OFFICE of INSPECTOR GENERAL
UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

CMG Mortgage, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans

Audit Report Number: 2025-NY-1001

February 27, 2025

Office of Audit | Office of Inspector General
U.S. Department of Housing and Urban Development

To: Julie A. Shaffer
Associate Deputy Assistant Secretary for Single Family Housing, HU

//signed//
From: Kilah S. White
Assistant Inspector General for Audit, Office of Inspector General, GA

Subject: CMG Mortgage, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans, San Ramon, CA

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of CMG's quality control program for originating and underwriting Federal Housing Administration (FHA)-insured loans.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, as amended, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at https://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call Kimberly S. Dahl, Audit Director, at (202) 617-6886.

Highlights

CMG Mortgage, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans | 2025-NY-1001

What We Audited and Why

We audited CMG Mortgage, Inc., to evaluate its quality control (QC) program for originating and underwriting Single Family FHA-insured loans. We selected CMG for review based on its loan volume and delinquency rate and because its rate of self-reporting loans to HUD when it identified fraud, material misrepresentations, and other material findings that it could not mitigate was below average for more than a 5-year period.

What We Found

CMG's QC program for originating and underwriting FHA-insured loans was not sufficient. Specifically, CMG (1) did not select the proper number of loans for review and maintain complete and accurate data to document its loan selection process; (2) did not always complete key review steps and sometimes missed material deficiencies; and (3) did not adequately mitigate and report loan review findings, which included self-reporting loans to HUD when required. These issues occurred because CMG had insufficient controls over its QC program and was not always familiar with HUD requirements. As a result, HUD did not have assurance that CMG's QC program fully achieved its intended purposes, which include, among other things, protecting the FHA insurance fund and lender from unacceptable risk, guarding against fraud, and ensuring timely and appropriate corrective action.

What We Recommend

We recommend that HUD require CMG to (1) update its QC plan and related procedures to align with HUD requirements; (2) demonstrate that its training for staff and management has been updated to reflect changes to its QC plan and related procedures, and to cover the underlying requirements for lender QC programs; (3) review the loans that it had not selected and take appropriate actions when applicable; (4) evaluate its QC files for the loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that it did not acceptably mitigate.

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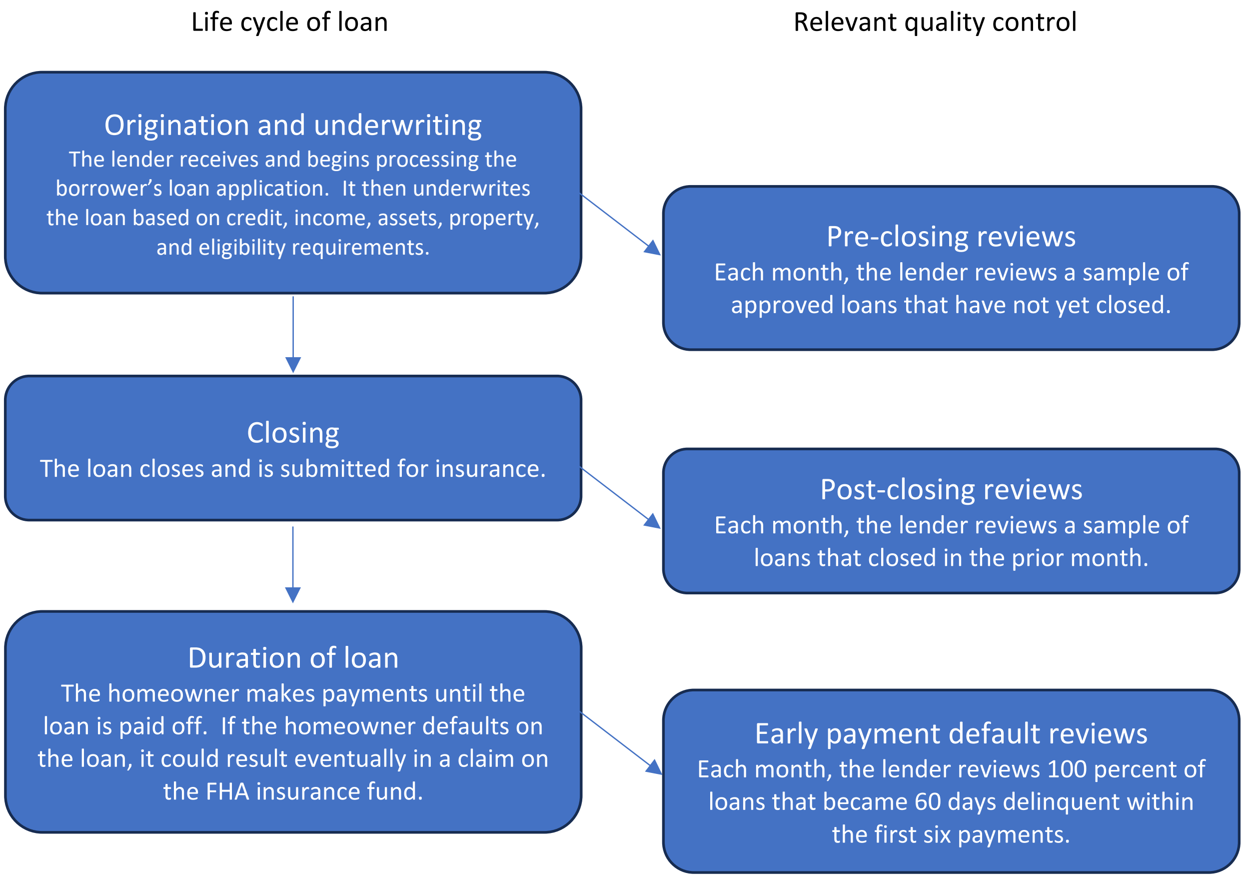
Background and Objective

