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Audit Report Number 2008-FW-1010

TO: Brian D. Montgomery
Assistant Secretary for Housing—Federal Housing Commissioner, H
Gerald R. Kirkland

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

SUBJECT: Senior Reverse Mortgage Services, Bedford, Texas, Generally Complied with HUD Regulations but Could Improve

HIGHLIGHTS

What We Audited and Why

We reviewed Senior Reverse Mortgage Services, Incorporated (originator), a home equity conversion mortgage (HECM)¹ originator. The originator originated loans for one of the largest lenders in Texas, Financial Freedom Senior Funding Corporation (Financial Freedom).

Our objective was to determine whether the originator complied with U. S. Department of Housing and Urban Development (HUD) regulations and adequately counseled borrowers and disclosed costs.

What We Found

Generally, the originator complied with HUD regulations when it originated HECM loans. However, the originator could have improved its service by consistently following requirements to (1) adequately disclose the financial aspects of the loans to borrowers, (2) counsel the borrowers on other available financing options, and (3) complete documents. Because the originator did

¹ Also known as reverse mortgages.

not consistently follow these procedures, borrowers may not be fully aware of the financial implications of the loans.

What We Recommend

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require the originator to implement procedures that ensure that it (1) provides at least two assumptions for at least two loan terms and two appreciation rates to borrowers; (2) provides a list of eligible counselors to the borrowers so that they can select their counselor; and (3) completes all loan documents.

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

Auditee's Response

We provided our draft report to the originator on June 3, 2008, and requested a written response by June 13, 2008. The originator's consultant requested an extension until July 30, 2008 to respond. After discussion with the originator, we issued a revised draft report on June 12, 2008, and requested a response by June 30, 2008, which the originator provided on July 2, 2008. We held an exit conference on June 20, 2008. In its response, the originator stated it would continue to follow HUD and Federal Housing Administration requirements. The originator's response along with our evaluation is included in appendix A of this report.

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BACKGROUND AND OBJECTIVES

Of the 4,873 home equity conversion mortgage (HECM) loans closed in Texas in 2007, Financial Freedom Senior Funding Corporation (Financial Freedom) submitted almost half the mortgages through sponsored entities. These loans total about \$460 million. Of the entities sponsored by Financial Freedom, Senior Reverse Mortgage Services, Incorporated (originator), originated 33 loans valued at more than \$1.9 million with a maximum claim potential of more than \$4.4 million.

A HECM loan, also known as a reverse mortgage, is a special type of home loan that lets borrowers, 62 years of age or older, convert a portion of the equity in their home into cash. Unlike a traditional home equity loan or second mortgage, the loans do not have to be repaid until the borrowers no longer use the home as their principal residence.

The originator began originating HECM loans in 2005 exclusively for Financial Freedom. Financial Freedom provided the necessary software, training, and other support services to originate the loans. The originator paid a fee to Financial Freedom for each loan submitted. The originator obtained borrowers through advertising or referrals. It conducted initial interviews with the borrowers to determine whether a HECM loan was suitable for them. If suitable, the originator referred the borrower to a counseling service to schedule a counselor to counsel the borrower. If the borrower and the originator agreed that a HECM loan would meet the borrower's needs, the originator ordered an appraisal and processed the loan application. The originator is located at 312 Harwood Road in Bedford, Texas.

Our objective was to determine whether the originator complied with HUD regulations and adequately counseled borrowers and disclosed costs.

RESULTS OF AUDIT

Finding 1: The Originator Generally Complied With HUD Regulations, but Could Improve

Generally, the originator complied with HUD regulations when it originated HECM loans. However, the originator could have improved its service by consistently following requirements to (1) adequately disclose the financial aspects of the loans to borrowers, (2) counsel the borrowers on other available financing options, and (3) complete documents. Because the originator did not consistently follow these procedures, borrowers may not be fully aware of the financial implications of the loans.

