



Loan Fraud, Quality Control & Underwriting



FBI 2008 Year In Review



- Based on law enforcement, HUD-OIG, FHA, and other data
- Key Findings
 - SAR fraud filings increased 36%
 - Decrease in originations and increase in foreclosures
 - Top states include CA, FL, GA, IL, MI, AZ, TX, MD, MO, NJ, NY
 - Downward trend favorable to mortgage fraud

Increase in FHA Mortgages



- Increase from 3% in 2006 to 30% in 2009
- Attracts former sub-prime lenders
- HUD-approved lenders increased 350% to 3,300
- FHA endorsements increased 239% in total dollars of mortgage loans insured



- In 2008 OIG has 451 pending investigations and anticipates more in next few years
- HUD's top 10 fraud states include
 - CA, IL, TX, GA, OH, CO, MD, FL, MO & NY
- Foreclosure rates from 9.46% to 5.2%

Emerging Schemes Being Seen



- HECM
 - Equity theft, foreclosure rescue and investment schemes
- Credit Enhancement
- Builder Bailout
- Foreclosure Rescue
- Serial Flipping
- Short sales



- During the 12-15 month period ending in August 2009, HUD OIG had issued 16 reports lenders.
- Reports can be summarized with 3 main findings.
 - Underwriting
 - No controls over underwriting function
 - Underwriting criteria not being followed
 - Quality control not properly applied
 - Improper branch/employee arrangements
 - No early default monitoring

HUD OIG Reports Issued During Year

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- Reports included
 - Supervised lenders
 - Correspondent lenders
 - Non-supervised lenders
 - Discrepancies apply to all programs
- Other findings included
 - Improper payments
 - HECM violations
 - Improper branch arrangements
 - Improper down payment assistance
- See following examples

Companies Included in Reports



- FNB of Gillette, WY
- A-Plus Mortgage
- First Source Financial LC
- First Magnus Financial
- Financial Freedom Senior Funding
- Eagle Home Mortgage
- Meridian Funding
- Heartland Funding
- Security National Mortgage Company
- CitiMortgage
- Bank of America – Seattle
- Allied Home Mortgage
- Midwest Mortgage Capital
- Peoples Bank of Overland, KS
- Clarion Mortgage
- CTX Mortgage

Results of HUD-OIG Reports



- First National Bank of Gillette, WY
 - High default rate (6.71%) totaling \$3.2 million
 - Underwriting guidance not followed
 - Improper training, high turnover, weak internal controls
 - Quality not a management focus
 - No written quality control plan
 - 3rd party review not timely
 - Early defaults not reviewed
 - No action taken by management on findings



- A-Plus Mortgage (correspondent lender)
 - Deceptive lending practices
 - Charged loan discount fees without reducing interest rates which paid high YSP
 - Loans originated by independent contractors
 - Deceptive disclosure of YSP to borrowers
 - Non-disclosure of fees charged on HUD-1
 - Reviewed loans originated by non-approved sources
 - 50 branches listed on website, none approved
 - Sanctions from HUD, return \$153k in YSP



- First Magnus Financial
 - Paid \$753,000 in marketing and non-competition fees on \$937 million in FHA mortgages
 - Violations of RESPA in paying fees
 - Monthly fees paid differed from the agreement (apparently due to volume)
 - Lost approved status and referred to Mortgagee Review Board



- Financial Freedom Senior Funding
 - Generally followed HECM rules
 - No follow-up on conflicting file info
 - Loan for home not primary residence
 - Improper inspection
 - Underwriting errors
 - Various sanctions and possible penalties



- Heartland Funding

- 23% of FHA loans considered late payers
- Fee splitting with affiliate regarding downpayment assistance program
- Sellers paid affiliate approx 4% while donations of 3% were shown on HUD-1
- No money actually changed hands
- Did not follow underwriting procedures
- Downpayment assistance s/b verified from an acceptable source
- QC program did not contain required elements
- Paid loan officers on 1099



- Allied Home Mortgage Capital
 - Improper branch arrangements
 - Office & Equipment leases not in name of mortgagee
 - Third-party originations of FHA Loans
 - Exclusive employment rules not followed



- Midwest Mortgage
 - Inadequate underwriting
 - Improper documentation of credit history
 - Outstanding judgments
 - Child support
 - Not following ratios
 - QC reviews not performed on underwriting requirements
 - Reviews did not cover all loans, reverifications or branches
 - \$1.1 million in indemnifications

HUD's Total Scorecard Requirements

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- With AUS evaluates applicant's credit worthiness
- Decision to either accept or refer
- Referrals are manually underwritten
- Loans marked "Accept" or "Approve" do not require additional DE review
- Scorecard document must be the right side of binder
- Lender remains accountable for compliance with FHA requirements



