Issue Date	June 7, 2011
Audit Report Number	2011-FW-1010

TO: Ivery Himes, Acting Director, Office of Single Family Asset Management, HUF

//signed//

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

SUBJECT: Wells Fargo Home Mortgage, Fort Mill, SC, Did Not Always Approve FHA-HAMP Loans or Trial Plans in Accordance With Rules and Regulations

HIGHLIGHTS

What We Audited and Why

We performed a limited review of Wells Fargo Home Mortgage (Wells Fargo) as a result of our internal audit of the Federal Housing Administration's (FHA) Home Affordable Modification Program (HAMP). During the audit, we visited Wells Fargo and reviewed a limited number of loans to determine whether the National Servicing Center implemented and operated FHA-HAMP in accordance with rules and regulations. Our objective for this limited review was to determine whether Wells Fargo followed U. S. Department of Housing and Urban Development (HUD) rules and regulations when processing defaulted loans for the FHA-HAMP loss mitigation option.

What We Found

Our limited review of 15 loans[1] showed that Wells Fargo did not always correctly calculate gross income, include all necessary debts, put borrowers in proper trial plans, or check for borrower eligibility. As a result, it approved more than $127,000 in FHA-HAMP claims than it should have. Wells Fargo changed its policy regarding gross income calculation and ensuring borrower eligibility.

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[1] We reviewed 10 loans that had FHA-HAMP paid claims and 5 loans for default status code issues.

In addition, Wells Fargo used verbal financial information to qualify four borrowers for the FHA-HAMP trial plan. After the borrowers completed the trial plans, Wells Fargo determined that the borrowers did not qualify for the FHA-HAMP loss mitigation option. Wells Fargo changed its policy to ensure that it obtains written financial documentation before considering borrowers for FHA-HAMP trial plans.

What We Recommend

We recommend that the Acting Director of the Office of Single Family Asset Management require Wells Fargo to (1) reimburse HUD $127,853 for the FHA-HAMP claims it should not have approved and (2) ensure that it properly reports FHA-HAMP borrowers' status in HUD's systems.

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 a draft report to Wells Fargo on May 12, 2011, and requested comments by May 31, 2011. We held an exit conference with Wells Fargo on May 24, 2011. Wells Fargo provided its comments on June 2, 2011. Wells Fargo agreed with the majority of the report and provided documentation to support the amount of one FHA loan. We made appropriate changes to the report. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

Wells Fargo Home Mortgage (Wells Fargo) is a division of Wells Fargo Bank, N.A. Wells Fargo originates and services home mortgages.

This limited review of Wells Fargo resulted from a spinoff of an internal audit of the Federal Housing Administration's (FHA) Home Affordable Modification Program (HAMP) loss mitigation option.[2] Wells Fargo Bank, N.A. is an FHA-approved servicer. Therefore, Wells Fargo can offer the FHA-HAMP loss mitigation option for FHA-insured loans either facing imminent default or already in default.

HUD introduced the FHA-HAMP loss mitigation option on July 30, 2009, and it became effective August 15, 2009.[3] FHA-HAMP combines the already established loan modification and partial claim loss mitigation options. The FHA-HAMP loan modification must reduce the unmodified monthly principal and interest payment, and the servicer must reamortize the loan for 30 years. The FHA-HAMP partial claim can be up to 30 percent of the unmodified unpaid principal balance. The FHA-HAMP partial claim is due at the (1) maturity of the FHA-HAMP mortgage, (2) sale of the property, or (3) payoff or refinancing of the FHA-HAMP mortgage.

As of June 7, 2010, Wells Fargo had 181 of the 731 completed FHA-HAMP claims. We chose Wells Fargo to review during our internal audit due to the number of completed FHA-HAMP claims.

Our objective was to determine whether Wells Fargo followed U. S. Department of Housing and Urban Development (HUD) rules and regulations when processing defaulted loans for the FHA-HAMP loss mitigation option.

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[2] See audit report 2011-FW-0001, dated April 8, 2011, "The National Servicing Center Implemented the FHA-HAMP Loss Mitigation Option in Accordance With Rules and Regulations" for the results of the review.

[3] Mortgagee Letter 2009-23

RESULTS OF AUDIT

Finding: Wells Fargo Did Not Always Approve FHA-HAMP Loans or Trial Plans in Accordance With Rules and Regulations

Of the 10 Wells Fargo FHA-HAMP paid claim loans reviewed, 4 contained gross income, and/or debt miscalculations. Another one did not qualify based on the type of trial plan Wells Fargo approved for the borrower. In addition, Wells Fargo did not always check for borrower eligibility and approved trial plans for borrowers based on verbal information that ultimately did not qualify for the FHA-HAMP trial plan. Since this was a recently developed program, a limited review within the first year of the program showed that some processes needed improvement. While Wells Fargo implemented new policies to correct future occurrences, it will need to reimburse HUD $127,853 for FHA-HAMP claims it approved but should not have.

