February 29, 2008. The total maximum claim amount insured by HUD for the 203,232 loans was nearly \$47 billion (the maximum dollar amount that HUD will pay on a claim for insurance benefits).

With the assistance of an Office of Inspector General (OIG) computer audit specialist, we compared the borrowers' Social Security numbers for the 203,232 loans by a deceased database provider. Of the 203,232 loans, we identified 6,109 borrowers and 2,946 coborrowers as potentially being deceased. When we compared information maintained in HUD's Single Family Data Warehouse system, we determined that 5,919 of the 6,109 deceased borrowers (97 percent) and 2,737 of the 2,946 deceased coborrowers (93 percent) were not reported as being deceased in HUD's system. In reducing the duplicates in our data, we identified that deceased borrowers and coborrowers overlapped resulting in 3,810 deceased borrowers. We further determined that of the 2,737 coborrowers that were deceased, 157 of the loans also had deceased borrowers; however, the loans were still active, and were not previously identified. Therefore, we statistically selected 35 of the 3,967 (3,810 plus 157) loans for review.

For the 35 loans, we verified the borrowers' deceased status by reviewing the lenders' and HUD's contractor's documentation, in addition to reviewing information contained in the same databases most of the lenders used. We also telephoned and mailed confirmation letters to the borrowers' residences. Of the 35 loans, we determined that borrowers for four of the loans were not deceased, thus reducing the number of loans reviewed to 31.

Additionally, of the total universe of 203,232 loans, we determined that HUD paid claims on 30 loans. Therefore, we reviewed all 30 loans for compliance with HUD's requirements.

We performed the audit work in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weakness

Based on our audit, we believe the following item is a significant weakness:

- HUD's Office of Single Family Housing lacked adequate procedures and controls for monitoring lenders for compliance with HUD's requirements regarding the HECM program (see findings 1 and 2).

APPENDIXES

Appendix A

FEDERAL REQUIREMENTS

Mortgagee Letter 2003-22 states when a borrower dies and the property is not the principal residence of at least one surviving borrower, the HECM balance becomes due and payable in full. The lender is required to notify HUD. This notice must also occur as soon as possible following the death but no longer than 60 days from the date of the borrower's death. This notice must be in writing; must provide the case number, the borrower's name, the property address and the date of death; and may be delivered via facsimile or letter. The notice must be delivered to HUD's HECM servicing contractor.

Mortgagee Letter 2003-22 states that with respect to a HECM mortgage that is foreclosed as a result of the death of the borrower, the "due date" is the date that HUD is notified of the borrower's death (notification date). Lenders are entitled to receive interest at the debenture rate from the due date (notification date) to the date the claim is paid as provided by 24 CFR (*Code of Federal Regulations*) 206.125(d).

Also when a borrower dies and the property is not the principal residence of at least one surviving borrower, the HECM mortgage balance becomes due and payable in full. The mortgagee is required to notify HUD (see 24 CFR 206.27(c)(1)). This notice must occur as soon as possible following the death but no later than 60 days from the date of the borrower's death.

HUD Handbook 4330.1, REV-5, paragraph 9-3(A)(1), states that if the mortgage is in default and the property has been determined to be vacant or abandoned, foreclosure must be initiated (or a deed in lieu of foreclosure must be recorded) within nine months after date of default or within the latter of 120 days after the date the property became vacant, is discovered vacant, or should have been discovered vacant. Section 13-22 states that the lender must provide a written certification for the borrower's signature to the borrower annually. Although written certification may be useful in determining the borrower's occupancy status, other supplemental measures may be needed to effectively determine the date of death to meet the six-month requirement for first legal action. Lenders may consider subscribing to one of several commercial resources that offer a monthly match of loan files against a Social Security database of death records.

HUD's regulations at 24 CFR 206.125(d) state that the lender shall commence foreclosure of the mortgage within six months of giving notice to the borrower that the mortgage is due and payable or six months from the date of the borrower's death, if applicable, or within such additional time as may be approved by the Secretary of HUD.

HUD's regulations 24 CFR 203.402(k)(2) state that when a claim for insurance benefits is being paid without conveyance of title to the Federal Housing Commissioner in accordance with 24

CFR 203.368 and was endorsed for insurance on or before January 23, 2004, an amount equivalent to the sum of

(A) The debenture interest that would have been earned, as of the date the lender or a party other than the borrower acquires good marketable title to the mortgaged property, on an amount equal to the amount by which an insurance claim determined in accordance with 24 CFR 203.401(a) exceeds the amount of the actual claim being paid in debentures; plus

(B) The debenture interest that would have been earned from the date the lender or a party other than the lender acquires good marketable title to the mortgaged property to the date when payment of the claim is made on the portion of the insurance benefits paid in cash if such portion had been paid in debentures, except that if the lender fails to meet any of the applicable requirements of 24 CFR 203.355, 203.356, and 203.368(i)(3) and (5) within the specified time and in a manner satisfactory to the Federal Housing Commissioner (or within such further time as the Commissioner may approve in writing), the interest allowance in such cash payment shall be computed only to the date on which the particular required action should have been taken or to which it was extended.