FHA, a part of HUD, provides mortgage insurance on single family loans made by FHA-approved lenders throughout the United States and its territories. This insurance protects lenders against losses as a result of homeowners' defaulting on their mortgage loans. The lenders bear less risk because HUD will pay a claim to the lender in the event of a homeowner's default.

HUD monitors a number of lenders each year and performs random and targeted reviews of loans throughout the year. Further, HUD requires each lender to implement a quality control (QC) program to (1) ensure compliance with policy and guidelines; (2) protect FHA and the lender from unacceptable risk; (3) guard against errors, omissions, negligence, and fraud; (4) determine the root cause of any deficiencies and identify potential internal and external control weaknesses; (5) alert lender management to patterns of deficiencies; (6) ensure timely and appropriate corrective action; (7) ensure the existence of required documentation that is the basis of underwriting decisions; (8) ensure that loans are secured by properties with values sufficient to support the loan; and (9) ensure compliance with fair lending laws.

Lender QC programs must cover the life cycle of an FHA-insured loan for any functions that the lender performs. As shown below, lenders who originate and underwrite loans must review samples of loans before closing, after closing, and if they default early in the life of the loan.



To help ensure that lender QC programs meet their intended purposes, Section V of HUD's FHA Single Family Policy Handbook requires lenders to have written QC plans setting forth the procedures they will use. It also sets parameters for how many loans lenders must review each month and requires them to document the results of each loan review performed, including any corrective actions taken. Lenders must review all loan files selected for compliance with the handbook's requirements related to debts, employment, income, sources of funds, the property, how documents were handled, underwriting accuracy and completeness, etc. Further, they must do additional analysis when conducting post-closing and early payment default (EPD) reviews by obtaining new credit reports, reverifications of borrower information, and appraisal field reviews if relevant based on the type of loan.

As shown below, lenders must also meet key requirements when their reviews identify findings.

Requirement	Description
Loan sample risk assessment	Loans must be evaluated based on the severity of the violations found using prescribed risk categories, and lenders must use this information to conduct trend analyses over time.
Reporting to lender management	Initial findings and final reports must be shared with senior lender management. The lender must respond to each instance of fraud, material misrepresentation, or other material finding.
Reporting to HUD	Lender management must self-report to HUD all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.

CMG Mortgage, Inc., is a nonsupervised lender based in San Ramon, CA.[1] It is a nonbank entity and has been approved to conduct business with FHA since 1995. Over the past 5 years, CMG has originated or underwritten more than 46,000 FHA-insured loans. It conducts pre-closing, post-closing, and EPD reviews in-house.

