

Federal Housing Finance Agency  
Office of Inspector General



# **FHFA Oversight of Fannie Mae's Collection of Funds from Servicers that Closed Short Sales Below the Authorized Prices**

Audit Report • AUD-2014-015 • August 7, 2014



## At A Glance

August 7, 2014

# FHFA Oversight of Fannie Mae's Collection of Funds from Servicers that Closed Short Sales Below the Authorized Prices

## Why OIG Did This Report

The Federal Housing Finance Agency (FHFA or Agency) currently serves as both the regulator and conservator of the Federal National Mortgage Association (Fannie Mae or Enterprise) and the Federal Home Loan Mortgage Corporation (Freddie Mac). As conservator, FHFA's responsibilities are to preserve and conserve Fannie Mae's assets. Short sales are part of Fannie Mae's loss mitigation strategy to pursue foreclosure alternatives in order to help minimize the severity of losses it incurs as a result of loan defaults. Between August 2010 and December 2013, Fannie Mae and its servicers closed over 210,000 short sales.

This report focuses on the effectiveness of FHFA's oversight and Fannie Mae's controls over delegated servicers to ensure that net proceeds received for short sales met the minimum amount authorized by Fannie Mae.

## What OIG Found

In January 2014, Fannie Mae determined that between August 2010 and December 2013, 4,883 short sale transactions were potentially closed in violation of servicer delegations of authority, because the net proceeds from the sales were less than the authorized minimum net reserve (MNR) established by Fannie Mae. Fannie Mae analyzed these transactions and determined that only 2,434 of them with MNR shortfalls of \$16,955,656 should be included in a remediation plan. Nearly half of these transactions were removed for one of three reasons: (1) they would have been approvable if properly submitted to Fannie Mae for approval, (2) they had already been remedied through a make whole agreement or repurchase, or (3) they had actually received Fannie Mae review prior to the sale.

Fannie Mae then applied a series of four exclusions to the 2,434 short sale transactions included in its remediation plan that reduced the number of transactions the Enterprise would consider for pursuing an indemnification demand to 453, with a total MNR shortfall of \$10,818,979. Despite Fannie Mae's authority to require indemnification for each transaction with an MNR shortfall, a decision was made to exclude 1,740 transactions with MNR shortfalls of \$6,136,677 and 241 transactions where an MNR value was not obtained by the servicer.



## At A Glance

August 7, 2014

Fannie Mae furnished OIG with a revised remediation plan just prior to the release of this report. While the plan did in fact remove delegated transactions erroneously included for remediation, the methodology of the plan remained substantially unchanged from the initial version that was the basis for this report. Further, the plan did not address potential shortfalls in non-delegated short sale transactions where Fannie Mae retains approval authority.

Fannie Mae went to considerable lengths to demonstrate why it should not pursue servicer noncompliance rather than emphasize the importance of established controls. Additionally, Fannie Mae did not fully address this lack of servicer compliance through consideration of penalties, including, for example, interest on shortfalls collected and recoupment of incentive fees for completing short sale transactions.

### What OIG Recommends

OIG recommends that FHFA communicate a written supervisory expectation to Fannie Mae requiring that its business units perform a review of non-delegated short sale transactions to identify any transactions where the servicer submitted net proceeds that were less than the sale amount approved by Fannie Mae and draft a remediation plan, as appropriate. OIG further recommends that FHFA communicate a written supervisory expectation to Fannie Mae requiring its internal audit group to review Fannie Mae's plan to collect funds for delegated and non-delegated short sale transactions where the net proceeds received were less than the amounts authorized by Fannie Mae. Additionally, OIG recommends that FHFA analyze Fannie Mae actions and remediation plans regarding delegated and non-delegated short sale transactions to determine whether Fannie Mae has taken necessary steps to ensure that servicers are held accountable for servicing violations and credit losses are minimized, including by assessing appropriate penalties and recouping incentive fees paid for improperly closed short sale transactions.

FHFA agreed with OIG's recommendations. To the extent that the above actions result in monetary benefits, OIG will be reporting those amounts in its semiannual report to Congress.

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## ABBREVIATIONS .....

Agency or FHFA	Federal Housing Finance Agency
BPO	Broker Price Opinion
Fannie Mae or Enterprise	Federal National Mortgage Association
MANP	Minimum Acceptable Net Proceeds
MNR	Minimum Net Reserve
NSO	National Servicing Organization
OIG	Federal Housing Finance Agency Office of Inspector General
REAM	Real Estate Asset Management
SQR	Servicer Quality Review

## PREFACE.....

The Housing and Economic Recovery Act of 2008 established the FHFA Office of Inspector General (OIG). OIG is authorized to conduct audits, evaluations, investigations, and other activities pertaining to FHFA's programs and operations. As a result of its work, OIG may recommend policies that promote economy and efficiency in administering FHFA's programs and operations, or that prevent and detect fraud and abuse in them.