HUD's regulations at 24 CFR 203.410 state that for conveyed properties, claims without conveyance, preforeclosure sales in which the property is conveyed to the Federal Housing Commissioner, or instances in which the lender or other party acquires title to the property under the claim without conveyance procedure or the preforeclosure sale procedure, debenture shall be dated

(2) If issued on or after September 2, 1964, and a certificate of claim is not issued, as of the date of default as defined in this part.

(c) Notwithstanding paragraph (a) of this section, in connection with conveyed properties and claims without conveyance, debentures issued as reimbursement for expenditures made by a lender after the date of default shall be dated as of the date the expenditure is actually made by the lender.

HUD's regulations at 24 CFR 206.129(d)(1) state that the due date means the date when the mortgagee notifies the Secretary of HUD under 24 CFR 206.27(c)(1) that the mortgage became due and payable or, if applicable, the date the Secretary granted approval under 24 CFR 206.27(c)(2) for the mortgage to become due and payable. Section (d)(2) state the claim shall include the following items: (d)(2)(iii) an amount equal to the interest allowance which would have been earned from the due date to the date when payment of the claim is made.

HUD Handbook 4330.4, section 3-2, states that the lender must comply with the following time requirements when submitting a claim involving an assigned mortgage which is in default. Failure to comply will result in curtailment of debenture interest to the date the action should have been taken or to the date to which it was extended by HUD.

Section 3-13(a)(4) of the handbook states debenture interest on the net claims amount (excluding mortgage interest) from the date of assignment to the date of payment unless such interest is curtailed because of the lender's failure to meet the time requirements identified in section 3-2.

HUD Handbook 4235.1, REV-1, section 8-2(b)(3), states that the mortgage cannot be due and payable due to the death of the borrower (with no surviving borrower maintaining the property as a principal residence).

Section 8-3 of the handbook states that the lender must notify the local HUD office having jurisdiction over the property when the lender is preparing to assign the property to HUD and file a claim for insurance benefits. The local HUD office must be notified at least 30 days but not more than 60 days before the anticipated date of recording the assignment to HUD. The lender notifies HUD of its intent to assign the mortgage.

Appendix B

BORROWERS' DATES OF DEATH NOT REPORTED TO HUD OR REPORTED IN AN UNTIMELY MANNER

Case number	Date contractor was notified	Borrower's date of death reported by the lenders	Date differences
042-7947882	Oct. 9, 2007	July 10, 2007	91
042-7968915*	Aug. 17, 2007	Feb. 2, 2007, Apr. 3, 2007	136
044-4296050	Feb. 8, 2008	July 10, 2007	213
048-4429572	July 28, 2007	Jan. 7, 2007	202
061-3057573	Feb. 8, 2008	Sept. 7, 2007	154
093-6044690	Apr. 13, 2007	Nov. 18, 2006	146
151-8012441	Feb. 15, 2008	July 21, 2007	209
251-3220314	Apr. 17, 2008	Aug. 11, 2007	250
292-4715189	Aug. 31, 2007	June 2, 2007	90
371-3596469	May 25, 2007	Nov. 15, 2006	191
374-4573519	Oct. 20, 2007	May 28, 2007	145
541-7334817	Oct. 11, 2006	Feb. 19, 2006	234
541-7403124	May 1, 2007	Oct. 23, 2006	190
043-7323610	Not notified	May 9, 2007	N/A
043-7365321	Not notified	Dec. 27, 2006	N/A
048-4379397	Not notified	May 3, 2007	N/A
048-4446462	Not notified	Aug. 29, 2007	N/A
093-6040790	Not notified	Aug. 31, 2007	N/A
093-6071405	Not notified	Feb. 10, 2007	N/A
137-3521533	Not notified	May 9, 2007	N/A
197-3558643**	Not notified	Active/not deceased	N/A
249-5040544	Not notified	July 4, 2007	N/A
249-5066180	Not notified	Aug. 22, 2007	N/A
431-4171144	Not notified	Apr. 13, 2006	N/A

Legend:

- *The lender had identified two different dates for the borrower's date of death.
- **The lender reported that the borrower was still alive; however, we confirmed that the borrower was deceased.