Our objective was to evaluate CMG's QC program for originating and underwriting FHA-insured loans.

1 Nonsupervised lenders are lending institution that have as their principal activity the lending or investing of funds in real estate mortgages, consumer installment notes or similar advances of credit, the purchase of consumer installment contracts. In contrast, supervised lenders are banks, savings banks, or credit unions that are members of the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), or the National Credit Union Administration (NCUA). Nonsupervised lenders do not fall under the supervision of the FDIC, OCC, or NCUA.

Results of Audit

CMG's Quality Control Program Did Not Fully Achieve Its Purpose

CMG's QC program for originating and underwriting Single Family FHA-insured loans was not sufficient. Specifically, CMG (1) did not select the proper number of loans for review and maintain complete and accurate data to document its loan selection process; (2) did not always complete key review steps and sometimes missed material deficiencies; and (3) did not adequately mitigate and report loan review findings, which included self-reporting loans to HUD when required. These issues occurred because CMG had insufficient controls over its QC program and was not always familiar with HUD requirements. As a result, HUD did not have assurance that CMG's QC program sufficiently protected the FHA insurance fund and lender from unacceptable risk, guarded against fraud, and facilitated timely and appropriate corrective action.

CMG's Loan Selection Process Was Insufficient

While CMG selected a sufficient number of loans for pre-closing reviews, it did not always select the proper number of loans for post-closing and early payment default (EPD) reviews. Further, it did not maintain complete and accurate data to document its loan selection process.

Post-Closing Review Sampling Was Insufficient

HUD requires lenders who originate or underwrite more than 3,500 FHA-insured loans per year, such as CMG, to select either 10 percent of those loans for pre-closing and post-closing reviews or to determine their sample size using a statistical stratified random sample that would ensure a 95 percent confidence level with a confidence interval not to exceed 2 percent on an annual basis, based on defect rates for FHA loans recently reviewed.[2] Further, HUD requires that lenders perform post-closing reviews on at least 90 percent of the sample size.[3] This is important because post-closing reviews are more thorough. While CMG chose to determine its sample size using a statistical sampling method, it did not select a sufficient number of loans for post-closing reviews.

Based on information provided by CMG, we estimate that it should have performed at least 1,083 post-closing reviews on loans that it originated or underwrote over the 2-year period.[4] However, it performed only 495 post-closing reviews, which means that it failed to conduct approximately 588 post-closing reviews. This condition occurred because CMG's QC plan and sampling methodology did not adequately cover HUD's requirements and because its staff was unfamiliar with them. For example, (1) CMG's plan did not require it to properly weight its sample so that it performed post-closing reviews on at least 90 percent of its sample size, and (2) CMG's sampling universe and defect rate were based on all types of mortgage loans rather than only FHA loans that it originated or underwrote.[5] In addition, its plan did not require it to stratify loans based on mortgage product type and how the loans were originated, and CMG could not provide detailed information that would allow us to recreate its sample sizes.

2 HUD Handbook 4000.1, section V.A.3.a.iii.(B)

3 HUD Handbook 4000.1, section V.A.3.a.iii.(C)

4 We estimated the minimum sample size using CMG's loan volume for the 2-year period, the percent of material findings that it identified in post-closing reviews of FHA loans, and the same 95 percent confidence level and 2 percent confidence interval used by CMG.

5 CMG's sampling universe contained all loans, such as conventional loans, U.S. Department of Veterans Affairs (VA) loans, and even FHA loans that it did not originate or underwrite.

As a result of the issues noted above, CMG did not develop relevant and timely insights on at least 588 loans with estimated original mortgage amounts totaling approximately $152 million that could have been used to mitigate risks and strengthen its operations over time.[6]

EPD Loans Were Not Always Selected for Review

HUD requires lenders to review 100 percent of early payment default (EPD) loans when they become 60 days delinquent within the first six payments.[7] These reviews are important because they can provide valuable insight into what caused the borrowers to default on their loans and identify underwriting weaknesses. From October 2020 through September 2022, CMG reviewed only 595 of the 915 loans in which borrowers went into early payment default.[8] CMG did not perform approximately 35 percent of the required EPD reviews primarily because its staff incorrectly excluded loans originated by other lenders that CMG had underwritten. HUD's guidance specifically requires lenders to review all EPD loans that it underwrote, even if the loans were originated by other lenders. CMG failed to review the remaining loans due to human error or because it did not obtain sufficient data to identify all EPD loans. As a result, CMG was unable to develop relevant and timely insights on 320 loans with original mortgage amounts totaling more than $80.7 million that could have been used to mitigate risks and strengthen its operations over time.