Short sales are Fannie Mae's primary foreclosure alternative to mitigate losses. This audit report is a part of OIG's proactive audit and evaluation strategy to assess the Agency's related oversight and conservatorship efforts. The audit focused on the effectiveness of FHFA's oversight and Fannie Mae's controls over delegated servicers to ensure that net proceeds received for short sales met the minimum amount authorized by Fannie Mae.

OIG found that Fannie Mae's servicers did not always close short sales at the authorized price, and Fannie Mae's remediation plan does not hold these servicers fully accountable for the resulting losses. This report's recommendations can increase FHFA's assurance that Fannie Mae's assets are being preserved and conserved.

OIG appreciates the cooperation of all those who contributed to this audit, including officials at FHFA and Fannie Mae. This audit was led by Laura Benton, Audit Director, and Scott H. Smith, Audit Manager, who were assisted by Cairo Carr, Auditor-in-Charge, and Jacob Trewe, Auditor.

This audit report has been distributed to Congress, the Office of Management and Budget, and others, and will be posted on OIG's website, [www.fhfaoig.gov](http://www.fhfaoig.gov).



Russell A. Rau  
Deputy Inspector General for Audits

## CONTEXT .....

### Short Sale Pricing Process

Fannie Mae seeks to preserve and conserve its assets through foreclosure alternatives designed to mitigate losses from defaults on residential mortgage loans. Short sales, also known as pre-foreclosure sales, are a part of Fannie Mae's foreclosure alternative strategy that can minimize the severity of losses it incurs as a result of loan defaults. In a short sale, the borrower sells a residence for less than the amount of debt secured by liens against the property, which most often results in a loss to the Enterprise.

The minimum amount that Fannie Mae will accept for a delegated short sale is known as the Minimum Net Reserve (MNR).<sup>1</sup> Through its delegations of authority, Fannie Mae has granted certain servicers the authority to close short sale transactions without its approval if the net proceeds from the transaction meet or exceed MNR. Fannie Mae explained that requiring delegated servicers to collect MNR provides a high level of confidence that each servicer closing a delegated short sale will do so at a price that is superior to a real estate owned sale. In turn, this helps to minimize credit losses to the Enterprise.

Fannie Mae determines MNR for each short sale transaction upon notification from its delegated servicers that a short sale is anticipated. After calculating MNR, Fannie Mae informs its servicers of their delegated authority and how much money they need to collect from the sale. If the servicer determines that the projected net proceeds from a proposed sale are less than the authorized MNR amount, the short sale transaction becomes non-delegated and the servicer submits it to Fannie Mae to determine an acceptable price. After Fannie Mae determines the price that it will accept for the property, it communicates this price to the servicer and any additional pricing changes that may result from negotiations with the prospective buyer. The authorized price for non-delegated short sales is almost always less than MNR and requires approval from varying levels of authority at Fannie Mae, depending upon the difference between the expected net proceeds from the sale and the non-delegated pricing thresholds used by Fannie Mae.<sup>2</sup> The larger the difference and credit loss to Fannie Mae, the higher the level of approval required.

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<sup>1</sup> MNR was derived through a process that is proprietary to Fannie Mae that utilizes broker price opinions (BPO), appraisals, market data, and the results of Fannie Mae's valuation analytics.

<sup>2</sup> In certain instances involving non-delegated short sales, Fannie Mae negotiated a price that resulted in net proceeds exceeding MNR.

## Remedies Available to Fannie Mae in the Event of Servicing Guide Violations

Fannie Mae rewards its servicers for closing short sales with an incentive fee ranging from \$750 to \$2,500, depending on how many days the property had been delinquent as of the day of the short sale. Prior to June 2012, servicers were paid incentive fees at a flat rate of \$1,700 per short sale closed. Conversely, if Fannie Mae's servicers fail to comply with their servicing requirements, the guide allows Fannie Mae broad discretion to penalize servicers for non-performance. While the guide does not address specific remedies for MNR violations by servicers related to short sales, it provides for the application of interest penalties in situations where servicers do not remit funds to Fannie Mae as required, such as untimely remittance of loan payments.