Wells Fargo Did Not Always Correctly Calculate Gross Income and/or Debt

Of the 10 Wells Fargo loans reviewed for FHA-HAMP paid claims, 4 contained gross income and/or debt miscalculations. At the inception of FHA-HAMP, Wells Fargo's policy for income calculation was to use 125 percent of net income. However, regulations required servicers to use gross income.[4] Wells Fargo acknowledged the error and corrected its income calculation policy.

The four borrowers that Wells Fargo approved for FHA-HAMP claims that contained miscalculations either did not qualify for the loss mitigation option or qualified for a lesser claim amount. If the borrower did not qualify, Wells Fargo will need to reimburse HUD for the amount of the partial claim plus any incentive fees. If the borrower did qualify for the option but for a lesser claim amount, Wells Fargo will need to reimburse HUD the difference between the claim filed and the updated calculation with the appropriate gross income.

In addition to the gross income miscalculation for one borrower, Wells Fargo did not include in the computation all of the borrower's debt. If the debt had been included as required, the borrower's back ratio would have exceeded the 55 percent threshold.[5] Therefore, the borrower did not qualify for the FHA-HAMP loss mitigation option.

4 Mortgagee Letter 2009-23 and its attachment.
5 *Ibid*

Overall, Wells Fargo incorrectly approved $77,319[6] in partial claims. Even though Wells Fargo started using gross income in accordance with rules and regulations, it will need to reimburse HUD for the amount it inappropriately approved.

Wells Fargo Used a Lump Sum Payment Trial Plan

In 1 of the 10 FHA-HAMP completed claim loans, Wells Fargo established a lump sum payment trial plan instead of a 3- or 4-month payment trial plan as regulations required.[7] This borrower had received a regular partial claim at about the same time the FHA-HAMP rules and regulations became effective. However, the borrower went into default again the month following the regular partial claim. Wells Fargo then qualified the borrower for FHA-HAMP.

Wells Fargo used the lump sum payment trial plan as a way to accelerate the trial payments. If the borrower was unable to qualify for at least a 3-month trial plan, the borrower was not eligible for FHA-HAMP. However, the borrower made the one-time lump sum payment. Wells Fargo filed the claims for FHA-HAMP in April 2010, which totaled $50,534. That same month, Wells Fargo put the borrower into a delinquent status again. By March 2011, Wells Fargo had obtained bankruptcy court clearance for this loan. Wells Fargo will need to reimburse HUD $50,534 as a result of the improper trial plan.

Wells Fargo Did Not Ensure Borrower Eligibility

In the 10 loans reviewed for FHA-HAMP paid claims, Wells Fargo did not check to ensure borrower eligibility. To participate in FHA-HAMP, regulations required servicers to check HUD's limited denial of participation list and the General Services Administration's (GSA) Excluded Parties List System to ensure borrower eligibility before approving a borrower for the loss mitigation option.[8] Upon request for borrower eligibility documentation, Wells Fargo checked both HUD's limited denial of participation list and GSA's Excluded Parties List System. All 10 borrowers were eligible. However, Wells Fargo must check borrower eligibility before qualifying borrowers for FHA-HAMP. Wells Fargo implemented this change, and no further action was necessary.

[6] This amount also includes any incentive fees paid for claims in which the borrowers did not qualify for FHA-HAMP.
[7] Mortgagee Letter 2009-23 and its attachment and Mortgagee Letter 2010-04
[8] Mortgagee Letter 2009-23 and its attachment

Wells Fargo Used Verbal Financial Information To Approve FHA-HAMP Trial Plans

Of the five files reviewed for default status code issues, Wells Fargo inappropriately approved four for FHA-HAMP trial plans based on verbal information. HUD regulations[9] required servicers to obtain written documentation to verify the borrowers' financial information before qualifying them for an FHA-HAMP trial plan. Although the borrowers completed the FHA-HAMP trial plan, three borrowers (75 percent) did not qualify for the plan. However, the three borrowers qualified for the regular loan modification loss mitigation option. The other borrower did not return the necessary documentation and Wells Fargo removed this borrower from the loss mitigation option. Wells Fargo stopped its practice of obtaining verbal financial information and now complies with the HUD requirement to obtain written documentation.