The Originator Did Not Adequately Disclose the Financial Aspects of the Loans

Six of the twelve borrowers that we interviewed said that they did not understand the high fees, the interest costs, or the complicated process. The originator provided the borrowers with an estimate of the future value of the loan using one set of assumptions, such as a 4 percent appreciation rate and the current adjustable interest rate. HUD regulations required at least two assumptions for at least two loan terms and two appreciation rates.² The originator should present a range of assumptions in its disclosures and discuss the effect of increased interest rate potential over the life of the loan.³

The originator believed that the 4 percent appreciation rate for the local area was a good estimate. It took the position that it wanted to maximize the proceeds to the borrowers, and it was not concerned with the interest rate since the borrowers did not have to repay the loans. However, some borrowers might want to pay off mortgages or leave part of the equity to heirs. The interest rate impacts the amount required for future repayment; thus, the originator should have disclosed this information to the borrowers.

² Section 255 of the National Housing Act and HUD Handbook 4235.1, REV-1, section 4-7 L.

³ The interest rate can increase as much as 10 percent over the life of the loan.

The Independent Counselors Did Not Adequately Counsel the Borrowers

Based upon interviews, counselors did not fully inform nine of twelve borrowers of other financing options available and costs associated with those options. Further, two of the twelve clients did not recall speaking with a counselor. All signed a certificate stating that they received counseling. HUD regulations⁴ required counselors to discuss other options available to the borrowers including social services, health, and other financing options as well as the financial implications of the HECM mortgage.

The originator contracted with a counseling service, which assigned a counselor to the borrower.⁵ HUD regulations required the originator to provide a list of eligible counselors to the borrowers so that they could select their counselor. The originator stated that borrowers were free to use any counselor. The originator should have ensured that borrowers were aware of their ability to choose any counselor.

Incomplete Documents Implied Lack of Explanation

In a few files, borrowers signed incomplete documents, which implied that the originator did not explain the documents to the borrowers. Also, one appraisal required repairs, but the mortgage was processed without documentation of repairs. These errors appeared to be infrequent and not systemic.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require the originator to

- 1A. Implement procedures that ensure that it (1) provides at least two assumptions for at least two loan terms and two appreciation rates to borrowers; (2) provides a list of eligible counselors to the borrowers so that they can select their counselor; and (3) completes all loan documents.

⁴ Section 255 of the National Housing Act and 24 CFR (*Code of Federal Regulations*) 206.41.

⁵ HUD required the originator to pay for the counseling.

SCOPE AND METHODOLOGY

Our objective was to determine whether the originator complied with HUD regulations and adequately counseled borrowers and disclosed costs. To accomplish our objective, we

- Reviewed applicable criteria and regulations for HECM loans,
- Interviewed 12 borrowers and observed their properties,
- Reviewed the loan origination files of 12 loans, and
- Interviewed HUD employees regarding the program.

We conducted our audit from February through May 2008 at the originator's office and our office in Fort Worth, Texas. Our audit period was from January 1 through December 31, 2007. We expanded the scope as necessary to accomplish our objective. We performed our audit 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, and
- Compliance with applicable laws and regulations.

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 objectives:

- Compliance with laws and regulations—policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

Significant Weaknesses

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

Our review did not disclose any significant weaknesses.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Mr. Norman Williams
Senior Reverse Mortgage Services, Inc.
312 Harwood Road
Bedford, TX 76021-4148

July 2, 2008

Mr. Gerald R Kirkland
Regional Inspector General
Office of Inspector General, Region IV
819 Taylor Street, Ste 13A09
Fort Worth, TX 76102

Dear Mr. Kirkland:

This is in response to your letter of June 12, 2008, which attached a draft audit report #2008-FW-100X. I have reviewed the information and have included my response to the findings and recommendations contained in that report.

Your draft audit report stated our internal controls regarding compliance with relevant laws and regulations did not disclose any significant weaknesses. In spite of our best efforts to maintain a sound record of internal controls, certain technical exceptions were noted at the audit. Our response to these is as follows:


The originator could have improved its service by consistently following requirements to

- A. Adequately disclose the financial aspects of the loans to borrowers**
- B. Counsel the borrowers on other available financing options, and**
- C. Complete documents.**

In order to ensure consistency, we strive to be extremely compliant and work hard to ensure that our borrowers understand their financial situation before entering into the loans. We work diligently in our meetings with the borrower to ensure that this loan will meet their financial needs and provide the money they need.