## Fannie Mae Identification of Short Sale Control Failures and Servicing Violations

Fannie Mae did not have adequate controls in place to confirm MNR compliance before 2014. Reviews of short sales conducted by Fannie Mae confirmed that the net proceeds received matched the expected net proceeds based on the final HUD-1, but did not focus on whether net proceeds received were at least equal to MNR. Until January 2014, delegated cases could be closed by the servicer without being reviewed by Fannie Mae to confirm that MNR requirements were met. Accordingly, there was no assurance that servicers were acting within their delegated authority.

Although Fannie Mae lacked controls to ensure compliance with its MNR requirement, it monitored servicers for compliance with its short sale program. Fannie Mae's top servicers were subject to annual reviews known as Servicer Quality Reviews (SQRs) performed by its National Servicing Organization (NSO). SQRs are conducted to test servicer compliance with the Servicing Guide and Delegation of Authority through sample audits. Short sales are included within the scope of most of these reviews and a full file review is completed that includes a review for compliance with MNR. Fannie Mae stated that from a scope perspective, at the end of 2013, less than 5% of short sales were able to be closed by servicers as delegated short sales without Fannie Mae approval. Fannie Mae further explained that the small percentage of delegated short sales was due to increases to MNR values based on strong real estate sales. Delegated servicers had to obtain approval from Fannie Mae to close short sales when projected net proceeds from prospective offers fell short of MNR. In turn, many transactions became non-delegated.



## FINDING .....

### **Fannie Mae’s Servicers Did Not Always Close Short Sales at the Authorized Price and Fannie Mae’s Remediation Plan Does Not Hold Servicers Fully Accountable for the Resulting Loss**

From August 2010 through December 2013, Fannie Mae’s delegated servicers did not always collect MNR, the price at which Fannie Mae authorized them to close short sales. As a result, these servicers remitted proceeds that were less than the authorized amount, causing further losses to the Enterprise. Fannie Mae also compiled a proposed remediation plan, however, the plan does not fully account for resulting losses or impose remedies on servicers that repeatedly violate Fannie Mae’s delegations of authority.

#### ***Operational Incident Involving Delegated Short Sales***

On or about January 13, 2014, a servicer contacted a Fannie Mae Real Estate Asset Management (REAM) Sales Representative to request an extension on a short sale. The REAM representative determined that the short sale was never submitted to Fannie Mae for approval, despite the net proceeds not meeting MNR. Following this contact, REAM conducted an investigation of short sales completed between January 1, 2013, and December 31, 2013, to determine if other delegated short sales did not meet MNR. On January 27, 2014, Fannie Mae filed an internal operational incident report which disclosed that numerous servicers approved short sales for cases considered to be delegated even though the servicers did not meet the minimum threshold established by Fannie Mae for delegated authority.<sup>3</sup> Fannie Mae’s investigation determined that out of an initially identified \$10 million in MNR shortfall for short sales completed during 2013, \$3.4 million would not have been approved by Fannie Mae if properly submitted as non-delegated short sales. Fannie Mae, therefore, estimated the loss to Fannie Mae at \$3.4 million for 2013 only. REAM, who took ownership of the short sale closing space beginning in January 2013, confirmed that \$3.4 million should have been subject to non-delegated review and approval by Fannie Mae.

This operational incident report identified the cause of this incident as “...delegated short sales executed by servicers were not reviewed by the REAM Fulfillment Department to ensure minimum net reserve was met. The root cause was Inadequate Process Design –

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<sup>3</sup> Fannie Mae officials informed OIG that the servicer contact during January 2014 to request an extension for a short sale triggered the filing of this operational incident report. Nonetheless, Fannie Mae was initially put on notice that a delegated servicer had executed a short sale that did not meet the minimum acceptable net proceeds following the completion of an SQR report in October 2012. FHFA was put on notice about the operational incident in February 2014.

Procedures and Processes.” It also disclosed that the NSO Loss Mitigation Team was conducting research for cases submitted prior to January 1, 2013, to determine whether the operational incident also affected short sale transactions completed before REAM assumed ownership of this process in January 2013.

### ***Fannie Mae’s Remediation Plan***

Following completion of additional research, Fannie Mae compiled a memorandum dated May 8, 2014, on the subject of “Remedy Recommendation for Minimum Net Reserve (MNR) Shortages on Delegated Short Sales.” According to this remediation plan, Fannie Mae identified 2,114 cases closed between August 2010<sup>4</sup> and December 2013 where MNR was not met, and an additional 320 cases where no MNR value was provided at all. Through interviews with Fannie Mae officials and short sale transactional data provided by the Enterprise, OIG determined that Fannie Mae identified 4,883 transactions where servicers closed short sales below their delegated authority dating from August 2010 to December 2013. However, Fannie Mae informed OIG that 2,449 of those transactions were excluded from its remediation plan for one of three reasons: (1) because the short sale would have been approvable if properly submitted as non-delegated, (2) the loan underlying the short sale had already been remedied through a make whole agreement or repurchase, or (3) the transaction had actually received Fannie Mae review prior to sale, but was not accurately represented in their database as having received a non-delegated short sale review.