Since the borrowers completed the trial plan, they were technically disqualified from future use of the FHA-HAMP loss mitigation option. However, due to Wells Fargo not following the necessary rules and regulations by not obtaining written financial documentation before approving the borrowers for the trial plan, HUD considered the borrowers eligible for potential future use of the FHA-HAMP loss mitigation option.

Further, this condition might be responsible for many of the 4,754 Wells Fargo-serviced loans that showed a default status code 39[10] without a corresponding default status code 41[11] in HUD's system. As discussed in an internal audit report,[12] Wells Fargo made up 62 percent of the 7,672 loans that had this condition as of January 2011. Wells Fargo should properly report the borrowers' status in HUD's systems.

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[9] Mortgagee Letter 2009-23 and its attachment

[10] Default status code 39 indicates that the servicer approved the borrower to participate in the FHA-HAMP trial plan.

[11] Default status code 41 indicates that the borrower completed the trial plan and the servicer was beginning the process of filing the partial claim and loan modification claims.

[12] See audit report 2011-FW-0001, dated April 8, 2011, "The National Servicing Center Implemented the FHA-HAMP Loss Mitigation Option in Accordance With Rules and Regulations" for the results of the review.

Conclusion

Since FHA-HAMP was a recently developed program, a limited review showed that Wells Fargo needed to improve some processes. Wells Fargo implemented new policies concerning gross income calculation, ensuring borrower eligibility, and obtaining written financial information to ensure that it follows FHA-HAMP rules and regulations. However, it filed for $127,853 in claims and incentive fees that it should not have due to miscalculations and an improper trial plan.

Recommendations

We recommend that the Acting Director of the Office of Single Family Asset Management require Wells Fargo to

1A. Reimburse HUD for $127,853 in FHA-HAMP claims that it should not have approved and incentive fees that it did not earn.

1B. Ensure that it properly reports FHA-HAMP borrowers' status in HUD's systems.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Reviewed relevant criteria including laws and mortgagee letters,
- Reviewed Wells Fargo loan files,
- Interviewed National Servicing Center and Wells Fargo staff, and
- Analyzed the Single Family Data Warehouse's loss mitigation table and default history table as discussed in detail below. We performed this analysis under the internal audit; however, we used it to select a sample of loans to review from Wells Fargo.

Loss Mitigation Table

The Single Family Data Warehouse's loss mitigation table contained more than 1.1 million records[13] as of June 7, 2010. Using ACL software, we filtered these records to show paid claims for loan modifications and partial claims with or without an FHA-HAMP indicator. Further, we tested for duplicate claims to determine whether HUD paid any claims twice on the same loan that had a loan modification or partial claim with an FHA-HAMP indicator. One loan had a duplicate claim for a loan modification with an FHA-HAMP indicator. We joined these filtered records to determine the number of

- Completed FHA-HAMP claims (731),
- Paid claims for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim (14),
- Paid claims for an FHA-HAMP partial claim without a corresponding FHA-HAMP loan modification (131),
- Paid claims for an FHA-HAMP partial claim that had a previous partial claim without an FHA-HAMP indicator (41), and
- Instances in which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date (7).

As of June 7, 2010, Wells Fargo had 181 completed FHA-HAMP claims.

We chose a total of 10 files as follows:

- Two loans from the completed FHA-HAMP data – one with the oldest endorsement date and one with the highest FHA-HAMP partial claim amount;
- Two loans from the paid claim data for an FHA-HAMP partial claim without a corresponding FHA-HAMP loan modification – one with the highest FHA-HAMP partial claim amount and one with the oldest process date;
- The first three loans listed from the paid claim data for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim;

[13] The loss mitigation table included special forbearance, loan modification, and partial claim.

- The only loan from the paid claim data for an FHA-HAMP partial claim that had a previous partial claim without an FHA-HAMP indicator; and
- The two loans for which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date.

Default History Table

As of June 10, 2010, HUD's data for the default history table for default status codes 39 and 41 had more than 18,800 records. Using ACL software, we filtered the records to isolate the default status codes into individual tables: default status codes 39 had 16,662 records and default status code 41 had 2,139 records. We then joined the default status code tables to determine how many loans had a default status code 39 that matched or did not match default status code 41. After eliminating any duplicate case numbers,[14] our analysis showed that 746 loans had both a default status code of 39 and 41. Additionally, 8,848 loans had a default status code of 39 but not 41.