Selection Data Were Inadequate

CMG did not maintain complete and accurate data to document its pre-closing, post-closing, and EPD loan selection process as required by HUD.[9] For example, the sample universe data it provided did not reconcile with the list of sampled loans CMG provided to us. In addition, more than 6,700 of the 27,496 loans in CMG's sample universe data and 264 of 2,135 loans in the sampled loan data CMG provided were not originated or underwritten by CMG. This condition occurred because CMG did not have an adequate process for documenting and maintaining data on its monthly sample selection. Because CMG maintained data on all loans reviewed together, it had to separate the relevant FHA loans when it compiled information for this audit, and human errors occurred during the process. In addition, CMG indicated that errors when staff entered reviews into its system may have caused the remaining issues. As a result, it was initially difficult to reconcile CMG's data and ensure that it had adequate coverage. We were able to confirm the information through communication with the lender, but CMG's existing process for documenting and maintaining data could compromise the integrity of its QC program by making it difficult to confirm compliance and adequate coverage.

CMG's Loan Reviews Were Inadequate

While CMG generally completed its loan-level reviews within established timeframes, the reviews were not always of sufficient quality. Lenders must review selected loans for compliance with requirements, such as those related to debts, employment, income, sources of funds, the property, how documents were handled, and underwriting accuracy and completeness. Further, for post-closing and EPD reviews,

[6] We estimated the original mortgage amount of the 588 loans based on the average original mortgage amount for FHA-insured loans that were originated or underwritten by CMG and closed during our audit period.

[7] HUD Handbook 4000.1, section V.A.3.a.iv.(B)

[8] CMG reviewed an additional 53 loans that did not meet HUD's definition for EPD. While lenders may choose to conduct reviews on additional loans that do not meet HUD's definition, these would not satisfy its responsibility to review all EPD loans.

[9] HUD Handbook 4000.1, section V.A.3.a.v

HUD requires lenders to conduct a deeper analysis using new credit reports, reverifications of borrower information, and appraisal field reviews when relevant based on the loan type. CMG's loan reviews sometimes missed key steps or failed to identify material deficiencies that would have affected loan approval and insurance eligibility.

Reverifications Were Obtained for Only 80 Percent of Loans Sampled

HUD requires lenders to document their due diligence in attempting written and electronic verifications, as well as telephone reverifications when written or electronic reverifications are not returned.[10] However, CMG complied with HUD's reverification requirements for only 80 percent of the 20 loans sampled. It used a re-verification checklist to show due diligence in documenting the verification. However, for 4 of the 20 loans sampled, CMG's QC files did not include completed reverification checklists for employment, income, assets, or sources of funds. For example, one file did not contain evidence showing that borrower assets were reverified with the bank during the QC review. While CMG attempted to reverify the borrower's assets in writing, the file did not show that it attempted to reverify the information via telephone when the bank did not respond. The condition noted above occurred because CMG's QC policy did not require it to confirm that all required reverification attempts had been performed and documented. As a result, CMG missed opportunities to confirm that the documentation used to approve the loan was valid and sufficient and to evaluate any discrepancies between the original and new documents.

Material Deficiencies Were Missed

CMG did not always detect origination and underwriting deficiencies that would have affected loan approval and insurance eligibility during its QC reviews. A comparison of CMG's QC data with data from HUD's quality assurance reviews found four loans in which HUD identified material deficiencies that resulted in indemnification agreements, but CMG's reviews had failed to detect the deficiencies.[11] These issues occurred because CMG did not adequately review some files for compliance with requirements. As a result, HUD did not have assurance that CMG's loan reviews sufficiently supported compliance with underwriting requirements and protected the FHA insurance fund and lender from unacceptable risk.