Fannie Mae identified 2,434 short sale transactions to include in the remediation plan with indemnification amounts totaling \$16,955,656 (MNR less net proceeds). However, it incorporated four “recommended exclusions” utilizing a waterfall approach to exclude all but 453 transactions from consideration to pursue an indemnification demand. See Figure 1 below, which lists each exclusion, the total number of short sales affected, and the total indemnification amount for each exclusion category.

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<sup>4</sup> In August 2010, a select group of servicers was granted delegated authority to approve and execute short sales which met Fannie Mae’s eligibility requirements and MNR. This authority was extended in August 2012 with the issuance of Fannie Mae Servicing Guide Announcement SVC-2012-19.

**FIGURE 1. FANNIE MAE RECOMMENDED EXCLUSIONS TO REMEDIATION PLAN**

Category	Loan Count	Indemnification Amount
Population Included in Fannie Mae’s Remediation Plan	2,434	\$16,955,656
1. Harm Below Tolerable Threshold	(943)	(\$1,165,930)
2. Meets NSO Non-Delegated Criteria	(652)	(\$3,377,674)
3. Meets REAM Non-Delegated Criteria	(145)	(\$1,593,073)
4. Proceeds Exceed Estimated MNR	(241)	(\$0)
<b>Perceived Harm to Fannie Mae</b>	<b>453</b>	<b>\$10,818,979</b>

Source: Fannie Mae, Remedy Recommendation for Minimum Net Reserve (MNR) Shortages on Delegated Short Sales memorandum (May 8, 2014).

A description of each exclusion from Figure 1 included within Fannie Mae’s remediation plan is as follows:

1. Harm Amount Below Tolerable Threshold: Based on agreed upon thresholds established through FHFA’s Contract Harmonization Project.<sup>5</sup>
2. Meets NSO Non-Delegated Criteria: Cases identified that closed prior to the transition to REAM that would have met the NSO’s loss mitigation approval requirements for non-delegated cases.
3. Meets REAM Non-Delegated Criteria: Cases identified that closed after the transition of the process to REAM that would have met REAM’s requirements for consideration as non-delegated cases.
4. Proceeds Exceed Estimated MNR: In instances where an MNR value was not obtained by the servicer, the Modeling and Analytics group was able to estimate with a high confidence level that MNR would have been provided at the time of closing based on BPO values. In the event net proceeds exceeded the estimated MNR amount, [Fannie Mae] logically assumes there was no loss.

After applying the four exclusions, Fannie Mae was left with a population of 453 transactions in the “perceived harm” category. According to the remediation plan, it anticipates following up with servicers by requesting confirmation from the impacted servicers of the values used

<sup>5</sup> In January 2012, FHFA established the Contract Harmonization Project to increase consistency in Enterprise contracts. While Fannie Mae applied the threshold established under the Contract Harmonization Project to its remediation plan, OIG noted that Fannie Mae’s own internal threshold for pursuing make whole agreements for executing short sales at a price below servicer’s delegated authority was significantly less than the Contract Harmonization threshold.

on the short sales in question. The responses and documentation received from the servicers would then be used to determine if cases completed outside of their delegated authority were to the material detriment of Fannie Mae. If material harm is confirmed, a formal indemnification demand would be issued to the servicer for the amount of the variance between MNR and net proceeds. The 453 transactions are concentrated among six servicers as shown in Figure 2 below.

**FIGURE 2. CONCENTRATION OF MNR SHORTFALLS WITHIN THE 453 SHORT SALE TRANSACTIONS WHERE FANNIE MAE PERCEIVED HARM**

Servicer	Indemnification Amount	Concentration Percentage [Rounded]
Servicer 1	\$2,724,574	25.18%
Servicer 2 <sup>6</sup>	\$2,163,596	20.00%
Servicer 3	\$1,252,145	11.57%
Servicer 4	\$1,235,992	11.42%
Servicer 5	\$687,087	6.35%
Servicer 6	\$602,012	5.56%
Servicers 7–30	\$2,153,573	19.91%
<b>Total for All Servicers</b>	<b>\$10,818,979</b>	<b>100.00%</b>

Source: Fannie Mae, Remedy Recommendation for Minimum Net Reserve (MNR) Shortages on Delegated Short Sales memorandum (May 8, 2014).

