

Federal Housing Finance Agency
Office of Inspector General



Compliance Review of FHFA's Enterprise Non-Performing Loan Sales Program

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Executive Summary

In 2015, the Federal Housing Finance Agency (FHFA or Agency) authorized Fannie Mae and Freddie Mac (the Enterprises) to sell non-performing loans (NPLs) to reduce the number of delinquent loans held in their retained portfolios and to transfer credit risk to the private sector. FHFA established multiple NPL program sales requirements, including but not limited to post-sale reporting by NPL buyers to the Enterprises for a four-year period regarding borrower outcomes.

In 2017, we issued an audit report that found the Enterprises were not collecting from NPL buyers all information necessary to determine buyer/servicer compliance with FHFA's requirements. We recommended that FHFA (1) determine the information necessary to ensure NPL program requirements are being met and update the reporting standards accordingly, and (2) direct the Enterprises to establish controls to prevent NPL buyers from abandoning vacant properties.

In response, FHFA required the Enterprises to collect four additional data fields from NPL buyers and impose additional follow-up requirements on buyers for potentially vacant properties. We closed our recommendations based on these two corrective actions.

We initiated this compliance review to verify the Enterprises' compliance with these two corrective actions for the period June 2018 through November 2019. We found that Freddie Mac complied with the data collection requirements for the first corrective action but Fannie Mae did not. Fannie Mae has provided us with its proposed plan to collect the data starting in 2020. Regarding the second corrective action, Fannie Mae reported that it is following up with NPL buyers on three potentially abandoned properties (out of 78,281 NPL sold) whereas Freddie Mac has not identified any such cases.

We provided FHFA an opportunity to respond to a draft of this report. In its management response, reprinted in the appendix, FHFA concurred that the second corrective action had been implemented, but does not discuss Fannie Mae's failure to implement the first corrective action.

This report was prepared by Wesley M. Phillips, Senior Policy Advisor, with assistance from Alisa Davis, Senior Policy Advisor, and Omolola Anderson, Senior Statistician. This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaoig.gov.

/s/

Brian W. Baker
Acting Deputy Inspector General for Compliance & Special Projects

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ABBREVIATIONS

DHMG	Federal Housing Finance Agency Division of Housing Mission and Goals
Enterprises	Fannie Mae and Freddie Mac
FHFA or Agency	Federal Housing Finance Agency
MLS	Multiple Listing Service
NPL	Non-Performing Loan
OIG	Federal Housing Finance Agency Office of Inspector General
REO	Real Estate Owned

BACKGROUND

The NPL Sales Program's Goals and Requirements

The Enterprises provide liquidity to the housing finance system by purchasing residential mortgages. Historically, the Enterprises have either packaged these mortgages into mortgage-backed securities that were, in turn, sold to investors, or held them in a retained portfolio. Included in the retained portfolios are NPLs that the Enterprises purchase out of mortgage-backed securities to make investors whole and facilitate loss mitigation.

The Department of the Treasury committed to provide financial support to the Enterprises through senior preferred stock purchase agreements with FHFA as conservator so they could continue to operate. The senior preferred stock purchase agreements, as amended, required the Enterprises to reduce their retained portfolios to no more than \$250 billion for each Enterprise by December 31, 2018.¹

The Enterprises sell NPLs to reduce the number of delinquent loans held in their retained portfolios and to transfer credit risk to the private sector. After an initial FHFA-approved pilot sale in August 2014, FHFA granted approval to Freddie Mac to sell NPLs on January 15, 2015, and to Fannie Mae on July 2, 2015.

FHFA established multiple sales requirements, including post-sale reporting from the NPL buyer regarding borrower outcomes and on other NPL sales requirements.

Our 2017 Audit Report Found Deficiencies in and Made Recommendations for the NPL Sales Program

Our 2017 audit report found that FHFA followed prescribed protocols and processes in authorizing the Enterprises to sell NPLs.² FHFA monitors loan resolutions and borrower and neighborhood outcomes based on aggregated data provided by the Enterprises, but it does not monitor compliance with specific NPL sales requirements.³

¹ According to FHFA, at year-end 2018, Fannie Mae's retained portfolio was \$179 billion and Freddie Mac's retained portfolio was \$218 billion. See *FHFA 2018 Report to Congress*, at 52 (June 11, 2019).

