OFFICE OF INSPECTOR GENERAL

Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

TO: Edward J. DeMarco, Director (Acting)

FROM: Steve A. Linick, Inspector General

SUBJECT: Systemic Implication Report: Servicer Mortgage Payment Remittance
SIR No.: SIR-2013-5
OIG Case No.: I-11-0046

DATE: June 17, 2013

Attached is a Systemic Implication Report (SIR) prepared by the staff of the FHFA-OIG Office of Investigations identifying a possible weakness in the control process by which servicers remit mortgage proceeds to the Federal National Mortgage Association (Fannie Mae) through information gathered during an ongoing criminal investgation.

We recommend that FHFA consider reviewing Fannie Mae's oversight of mortgage servicers to ensure visibility of borrowers' payments against their mortgages and the subsequent remittance by servicers to the GSEs.

I would appreciate if the Agency could respond to the OIG's recommendation by June 28, 2013. Please let me know if you have any questions or concerns.

cc: Bruce Crandlemire, Advisor to the Director

OFFICE OF INSPECTOR GENERAL

Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

TO: Steve Linick, Inspector General

FROM: Peter Emerzian, Deputy Inspector General, Office of Investigations

SUBJECT: Servicer Mortgage Payment Remittance
SIR No.: SIR-2013-5
OIG Case No.: I-11-0046

DATE: June 14, 2013

The Office of Investigations has identified a potential weakness in the control process by which a servicer remitted mortgage proceeds to the Federal National Mortgage Association (Fannie Mae) through information gathered during an ongoing criminal investgation that may be systemic throughout the industry.

Background

The Office of Investigations is conducting an ongoing criminal investigation pertaining to a signifigant mortgage modification fraud by a GSE mortgage servicer. The scope of the investigation has primarily focused on the servicer's portfolio of loans that it manages on behalf of Fannie Mae.

The mortgage servicer administered the Home Affordable Modification Program (HAMP) by soliciting, processing, and deciding on borrowers' mortgage loans for permanent HAMP modifications. Through the administration of the HAMP program, the servicer collected HAMP trial payments from borrowers in accordance with *Announcement 09-05R*, dated April 21, 2009,[1] which provides the following direction:

> *"In accordance with the Servicing Guide, Part III, Section 102.06: Pending Modifications, Announcement 07-03R2, and, if permitted by the applicable loan documents, servicers may accept and hold as "unapplied funds" (held in a T&I custodial account) amounts received which do not constitute a full monthly, contractual principal, interest, tax, and insurance (PITI) payment. However, when the total of the reduced payments held as "unapplied funds" is equal to a full PITI payment, the servicer is required to apply all full payments to the mortgage loan.*

[1] Announcement 09-05R was reposted May 15, 2009, with additional policy clarification and instructions and superseded the previous announcement.

Any unapplied funds remaining at the end of the trial payment period that do not constitute a full monthly, contractual principal, interest, tax, and insurance payment should be applied to reduce any amounts that would otherwise be capitalized onto the principal balance."

Analysis

Through a review of documents and borrower interviews this investigation has determined that in numerous instances the servicer held HAMP trial payments in suspense accounts despite funds accumulating in excess of one full monthly contractual PITI payment. The servicer held the funds without posting them to the borrowers' mortgage loan until the servicer determined whether the borrower was eligible for a permanent HAMP modification.

Interviews of servicer employees indicated the average HAMP trial period could last between 6 months and 2 years. In many instances, if a borrower was determined to be ineligible for a permanent HAMP modification, the servicer sent a refund check of funds held in suspense to the borrower, less the servicer's outstanding fees. The funds held in suspense represent funds that should have been remitted to Fannie Mae.