Fannie Mae informed OIG that although it anticipates no change to the structure of its remediation plan or the various recommended exclusions, the remediation plan was going to be revised and the number of identified short sale transactions would change.<sup>7</sup> OIG is

<sup>6</sup> Servicer 2 was subject to an SQR report during August 2012. One of the findings in that report was this servicer closed workout offers outside of the assigned delegated authority. Specifically, Fannie Mae’s review of closed delegated short sales found instances where the net proceeds to Fannie Mae did not meet the minimum acceptable net proceeds. As a result of this finding, the servicer agreed to provide updated procedures and controls to ensure that all delegated short sales are approved to at least the minimum acceptable net proceeds limit given by Fannie Mae; as well, the servicer agreed to certify the completion, implementation, and training of staff on the procedures and process. Although Fannie Mae conducted SQR reviews of 39 servicers in 2013 and 40 servicers in 2012, this was the only SQR report identified by OIG that included findings where a servicer closed short sales below the price authorized by Fannie Mae. Furthermore, 20 of the 30 servicers identified in Figure 2 were subject to an SQR review during 2013, and 21 of them were subject to an SQR review during 2012, which suggests the SQR reports were not effective with respect to identifying closed short sales that did not meet Fannie Mae’s authorized price.

<sup>7</sup> Fannie Mae officials explained that it was necessary to revise the plan as some short sale transactions included within the 2,434 transactions in the remediation plan had been remedied either through a repurchase or a make whole agreement and should be removed. Additionally, Fannie Mae informed OIG that all of the short sale transactions were for three servicers. These transactions accounted for approximately 30% of the transactions included in the remediation plan and would need to be manually reviewed before the plan could be

concerned that Fannie Mae has gone to some length to undercut the approval controls it established for short sale transactions using MNR by in essence concluding that there is no penalty for lack of compliance with established controls. The Enterprise's approach shifts responsibility from the servicer to Fannie Mae for ensuring compliance by not holding servicers accountable.

***Fannie Mae Has the Authority to Issue an Indemnification Demand to Servicers that Incurred MNR Shortfalls and Penalize Them***

While Fannie Mae's actions to identify MNR shortages and develop a remediation plan are positive steps, it is not aggressively pursuing available remedies to minimize its credit losses and deter future servicing violations. Additionally, FHFA has not been actively involved in oversight of the development of the remediation plan.

Although Fannie Mae identified 2,434 short sale transactions to include in the remediation plan with MNR shortages totaling \$16,955,656, it only plans to pursue indemnification from servicers for 453 transactions, approximately 19 percent of the population. Additionally, Fannie Mae does not intend to pursue any other remedies to penalize servicers, although servicers were paid incentive fees to close short sale transactions and did so improperly with many servicers being repeat offenders. Fannie Mae clearly has the authority to pursue indemnification demands for each delegated short sale with an MNR shortfall. Fannie Mae's delegations of authority to its delegated servicers going back to 2010 provide that the net proceeds received for each delegated short sale be greater than or equal to the Minimum Acceptable Net Proceeds (MANP).<sup>8</sup> Furthermore, the servicing guide allows broad discretion to the Enterprise with respect to penalizing servicers for compliance failures. Nonetheless, Fannie Mae's current plan is to exclude the majority of the shortfalls from indemnification where servicers failed to collect net proceeds that met MNR or request MNR from Fannie Mae.

Further, FHFA has not been actively involved in oversight of the development of the remediation plan or oversight of MNR requirements. The Enterprise informed FHFA of the January 2014 operational incident; however, the Agency has not undertaken any follow-up actions in response. FHFA was also not aware of the additional research that Fannie Mae performed to assess the number of short sale transactions with MNR shortfalls, the results of this research, or of Fannie Mae's remediation plan and the recommended exclusions from the plan. Additionally, although FHFA had performed a targeted examination of Fannie Mae's

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revised. OIG notes that while the revised plan does remove erroneous short sale transactions, it does not change the overall methodology of the initial remediation plan.

<sup>8</sup> MANP is the equivalent of MNR and this terminology is used interchangeably.

collateral valuation methodology for short sales in late 2012 and early 2013, compliance with Fannie Mae's MNR requirement was not included within the scope of that examination.