² OIG, *NPL Sales: Additional Controls Would Increase Compliance with FHFA's Sales Requirements* (July 24, 2017) AUD-2017-006.

³ During this compliance review, a Division of Housing Mission and Goals (DHMG) official said DHMG discussed NPL sales requirement oversight with the Enterprises in early 2018, including the benefits of hiring a third-party vendor. In May and June 2019, respectively, a third party issued reports to the Enterprises on post-sale reporting compliance by NPL buyers. These two reports covered NPL reporting periods that were in effect prior to the NPL reporting fields discussed in this report.

FHFA requires that NPL buyers/servicers report to the Enterprises on the loan resolution and borrower and neighborhood outcomes for four years after the NPL sale. We found that the Enterprises' templates for collecting the required information did not contain some data fields necessary to determine buyer/servicer compliance with FHFA's sales requirements.

For example, the templates lacked data fields necessary to determine whether NPL buyers/servicers were meeting FHFA's "REO" sales requirement. REO, or real estate owned, is real estate acquired through foreclosure or a deed-in-lieu of foreclosure. Under FHFA's REO sales requirement for NPL sales, for the first 20 days that an REO property is marketed, it may be sold only to buyers who intend to occupy the property as their primary residence, or to a nonprofit.

We also found that Fannie Mae was not monitoring for potential "walkaways." FHFA's no walkaways sales requirement is intended to ensure that if a property is vacant, buyers do not abandon the lien and "walk away" from the property. Instead, if a foreclosure alternative is not possible, the servicer must either complete a foreclosure, sell the property, or donate the loan, including to a government or nonprofit entity. Fannie Mae reported that it had identified five NPLs as potential walkaways, but had not followed up with the NPL buyers to mitigate the risks associated with those loans.

Our audit report made the following two recommendations to FHFA:

1. Based on the goals and requirements of NPL sales, as established by the Agency:
 - a. Determine the information necessary to assess whether all of the goals and requirements are being met;
 - b. Update/modify the NPL sales reporting requirements as necessary to obtain that information; and
 - c. Update/modify the templates the Enterprises use to collect loan-level data from NPL buyers and servicers, as necessary.
2. Direct the Enterprises to:
 - a. Put controls in place to identify and track the simultaneous reporting of charge-off and vacant property, as indicating a possible walk away violation; and
 - b. Take action, as necessary, to ensure that servicers resolve possible walk away violations through foreclosure, or sale or donation of the loan.

FHFA agreed with both recommendations.

Our Closure of the 2017 Audit Report Recommendations

FHFA advised us that it had taken corrective actions to address each recommendation.

Corrective Actions for First Recommendation: FHFA Required the Enterprises to Collect Four Additional Data Fields from NPL Buyers

FHFA reported to us on March 30, 2018, that it had reviewed the Enterprises' assessments of current NPL reporting and determined that changes were necessary to adequately assess compliance with the requirements. FHFA updated the requirements to include the following four additional data fields for NPL buyers to report to the Enterprises as applicable:⁴

- Initial Rate Period – FHFA requires that if an NPL buyer modifies a loan that has an adjustable interest rate, the first five years (or 60 months) of the loan's term must be subject to a fixed interest rate. This field requires the NPL buyer to report the number of months that a modified loan subject to an adjustable rate is initially in a fixed interest rate status (it must be at least 60 months).
- Initial Interest-Only Period – This field applies in cases where an NPL buyer modifies a loan that is an interest-only loan. For such loans, the NPL buyer must report the number of months the loan is in interest-only status.⁵
- REO Multiple Listing Service (MLS) Start Date – For REO properties marketed once the NPL purchase has settled, this field represents the date that the property is first listed on the MLS;⁶ and
- REO Sales Bid Acceptance Date – For REO properties marketed once the NPL purchase has settled, this field represents the date that the sales bid was accepted.⁷

Based on notice of these corrective actions, we closed the first recommendation.