As always, FHA & HUD guidelines are and will continue to be followed. Additionally, by utilizing the compliance tools provided to us by Financial Freedom, we are provided additional assurances to compliance because of their close relationship with HUD.

Sincerely,



Norman Williams

Comment 1

Finding A: The originator did not adequately disclose the financial aspects of the loan.

The borrower was informed that he would potentially have equity in the property assuming a 4% property appreciation rate for a period of time. It was HUD's conclusion that the borrower was not fully advised that the equity would be consumed in a much shorter time frame if there were no appreciation in the value of the property.

RESPONSE: To fully comply with HUD guidelines, we are utilizing disclosures as prepared by Financial Freedom. We have confirmed with Financial Freedom that we are providing the proper disclosures, calculations, and cost estimates to provide our borrowers with the information that complies with the laws. These disclosures are calculated and generated within HUD's guidelines for Reverse Mortgages. This information is also discussed in the Counseling session. The borrowers are made aware of their costs, equity scenarios, and loan comparisons well in advance of closing.

These documents discussed in the Face-to-Face application interview include, but are not limited to:

- Reverse Mortgage Summary Loan Comparison - Comparison 3 loans, with initial, expected and maximum interest rates.
- Expected Principal Limit Disclosure Home Equity Conversion Mortgage - FFSFC Form 601-3W
- Good Faith Estimate - with disclosure of providers
- Total Annual Loan Cost Rate
- Estimated Amortization Schedule

Comment 2

Finding B: The Independent Counselors did not adequately counsel the borrowers.

The counselors did not fully inform 9 of 12 borrowers of other financing options available and costs associative with the options. All borrowers signed a certificate stating they received counseling. The [REDACTED] file (loan number [REDACTED]) noted that the counseling service was located in Florida, which made it unlikely that he was provided knowledge of any local assistance or tax abatements that would have been available to him.

RESPONSE: All borrowers attend the mandatory counseling, which is provided by HUD approved counselors. The counseling session adds to the disclosures by discussing the effects on their equity, alternative loan programs, as well as their closing costs. As noted, all borrowers participated in counseling and signed the HECM Counseling Certificate.

In response to the out-of-state counseling provided to [REDACTED], HUD does not require that counseling to be performed by a counselor in the state of the loan being made. His tax abatements and other assistance were covered in the counseling.

Finding C: Incomplete documents implied lack of explanation.

A few files had signed disclosures that were not completely executed indicating that loan originators were not explaining the documents to the borrower. There was also a loan, which included an appraisal that required repairs, yet no documentation of the repairs was noted in the processing and closing of the loan file.

It was also noted in each file that the loan comparison sheet provided to each loan applicant only included Reverse Mortgage options for the borrower, which is allowed per HUD Handbook 4235.1 Rev 1.

Comment 3

RESPONSE: In order to ensure consistency, there are three levels of file review for each borrower to monitor that documents are being completely executed prior to closing. The Loan Officer reviews loan documents in the Face-to-Face borrower application, then the Loan Processor reviews prior to loan submission, who is followed by the Underwriter at the Lender. The closing docs are then executed by the borrower at the title company. We believe this system creates a strong oversight program to create the atmosphere where internal controls regarding compliance with relevant laws and regulations did not disclose any significant weaknesses.

Additionally, loan files with appraisal repairs would not have closed without addressing the items. Financial Freedom would have handled the documentation of the repairs through the appraiser and the borrower and as the originator; we would not have copies. This all takes place after closing and Financial Freedom would release no funds until the appraiser went back and approved the repairs.

FHA and HUD Guidelines will continue to be followed.

OIG Evaluation of Auditee Comments

- Comment 1** While the originator used forms provided by Financial Freedom, the disclosures listed in its response did not meet all HUD requirements. For instance, the estimated amortization schedule disclosed potential total cost at only one assumed appreciation.
- Comment 2** During interviews, the borrowers claimed that they did not receive adequate counseling. The originator did not address the recommendation that it provide a list of eligible counselors to the borrowers as required by HUD. We removed the issue pertaining to an out-of-state counselor before we issued the revised draft report; however, the originator should ensure that it allows the borrowers to select their counselor.
- Comment 3** OIG agrees with the lender's implemented corrective actions.