***Fannie Mae Revised Its Remediation Plan***

OIG received a revised remediation plan prior to final report issuance. The amount of short sales covered under the updated remediation plan increased from 2,434 to 4,936 and total potential shortfalls increased from \$16,955,656 to \$36,201,249. The potential harm category increased from 453 to 594 short sales and the associated potential MNR shortfall increased from \$10,818,979 to \$16,302,039. The amount of incentive fees paid to servicers for short sales identified under this updated remediation plan that had unaddressed MNR shortfalls totaled \$4,428,950.<sup>9</sup> While the plan appropriately removed transactions erroneously included for remediation, the methodology of the plan remained substantially unchanged from the initial version from which this report was completed.

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<sup>9</sup> This figure includes incentive fees paid for loans in the "potential harm" category, as well as those excluded by Fannie Mae for falling below a tolerable threshold or falling under either NSO or REAM non-delegated criteria.

## CONCLUSIONS .....

Fannie Mae’s remediation plan may be improved by a thorough, independent review by its internal audit group.<sup>10</sup> FHFA should communicate a written supervisory expectation to Fannie Mae requiring an independent internal audit of its completed remediation plan to assess the reasonableness of the assumptions used to develop the plan, the sufficiency of the analysis performed, and the other criteria included within OIG’s recommendation. FHFA should also conduct a supervisory review of this assessment after it has been finalized by Fannie Mae’s internal audit group and make any modifications to the remediation plan as deemed appropriate and necessary to preserve and conserve the Enterprise’s assets.

Fannie Mae may also further mitigate losses from short sales through a comprehensive review of its non-delegated short sales to determine whether servicers collected net proceeds that met or exceeded the amount approved by Fannie Mae. FHFA should communicate a written supervisory expectation to Fannie Mae requiring that the Enterprise perform this analysis and develop a remediation plan if the analysis identifies shortfalls between the approved amount and net proceeds for non-delegated short sales. This analysis and any resulting remediation plan should also be reviewed by Fannie Mae’s internal audit group and be subject to a final supervisory review by FHFA.

Following the issuance of its draft report, OIG learned that Fannie Mae’s internal audit group has added a special review to its 2014 audit plan to evaluate the revised remediation plan and plans to perform an assessment of MNR shortfalls and incentive fee recoupment. Such actions are consistent with OIG’s recommendations and will assist FHFA in carrying out its supervisory and conservator missions in this area.

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<sup>10</sup> Fannie Mae’s internal audit group provides an objective assessment of the design and execution of its internal control system, including its management systems, risk governance, and policies and procedures. Internal audit activities are designed to provide reasonable assurance that resources are safeguarded; that significant financial, managerial, and operating information is complete, accurate, and reliable; and that employee actions comply with Fannie Mae policies and applicable laws and regulations.

## RECOMMENDATIONS .....

OIG recommends that FHFA:

1. Communicate a written supervisory expectation to Fannie Mae requiring that its business units perform a review of non-delegated short sale transactions to identify any transactions where the servicer submitted net proceeds that were less than the sale amount approved by Fannie Mae and draft a remediation plan, as appropriate.
2. Communicate a written supervisory expectation to Fannie Mae requiring its internal audit group to review Fannie Mae's plan to collect funds for delegated and non-delegated short sale transactions where the net proceeds received were less than the amounts authorized by Fannie Mae.
3. Analyze Fannie Mae's actions and remediation plans in response to recommendations 1 and 2 to determine whether Fannie Mae has taken necessary steps to ensure that servicers are held accountable for servicing violations and credit losses are minimized. FHFA should also require modification by Fannie Mae of its remediation plans, as appropriate.



## OBJECTIVES, SCOPE, AND METHODOLOGY .....

The objective of this performance audit was to assess FHFA's oversight of Fannie Mae's controls over the pricing of properties sold in short sales.

OIG conducted this performance audit from January 2014 through June 2014 in Washington, D.C., at the headquarters of FHFA and Fannie Mae.

The scope of OIG's audit focused on the effectiveness of FHFA's oversight of Fannie Mae's controls to ensure that the Enterprise's delegated servicers received net proceeds from closed short sales that met Fannie Mae's authorized price. For purposes of this audit, OIG did not assess controls over computer-processed data.