⁴ The effective date for the four fields was March 30, 2018. A DHMG official said that the requirements are established by contract and apply to subsequent Enterprise sales, but not to prior NPL sales.

⁵ According to Enterprise NPL documentation, “[t]o the extent the proprietary modification includes an interest-only payment feature, it must only apply to an initial period and must be applied as the final step in the modification waterfall for loans that would not otherwise qualify for a proprietary modification.”

⁶ The MLS is designed to facilitate real estate transactions by sharing and publicizing information on properties for sale by the customers of real estate brokers.

⁷ According to FHFA, the REO MLS Start Date and REO Sales Bid Acceptance Date fields are intended to determine if NPL buyers are complying with the requirement that for the first 20 days that an REO property is marketed, that property may be sold only to buyers who intend to occupy the property as their primary residence, or to a nonprofit.

Corrective Actions for Second Recommendation: Enterprises Adopted Controls to Mitigate Potential Walkaways

FHFA reported to us on February 15, 2018, that it had reviewed the Enterprises' assessments of the NPL information collected and determined that the following additional controls were needed to address the simultaneous reporting of charge-offs and vacant properties:

- Fannie Mae instituted a process under which it is to review NPL loans to identify those reported in the NPL buyer templates as both vacant and charged off, i.e., potential walkaways. In such cases, Fannie Mae will communicate with the NPL buyer to discuss the buyer's disposition strategy once a property is reported as vacant and charged off, to ensure that the purchaser is continuing to work to resolve the delinquency.
- FHFA said that Freddie Mac would modify the post-sale reporting templates to include fields for "Occupancy Status" and "Resolution."

We closed the second recommendation based on this report.

FINDINGS

We tested whether the Enterprises collected the required data and information from NPL buyers, as required by the corrective actions adopted for both recommendations, for the period June 2018 through November 2019 (review period).

Corrective Actions for First Recommendation

Fannie Mae Acknowledged that It Failed to Comply with FHFA's Requirement to Collect Four Additional Data Fields from NPL Buyers

A Fannie Mae vice president reported to us that Fannie Mae did not incorporate the four data fields required by FHFA as of March 30, 2018. He explained that Fannie Mae recognized, in late 2019, that it had omitted to add these data fields and characterized that omission as an oversight on its part.

This Fannie Mae official volunteered that Fannie Mae was developing a plan to collect the four data fields and would provide the plan to us when it was completed. In January 2020, Fannie Mae provided a copy of the plan to us, 22 months after the requirement became effective.

Fannie Mae's plan revised Fannie Mae's NPL buyer reporting template to include the four required fields and training materials regarding those fields. Fannie Mae also revised its NPL offering memoranda with an updated appendix that includes references to those fields. Fannie

Mae's plan further states that it will require NPL buyers for two deals that settled in 2018 to retroactively provide data for the four fields that should have been reported in 2019. Additionally, Fannie Mae's plan notes that NPL buyers for two deals that settled in 2019 will now be required to submit the four data fields going forward, as will all future NPL buyers.

Freddie Mac Collected Data for the Four Additional Fields from NPL Buyers

A Freddie Mac official reported to us that Freddie Mac has required NPL buyers to report data for each of the four fields on a monthly basis since March 2018.

To validate that representation, we selected a random and statistically significant sample of 100 loans from the first NPL sale to which the four required data fields applied (an NPL sale of nearly 2,600 loans that settled in December 2018), and requested documentation of all reported NPL sales fields and data for these 100 loans. Our analysis of the data for the sampled 100 loans found that Freddie Mac required NPL buyers to report data for each of the four fields.⁸

Freddie Mac also provided a written description of automated controls that it has put into place to detect inconsistencies in NPL buyers' reporting of data for each of the four fields. For example, one control flags instances where an NPL buyer reports that a loan has been modified into an adjustable rate mortgage but the Initial Rate Period field has been left blank. Such an instance indicates a potential violation of NPL sales reporting requirements, because the first 60 months of a modified loan subject to an adjustable interest rate must be in fixed rate status and the number of such months must be included in the Initial Rate Period field.