- Loan Purpose
 - Purchase Money Mortgage, Regular Refi, Streamlines, Cash-outs
 - FHA Insurance product (203(b), 203(h), etc.
 - Property Type (single family, manufactured home)
 - Plan Type (fixed-rate, ARM)
 - Data captured from the URLA
 - Lender remains responsible for updating data for resubmission

Underwriting Requirements

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- Credit & Capacity to Repay
 - Adequacy of Income
 - Funds to close and cash reserves
 - Credit History
- Risk Classification (AUS does not override FHA requirements)
 - Accept/Approve
 - Approve/Ineligible (meet scorecard thresholds but not all eligibility) Lender must document decision to approve
 - Refer (manual underwriting)



- All FHA requirements must be met
- Faxed Documents
 - Must clearly identify the employer or other name
 - Lender is responsible for ensure documents are authentic
- Internet Downloads
 - Must be placed in binder in paper form
 - Must identify the employer or other name
 - Must show URL address and date and time



- Lender responsible for verifying accuracy of income being reported
- Changes must be reflected in ratios
- Different requirements for “Accept/Approve” and “Refer”
- Most recent pay stub and any one of
 - Written VOE, verbal or electronic verification
 - Employment history



- Must verify assets to close and cash reserves by
 - VOD
 - Cash reserves
 - Gifts
 - Sale of Home (Need HUD-1)
 - Other

Credit Report Processing and Reconciliation



- Must review all credit reports for all borrowers
- Lender may use any source available
- Other credit items revealed during processing not included on credit reports, the loan must be manually underwritten
 - These items might include, bankruptcy, foreclosure or late payments

System Overrides/Downgrades

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- Overrides trigger requirement that underwriter review the loan file
- Manual downgrades are required when other info is available regard the loan but not in the AUS data
- Borrower cannot have
 - Delinquent federal debt
 - CAIVRS
 - Suspended or debarred individuals
- Mortgage foreclosure within 3 years
- Bankruptcy within 2 years
- Late mortgage payments

Endorsement Procedures

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- Loan is eligible for endorsement if:
- Scorecard rates as “accept” or “approve” or if a “refer” is manually underwritten
- Loan package meets all other FHA requirements

Underwriter Responsibilities

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- For “Accept” or “Approve” DE is not
 - Required to personally review credit or ratios
 - Certify the borrower’s credit & capacity meets HUD’s requirements
 - Total Scorecard CHUMS number recorded on Form 92900-A
 - Must underwrite the appraisal according to FHA requirements



Underwriter Responsibilities con't

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- For “Refer” the DE is required to:
 - Underwrite credit and capacity
 - DE must certify that borrower meets FHA requirements
 - Must enter underwriter’s number of the HUD 92900-A
 - Meet all other FHA requirements



Manual Underwriting Requirements of Handbook 4155.1

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- Verify Occupancy Status
 - At least 1 owner must occupy home
 - Multiple loans are generally not made to one borrower unless
 - Relocations
 - Increase in family size
 - Vacating a jointly-owned property
 - Non-occupying co-borrower
- Secondary Residences – are only permitted when the HOC agrees that hardship exists

Maximum Mortgage Amount

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- Lesser of statutory loan limit for area or the applicable LTV ratio
- Require payment of upfront MIP (UPMIP not included LTV ratios)
- See Table for FHA LTV ratios
- Lower ratios for:
 - IOI transactions (85%)
 - Non-occupying borrowers
 - Building on own land
 - Other

Settlement Requirements

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- For each loan the lender must estimate
 - Closing costs
 - Prepaid items
 - Discount Points
 - Personal property items
 - Real estate broker fees
 - Mortgage broker fees
 - Premium pricing
 - YSP



- Mortgage amount limited to the lower of LTV or the existing debt
- Streamline refinancings (no cash back)
Appraisals may or may not be needed



- Evaluate the four C's
- Eligibility
 - Usually only individuals
 - Borrowers, Co-borrowers and Co-signers
 - Must meet US residency requirements
 - Age
 - Non-purchasing spouse
 - Military personnel
 - Living trusts

Analyzing Borrower's Credit

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- Past credit performance affects risk – overall pattern of behavior
- Minor items within 2 years does not require explanation. Major items must have written explanations
- Lack of credit history is not a basis for rejection



- The following require particular attention
 - Previous payment or rental history
 - Recent or undisclosed debt
 - Collections and judgments
 - Previous foreclosure
 - Bankruptcy
 - Consumer Credit Counseling plans