OIG did not conduct transaction testing of non-delegated short sale transactions to ensure short sales were closed as approved by Fannie Mae, however, OIG is recommending that FHFA direct Fannie Mae to conduct such analysis based on OIG's finding on delegated transactions. Also, the OIG's audit scope did not include a detailed review of Fannie Mae's short sale pricing and valuation methodologies due to FHFA's recent exam work in that area. To achieve the audit objective, OIG:

- Interviewed Fannie Mae officials responsible for the oversight of short sale pricing, including personnel from the Real Estate Asset Management team and the National Servicing Organization;
- Interviewed Fannie Mae internal audit officials to assess internal audit coverage of the pricing of short sale transactions;
- Consulted with FHFA staff from the Division of Enterprise Regulation about the Agency's oversight, supervision, and guidance of short sales operations;
- Reviewed Fannie Mae's delegations of authority and Servicing Guide for policies and procedures regarding short sales and other documentation concerning the pricing of short sale transactions; and
- Reviewed short sales between August 2010 and December 2013 that Fannie Mae identified had been closed below MNR and a preliminary remediation plan based upon Fannie Mae's analysis of these transactions.

OIG also assessed the internal controls related to the audit objective. Internal controls are an integral component of an organization's management that provides reasonable assurance that the following objectives are 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, and 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. Based on the work completed on this performance audit, OIG considers its findings regarding FHFA's oversight of Fannie Mae's controls over proceeds from short sales to be significant in the context of the audit's objective.

OIG conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that OIG plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objective. OIG believes that the evidence obtained provides a reasonable basis for the finding and conclusions included herein, based on the audit objective.

# APPENDIX A .....

## FHFA's Comments on OIG's Findings and Recommendations



### Federal Housing Finance Agency

#### MEMORANDUM

TO: Russell A. Rau, Deputy Inspector General for Audits

FROM: Nina A. Nichols, Acting Deputy Director, Division of Enterprise Regulation *nan*

SUBJECT: Audit Report: *FHFA Oversight of Fannie Mae's Collection of Funds from Servicers that Closed Short Sales Below the Authorized Prices (Audit Assignment AUD-2014-005)*

DATE: July 29, 2014

This memorandum transmits the Federal Housing Finance Agency's (FHFA) management response to the recommendations in the FHFA-OIG draft audit report, *FHFA Oversight of Fannie Mae's Collection of Funds from Servicers that Closed Short Sales Below the Authorized Prices (Audit Assignment AUD-2014-005) (Report)*. This memorandum identifies FHFA's agreement with the specific recommendations in the Report and describes actions that FHFA will take to address the recommendations.

The Report discusses instances in which Fannie Mae servicers closed short sale transactions under delegated authority for an amount less than a minimum amount authorized by Fannie Mae under established short sale procedures. Fannie Mae has reviewed these transactions and developed a remediation plan to require indemnification involving a small subset of these transactions, after screening for materiality, determination of *post hoc* compliance with standards, data errors, and remedies already applied.

FHFA agrees that these transactions may raise concerns about Enterprise oversight of servicers. As discussed below, FHFA expects that Fannie Mae's business units will manage the risks associated with short sales and that Fannie Mae's internal audit group will conduct an independent review of the Enterprise's risk management efforts for short sales.

**Recommendation 1:** The OIG recommends that FHFA communicate a written supervisory expectation to Fannie Mae requiring that its business units perform a review of non-delegated short sale transactions to identify any transactions where the servicer submitted net proceeds that were less than the sale amount approved by Fannie Mae and draft a remediation plan, as appropriate.

**Management Response to Recommendation 1:** FHFA agrees with this recommendation. By October 15, 2014, FHFA will communicate in writing to Fannie Mae the supervisory expectation that Fannie Mae will perform a risk-based review of non-delegated short sales. The review should result in a determination whether there is a significant difference between sale amounts approved by Fannie Mae for properties transferred in short sales and actual net proceeds received from servicers with respect to the transferred properties. In the event of a material shortfall in actual net proceeds received, the review should inform a risk-based remediation plan for the recovery of losses.

**Recommendation 2:** The OIG recommends that FHFA communicate a written supervisory expectation to Fannie Mae requiring its internal audit group to review Fannie Mae's plan to collect funds for delegated and non-delegated short sale transactions where the net proceeds received were less than the amounts authorized by Fannie Mae.

**Management Response to Recommendation 2:** FHFA agrees with this recommendation. FHFA will, by October 15, 2014, communicate to Fannie Mae the supervisory expectation that Fannie Mae's internal audit group will review Fannie Mae's risk management relating to the conduct of short sales by servicers and communicate findings to the business units. The review by internal audit should cover (i) the adequacy of controls for the short sale program for both delegated and non-delegated sales, (ii) recent or proposed changes to the controls, and (iii) any efforts to recover shortfalls in net proceeds from delegated or non-delegated short sales.

**Recommendation 3:** The OIG recommends that FHFA analyze Fannie Mae's actions and remediation plans in response to recommendations 1 and 2 to determine whether Fannie Mae has taken necessary steps to ensure that servicers are held accountable for servicing violations and credit losses are minimized. FHFA should also require modification by Fannie Mae of its remediation plans, as appropriate.