To validate the existence of these internal controls, we requested documentation of Freddie Mac's follow-up communications with NPL buyers regarding inconsistencies flagged by the controls in the data reported for the four fields. We reviewed emails and other communications with NPL buyers of about 23 potential inconsistencies and found, in each instance, that Freddie Mac determined that the inconsistencies were due to reporting errors rather than violations of the NPL requirements. Accordingly, we were able to validate the efficacy of these internal controls.

⁸ We understand that these four data fields are populated on an "as applicable" basis. This, as well as the fact that the NPL reporting requirements extend for four years post-sale whereas our testing covered less than one year of reporting (December 2018 to October 2019), might be why our review found very few entries in these data fields: only 2% of the sampled loans included data in the Initial Rate Period field, none included data in the Initial Interest Only Period field, 6% included data for the MLS Listing Start Date field, and 4% included data for the REO Sales Bid Acceptance Date field. As time progresses, the potential for reportable events occurring – such as adjustable rate loan modifications or REO sales – will likely increase, in which case one would expect to see additional data reported in these fields. See Objective, Scope, and Methodology for further details.

Corrective Actions for Second Recommendation

Fannie Mae is Following up With NPL Buyers Regarding Three Potential Walkaways

As described above, Fannie Mae established a process to follow up with NPL buyers regarding mortgages that are reported as both charged off and vacant, as such loans represent potential “walkaways.” To assess whether Fannie Mae implemented this process, we sought identification of all NPL loans that NPL buyers had reported as both charged off and vacant during our review period,⁹ and documentation reflecting follow-up by Fannie Mae with NPL buyers to resolve the loans.

Fannie Mae identified 34 NPLs (out of 78,281 total) that NPL buyers reported as both charged off and vacant. Fannie Mae explained that it was not following up on 28 of these 34 loans because they were sold prior to FHFA’s April 2016 prohibition against walkaways. According to Fannie Mae, the NPL buyers of these 28 loans were not bound by the FHFA’s April 2016 prohibition against walkaways. DHMG advised in writing that Fannie Mae’s position is consistent with the Agency’s April 2016 prospective prohibition.

The other six Fannie Mae potential walkaway NPLs were sold after the April 2016 prohibition. Fannie Mae determined that two of these loans were in bankruptcy and the NPL buyers had no legal interest in them as the bankruptcy courts had required the NPL buyers to relinquish their liens. Fannie Mae also determined that another loan was a short sale cash payoff rather than vacant and charged-off. Fannie Mae reported that it was communicating with NPL buyers on three loans as potential walkways but had no documentation of such communications.

Freddie Mac Did Not Identify Any Potential Walkaways

Freddie Mac reported that it initially identified five NPLs during our review period that were reported as both charged off and vacant as potential walkways.¹⁰ Its subsequent review found that the properties secured by the loans were not vacant when charged off and it determined that none were potential walkways.

CONCLUSIONS

In response to our 2017 audit report’s recommendations, FHFA adopted two corrective actions, the first of which required the Enterprises to collect four additional data fields from

⁹ See Objective, Scope, and Methodology for further details.

¹⁰ See Objective, Scope, and Methodology for further details.

NPL buyers. We found that Freddie Mac complied with the first corrective action in this review period but Fannie Mae did not. Since Fannie Mae has provided us with its plan to collect the required data fields as applicable beginning in 2020, we will revisit this matter after an appropriate interval to determine whether Fannie Mae has honored its commitment to collect the required data fields.