Coordination with Fannie Mae representatives throughout this investigation has determined that Fannie Mae does not have the ability to view real-time payments posted against mortgage loans serviced by any of its mortgage servicers. Fannie Mae representatives have indicated that a loan file is composed of two parts: a "service side" and "payment side." When Fannie Mae conducts quality assurance reviews of its loans, it reviews the service side of the mortgage loan files, which only includes the documents used to determine the creditworthiness of the borrower. Fannie Mae does not receive the payment side of the mortgage to assess if the mortgage servicer is remitting funds in a timely manner. Accordingly, Fannie Mae cannot determine if "unapplied funds" are being applied to the mortgage loans as required by Announcement 09-05R.

Conclusion

The servicer in this investigation did not follow the directives outlined in Announcement-09-05R, failing to apply the funds to the mortgage loan and returning the unapplied funds to the borrower. Fannie Mae was not able to detect the issue because of a weakness in Fannie Mae's control process and oversight of its own mortgage portfolio that resulted in an as yet unknown amount of funds being refunded to borrowers instead of being remitted to Fannie Mae.

The failure to forward the unapplied funds to Fannie Mae caused a financial loss to Fannie Mae. In addition, by not applying the funds Fannie Mae may have allowed the servicer to make inappropriate business decisions regarding default management of borrowers' mortgage loans based on the premise that the borrowers were not making their mortgage payments. However, unbeknownst to Fannie Mae, the borrower had indeed made their payments. Ultimately, the funds were not remitted to Fannie Mae and were refunded to the borrower minus fees applied by the servicer. The potential for inappropriate business decisions such as foreclosure of the property could have significant reputational risk for Fannie Mae.

If the process control and oversight of Fannie Mae was amended to include periodic review and/or real-time access to view borrowers' payment status and servicer remittance of funds to

Fannie Mae, it may enable Fannie Mae to make appropriate business decisions based on its own review of mortgage loans or at least provide the ability to manage the risk of servicers not remitting funds to Fannie Mae.

Recommendation

The FHFA-OIG Office of Investigations recommends that FHFA consider reviewing Fannie Mae's oversight of mortgage servicers to ensure visibility of borrowers' payments against their mortgages and the subsequent remittance by servicers to the GSEs.

Federal Housing Finance Agency

MEMORANDUM

TO: Peter C. Emerzian, Deputy Inspector General, Office of Investigations

FROM: Jon D. Greenlee, Deputy Director for Division of Enterprise Regulation

SUBJECT: FHFA Response – Systemic Implication Report: Servicer Mortgage Payment Remittance [SIR-2013-5]

DATE: July 2, 2013

This memorandum responds to the memorandum dated June 17, 2013, from Inspector General Linick to Acting Director DeMarco regarding a possible weakness in the control process by which servicers remit mortgage proceeds to Fannie Mae. As noted in the Inspector General's communication, FHFA-OIG recommends that FHFA consider reviewing Fannie Mae's oversight of mortgage servicers to ensure visibility of borrowers' payments against their mortgages and the subsequent remittance by servicers to the GSEs.

FHFA concurs with this recommendation and will follow-up with both Enterprises through our ongoing monitoring processes. In particular, core examination teams will assess the sufficiency of changes, if any, to business line monitoring as a result of this individual case, including the role of internal audit in the Enterprises' processes. We have had preliminary discussions with Fannie Mae management concerning this matter and agree with the basic circumstances described regarding this servicer. Our understanding from your report and from discussion with Fannie Mae is that issues concerning misapplication of payments from suspense accounts are relatively rare. Accordingly, our assessment will balance the risks with the complexity, cost, and operational risk both Enterprises would bear.

Since Fannie Mae contracts with servicers to manage payment operations, FHFA will also incorporate this matter into its assessment of third party vendor management. As you are aware, Fannie Mae uses the STAR program to monitor workout activity at the servicer level to identify issues through peer group comparisons. Fannie Mae's onsite reviews of Servicers (SQR) program does look at payment history on sampled workouts to understand application history. In this particular case, Fannie Mae has been aware of this servicer's poor performance and transfers loans to another servicer when loans become 60-day delinquent for further workout considerations by the better performing servicer.

Thank you for bringing this investigation to our attention. We would be happy to discuss these issues with you further.