**Management Response to Recommendation 3:** FHFA agrees with this recommendation. FHFA will, by July 31, 2015, perform and document ongoing monitoring by examiners to review the adequacy of Fannie Mae's controls for delegated and non-delegated short sales and internal audit coverage of controls.

cc: John Major, Manager, Internal Controls & Audit Follow-up

## APPENDIX B.....

### OIG's Response to FHFA's Comments

On July 29, 2014, FHFA provided comments to a draft of this report, agreeing with OIG's recommendations and identifying the specific actions it would take to address the recommendations.

FHFA agreed with Recommendation 1 and its planned actions are responsive. FHFA will communicate a written supervisory expectation that Fannie Mae perform a risk based review of non-delegated short sales by October 15, 2014. This review should result in a determination of whether there is a significant difference between sale amounts approved by Fannie Mae for properties transferred in short sales and actual net proceeds received from servicers. In the event of material shortfalls in actual net proceeds received, the review should inform a risk-based remediation plan for the recovery of losses.

FHFA agreed with Recommendation 2. FHFA will, by October 15, 2014, communicate a written supervisory expectation that Fannie Mae's internal audit group review Fannie Mae's risk management relating to the conduct of short sales by servicers and communicate findings to the business units. The review by internal audit should cover: (1) the adequacy of controls for the short sale program for both delegated and non-delegated short sales; (2) recent or proposed changes to the controls; and (3) any efforts to recover shortfalls in net proceeds from delegated or non-delegated short sales.

FHFA agreed with Recommendation 3. FHFA will perform and document ongoing monitoring by examiners to review the adequacy of Fannie Mae's controls for delegated and non-delegated short sales and internal audit coverage of those controls by July 31, 2015.

OIG intends to evaluate the results achieved by FHFA and Fannie Mae in the performance of work related to the recommended FHFA supervisory expectations in the areas of: (1) the amount Fannie Mae should be paid for the shortfalls in net proceeds on short sale transactions; and (2) recoupment of incentive fees for each short sale transaction with a shortfall. To the extent that monetary benefits result, OIG intends to report these benefits as funds put to better use in its next semiannual report to Congress. As a result, OIG is reporting that the amount of monetary benefits, if any, associated with Recommendations 1 and 2 as "To Be Determined."

OIG considers the planned actions sufficient to resolve the recommendations, which will remain open until OIG determines that the agreed-upon corrective actions are completed and responsive to the recommendations. We considered the Agency's full response (attached as Appendix A) along with technical comments in finalizing this report. Appendix C provides a

summary of management's comments on the recommendations and the status of agreed-upon corrective actions.

## APPENDIX C.....

### Summary of FHFA’s Comments on the Recommendations

This table presents management’s response to the recommendations in OIG’s report and the status of the recommendations as of when the report was issued.

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
1	FHFA will communicate in writing to Fannie Mae the supervisory expectation that Fannie Mae will perform a risk based review of non-delegated short sales. This review should result in a determination of whether there is a significant difference between sales amounts approved by Fannie Mae for properties transferred in short sales and actual net proceeds received from servicers with respect to the transferred properties. In the event of material shortfalls in actual net proceeds received, the review should complete a risk-based remediation plan for the recovery of losses.	10/15/2014	To Be Determined	Yes	Open
2	FHFA will communicate to Fannie Mae the supervisory expectation that Fannie Mae’s internal audit group will review Fannie Mae’s risk management relating to the conduct of short sales by servicers and communicate findings to the business units. The review by internal audit is to cover (1) the adequacy of controls for the short sale program for both delegated and non-delegated short sales, (2) recent or proposed changes to controls, and (3) any efforts to recover short falls in net proceeds from delegated and non-delegated short sales.	10/15/2014	To Be Determined	Yes	Open
3	FHFA will perform and document ongoing monitoring by examiners to review the adequacy of Fannie Mae’s	07/31/2015	\$0	Yes	Open

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
	controls for delegated and non-delegated short sales and internal audit coverage of controls.				

<sup>a</sup> Resolved means: (1) Management concurs with the recommendation, and the planned, ongoing, or completed corrective action is consistent with the recommendation; (2) Management does not concur with the recommendation, but alternative action meets the intent of the recommendation; or (3) Management agrees to the OIG monetary benefits, a different amount, or no amount (\$0). Monetary benefits are considered resolved as long as management provides an amount.

<sup>b</sup> Once OIG determines that the agreed-upon corrective actions have been completed and are responsive, the recommendations can be closed.



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