FHFA adopted a second corrective action pertaining to following up with NPL buyers on potential walkaways. Our compliance review found that Fannie Mae is following up with NPL buyers on three potentially abandoned properties (out of 78,281 NPL sold) whereas Freddie Mac has not identified any such cases. Based upon the foregoing, we determined that the second corrective action has been implemented.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA an opportunity to respond to a draft of this compliance review report. In its written management response, which is included as an appendix to this report, DHMG stated that it was pleased the compliance review determined that the second corrective action has been implemented. DHMG also stated that it was looking forward to working with us in the future to help the Enterprises resolve any outstanding items. DHMG did not address Fannie Mae's failure to implement the first corrective action. FHFA also provided technical comments which were incorporated as appropriate.

OBJECTIVE, SCOPE, AND METHODOLOGY

We performed this compliance review to determine whether the Enterprises and by extension NPL buyers complied with the FHFA-directed corrective actions in response to the first and second recommendations in our 2017 audit report.

To accomplish these objectives, we reviewed Enterprise and FHFA documentation pertaining to the NPL sales program and met with DHMG and Enterprise officials. We did not test Fannie Mae's compliance with the first corrective action that it collect four additional data fields given that a vice president acknowledged in our opening meeting that the Enterprise had not done so.

Regarding our testing of Freddie Mac's compliance with the first corrective action, we selected an NPL sales transaction that settled in December 2018 for review. This transaction consisted of nearly 2,600 NPL loans, which were divided among three separate pools of loans that were each purchased by three separate buyers. According to Freddie Mac, this transaction was the first NPL sales transaction to which the four required data fields applied,¹¹ and we selected it for testing since the longest period of time had elapsed for NPL buyers to populate the four fields in their monthly reporting to Freddie Mac.

We selected a random and statistically significant sample of a total of 100 loans from the nearly 2,600 loans in the transaction and requested that Freddie Mac provide the reported NPL sales data (including data for the four fields) for their October 2019 report, which was the most recent available at the time of our testing. Freddie Mac officials said that the most recent monthly reports provide a full recording of all data entered into the fields in prior reporting and thus provide a complete accounting of such reporting to date. We reviewed the October 2019 reported data to verify its format included the four data fields and to observe the incidence to which the NPL buyers were populating the fields.

The scope of our work did not include assessing whether the NPL buyers reported accurate information to Freddie Mac as the Enterprises do not collect the underlying loan documentation from the buyers on a monthly basis and our doing so would have been outside the reporting timeframes of this compliance review report.

Regarding the Enterprises' compliance with the second corrective action, we asked that they identify all loans reported as newly charged off and vacant during our review period to

¹¹ Freddie Mac officials said that the four fields applied for NPL sales transactions that were both offered and settled after March 2018.

identify potential walkaways. We also requested that the Enterprises provide documentation of their efforts to resolve these potential walkaways consistent with FHFA requirements.

We conducted our compliance review from November 2019 through February 2020 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

APPENDIX: FHFA MANAGEMENT RESPONSE.....

CONTROLLED



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TO: Brian W. Baker, Acting Deputy Inspector General

FROM: Sandra Thompson, Deputy Director, Division of Housing Mission and Goals

SJW
SUBJECT: Draft Report: *Compliance Review of FHFA's Enterprise Non-Performing Loan Sales Program*

DATE: February 25, 2020

Thank you for the opportunity to respond to the Federal Housing Finance Agency Office of Inspector General's (FHFA OIG) draft report, *Compliance Review of FHFA's Enterprise Non-Performing Loan Sales Program* (Report). This compliance review was initiated to verify the Enterprises' compliance with the two corrective actions issued in 2018 from FHFA to the Enterprises. The corrective actions resulted from findings in the FHFA OIG 2017 Audit of NPL Sales. The first corrective action included the addition of four (4) additional servicer data fields. The second corrective action identified additional controls to be implemented for the NPL Sales Program. Both corrective actions were intended to enhance the Enterprises' ability to verify compliance with the NPL Sales Requirements.

I am pleased the compliance review determined that the second corrective action has been implemented, and we look forward to working with you in the future to help the Enterprises to resolve any further outstanding items. Please feel free to contact me with any questions.

cc: Christopher Bosland, Senior Advisor for Regulation
Larry Stauffer, Acting Chief Operating Officer
John Major, Internal Controls and Audit Follow-up Manager

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