We chose to review a total of five loans that had a default status code of 39 but not 41. We assigned a random number to each loan and sorted in ascending order. Before selecting the loan to review, we reviewed Neighborhood Watch to ensure that the loan did not already have a completed FHA-HAMP claim.[15] If the loan had a completed FHA-HAMP claim, we discarded that loan and chose the next loan until we had five loans for each servicer.

Updated Default History Table

As of January 6, 2011, the default history table for default status codes 39 and 41 contained more than 58,800 records. We filtered the records to isolate default status code 41, which had 5,010 records after eliminating duplicate case numbers. We compared this information with the 8,848 records from the original default history table. Of the 8,848 records that had a default status code 39 but not a default status code 41 reported in June 2010, 7,672 records still did not have a default status code 41 reported in January 2011. Wells Fargo was responsible for 4,754 of those records.

We relied on the above data to select a sample of loans to review for our objective. We reviewed the underlying documentation to form our conclusions in the finding. We do not express an opinion on the overall reliability of the data.

We performed audit work at the National Servicing Center's office in Oklahoma City, OK, and at Wells Fargo's office in Fort Mill, SC. Our audit scope for Wells Fargo was from August 2009 to June 2010, although we expanded some of the data analysis to January 6, 2011. We performed this work from August 2010 through April 2011.

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[14] Servicers would report a default status code 39 for the 3- or 4-month period the participant was in the trial plan.

[15] HUD considered the FHA-HAMP loss mitigation option failed when the servicer reported a default status code 39 but not 41. We did not select any borrowers that had completed FHA-HAMP claims because this completion indicated that they did not fail the FHA-HAMP loss mitigation option.

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. 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:

- Program operations – Local policies and procedures that management has implemented to reasonably ensure that a program meets its 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.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that it obtains, maintains, and fairly discloses valid and reliable data in reports.

We assessed the relevant controls identified above.

A deficiency in internal controls 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

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. We did not design our evaluation of internal controls to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the Wells Fargo's internal control.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	$127,853

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

To: [redacted]

From: Mark Imm, Wells Fargo Home Mortgage

Date: May 31, 2011

RE: Wells Fargo Home Mortgage Response to HUD OIG 2010 Review

[redacted]

Wells Fargo Home Mortgage, WFHM, recognizes the review completed by the HUD OIG on the FHA HUD HAMP process. WFHM also appreciates the opportunity to respond to the findings as well.

Comment 1

With respect to the finding on FHA Case #044-4372814, WFHM has provided your office with information and documentation supporting our calculation of the HUD Partial Claim amount. We do agree with the findings of HUD OIG on the other accounts.

Comment 2

The audit scope of the HUD OIG was from August 2009 to June 2010. These were the initial stages of the FHA HAMP program. Since these dates, WFHM has made process improvements to prevent these types of errors from occurring. First, WFHM now requires the borrower to provide all necessary income documentation to be reviewed by an underwriter before they are placed into a FHA HAMP Trial plan. Secondly, we have added a second level review process to validate that the income and expense calculations that were completed by the initial underwriter are correct. WFHM is confident that these two process improvements significantly reduce the possibility that these errors would occur today.

WFHM looks forward to continuing to help as many FHA homeowners as possible. WFHM will also continue to partner with the National Service Center for HUD to ensure that the HUD guidelines are followed.

Respectfully submitted,

Mark L. Imm
Lending Manager, FHA/VA/USDA

Cc Russ Schwartzseid
Derrick McQueen
David Schabel
Jeff Engler
Ben Windust
Todd Boothroyd

Wells Fargo Home Mortgage
is a division of Wells Fargo Bank, N.A.

OIG Evaluation of Auditee Comments

Comment 1 We reviewed the documentation concerning FHA Case Number 044-4372814 and made appropriate changes to the report.

Comment 2 We commend Wells Fargo for implementing changes to strengthen its process concerning FHA-HAMP.

Appendix C

Schedule of Ineligible Amounts

FHA Case Number	Ineligible FHA-HAMP Amount[16]	Ineligible Incentive Fee	Total	Reason
023-2869618	$42,604	-	$42,604	Income Calculation Error
105-3544391	9,145	$1,250	10,395	Income Calculation Error
222-1683545	18,444	1,250	19,694	Income and Debt Calculation Error
249-5168697	4,626	-	4,626	Income Calculation Error
352-5544124	49,284	1,250	50,534	Improper Trial Plan
Total	**$124,103**	**$3,750**	**$127,853**	

[16] This column includes the title search and/or recording fees in relation to the loan modification when the borrower did not qualify for the FHA-HAMP loss mitigation option.