Credit Report Requirements

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- Traditional Credit Reports (TRMCR or RMCR)
One report per each borrower unless married
 - Must be received by lender and printed in office. Name & address of issuer. No whiteouts. Name of company ordering
 - All credit and legal information
 - Borrower's name and SSN
 - Other information not on CR must be developed separately
 - Some loans require RMCR
 - RMCRs must access at least 2 repositories

Eligibility for Federal Credit

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- Borrower is rejected if
 - List of Parties Excluded from Federal Procurement (GSA List)
 - Delinquent federal debts
 - Negative CAIVRS (include CAIVRS code)
 - Lender must consider all information regardless of CAIVRS





- Stability of income – no minimum time
- Verify employment for 2 years, explain gaps in employment
- Must consider employment, qualifications, training & education
- Recently returning to work force requires special treatment



- Expected to continue for first 3 years
- Average bonus or overtime
- Special rules for part-time, military, commission, retirement, alimony, other
- If borrower is starting a new job, FHA requires a written guaranteed employment agreement
- Additional income for self-employed or family-owned business



- Acceptable sources
 - Earnest money deposit $> 2\%$ requires documentation
 - Savings and checking
 - Gift funds
- Payment of consumer debt by a 3rd party is considered an inducement
- Contributions of up to 6% are allowable but pertain exclusively to mortgage financing



- Obtain a gift letter signed by borrower and donor
- Must state:
 - No repayment
 - Donor's name, address and phone
 - Transfer must be documented



- May be considered a cash equivalent
- May be gifted
- On existing home, only required repairs on appraisal w/b considered
- Must demonstrate ability to complete work
- No delayed work
- No cash back



- The following must be considered
 - Recurring obligations
 - Installment loan
 - Alimony & child support
 - Revolving accounts considered a the greater of 5% of balance or \$10
 - All other
 - Contingent liabilities
 - Mortgage assumptions
 - Projected liabilities
 - Obligations not considered debt (401(k), etc.)

Debt-To-Income Ratios

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- PITI < 29% of gross effective income
 - > 29% requires significant compensating factors
 - Lower fixed payments allow greater latitude
- Total fixed payments < 41% of GEI
- Compensating factors include
 - Demonstrated ability to pay
 - Large downpayment
 - Savings
 - Minimal increase in housing expense
 - Other

Underwriting Documentation

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- All documentation supporting the decision
- May be up to 120 days old for existing 180 days for new construction
- VOE and VOD must be requirements for faxed documents
- Cannot accept documents from interested 3rd parties
- See list
- All forms must be signed & dated by all borrowers
- General verification authorization allowed
- Not signed in blank
- Real estate agent must sign



HUD Audit Guide – Chapter 7





- See Example in book



- Policies and procedures in place
- Team and firm free of impairments
- Performance of non-audit services
 - Financial statements or notes
 - Depreciation schedules
 - Tax Returns
- Written understanding
- Complete documentation



- Safeguards require that audit personnel providing NAS be removed from the engagement
- PEER review checklist references Independence Q&A document question 30 for de minimus rule.
- Rely first on question 46 then question 30



- Policies for hiring and development
- Collectively possesses the skills necessary
- Meet CPE requirements



- System established and documented to comply with professional standards
- Monitoring and peer review
- Address required components
 - Leadership, independence, HR, Engagement performance and documentation
 - Monitoring Quality
- Monitor annually
- External peer review



- Audit report include auditor's TIN, name, address and telephone #
- Audit report on basic statements include reference to GAGAS and GAAS
- Report on supplemental data
- Refer to separate reports on internal control and compliance
- Meet professional standards



- Promptly report to HUD OIG any fraud
- Title II Lender contain
 - Report on basic statements & supplemental data
 - Computation of net worth
 - Fair presentation of LASS Financial Data
 - Report on IC and compliance
 - Report on compliance with major programs
 - AUP report on LASS submission



- Engagement letter specify
 - Audit in accordance with GAAS and GAGAS and Audit Guide
 - Audit scope and report contents meet HUD requirements
 - HUD access to w/ps
 - External peer review w/ comments provided
 - Meet out-of-state licensing requirements



- Workpaper documentation include
 - Evidence of testing of controls over compliance
 - Must be done regardless of risk assessment
 - Lack of controls testing requires report qualification or significant deficiency or material weakness



- Letter of Representation
 - Identified all laws and regulations effecting AFS and program requirements
 - Management responsible for compliance
- Auditor review comments on CAPs on prior findings or other gov't reviews



- Specific Program Requirements tested for areas that pertain to the audit
 - Quality control
 - Branch office
 - Loan Origination
 - Kickbacks
 - Mortgagee approval requirements