CMG's Mitigation and Reporting of Review Findings Were Inadequate

While CMG established a risk assessment methodology for its QC reviews and generally reported loan-level findings to internal management as required, it did not adequately mitigate findings and report them to HUD when necessary. HUD requires lenders to self-report to HUD all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.[12] Findings are considered material if disclosure of them would have altered the lender's decision to approve the loan or seek FHA endorsement for it.[13] Material findings are considered mitigated only if the deficiencies have been remedied so that the loan approval and insurance endorsement decisions are considered

[10] HUD Handbook 4000.1, section V.A.3.c.ii.(B)(1)(b)

[11] Indemnification agreements protect HUD against loss associated with a loan should it result in a claim against the FHA insurance fund. We identified 151 loans that had both a QC review by CMG and a HUD quality assurance review. HUD identified material deficiencies that resulted in indemnification agreements for 8 of the 151 loans. However, as noted above, for four of these loans, CMG did not detect these material deficiencies during its QC reviews. For the remaining four loans, CMG detected the deficiencies but had failed to adequately mitigate or self-report them to HUD.

[12] HUD Handbook 4000.1, section V.A.2.d.iv

[13] HUD Handbook 4000.1, section V.A.2.d.i.(B)

acceptable.[14] Further, HUD requires lenders to retain all QC results and documentation, including actions taken to mitigate findings.[15]

While CMG identified material findings during its QC reviews for 17 of the 20 loans we sampled, it only complied with HUD's requirement to mitigate or self-report the findings for 9 of these 17 loans, or 53 percent. For each of the nine loans, they complied with the requirement by documenting mitigation of the material findings. For the remaining 8 of 17 sampled loans with material findings, CMG's records did not show that it acceptably mitigated the findings or self-reported the loans to HUD. For example, for one of the loans, when performing a reverification of employment during the QC review, CMG discovered that the borrower had falsely claimed to be employed before closing. The QC review revealed that the borrower was unemployed as of the day before the closing. While CMG's QC report indicates the loan needed to be self-reported or have corrective action within 30 days, it did not self-report the loan to HUD as required, despite the finding representing suspected fraud or material misrepresentation.

In addition, we identified four loans in which HUD and CMG had separately reviewed the files and identified material deficiencies, and HUD's review had resulted in indemnification agreements. CMG indicated that the deficiencies identified during its QC reviews for these four loans were resolved. However, data provided from its system only showed the material findings for one of the four loans as being resolved. Further, the justification included in the system for the loan did not show that an employment history finding was acceptably mitigated, and CMG had not self-reported any of the four loans to HUD, which is required when it has not documented that material findings are acceptably mitigated.

In total, we identified 12 loans in which CMG failed to mitigate or self-report findings identified during its QC reviews. These issues occurred because CMG did not adequately implement HUD requirements for mitigation and self-reporting. For example, while its QC plan discussed self-reporting, CMG did not have a process in place to trigger and ensure self-reporting on loans in which it identified fraud, material misrepresentations, or other material findings that it did not show were mitigated. Further, while its QC plan stated that resolution would be formally documented in its system, which aligns with HUD requirements for mitigation, data provided for three loans showed material findings as being unresolved without comments despite CMG separately stating that they were resolved.

As a result, HUD did not have assurance that CMG's QC program guarded against fraud, ensured appropriate corrective action, and protected the FHA insurance fund and lender from unacceptable risk, including for the eight loans with original mortgage amounts totaling more than $1.9 million that were not self-reported and had not yet been indemnified. In addition, we identified 271 other loans with original mortgage amounts totaling more than $71.1 million that were reviewed by CMG and contained material findings that may not have been adequately mitigated or required self-reporting to HUD.[16]

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[14] HUD Handbook 4000.1, section V.A.2.d.i.(C)

[15] HUD Handbook 4000.1, section V.A.2.d.v

[16] CMG uses low, moderate, material, and critical risk assessment categories. Based on a comparison of HUD's definition for material findings and requirements for loan sample risk assessment categories (HUD Handbook 4000.1, section V.A.2.d.i.(B) and V.A.3.b.iii) and CMG's definitions for its material and critical risk categories, as well as the results of this review, we considered loans that CMG classified as material or critical risk to have material findings.

Conclusion

CMG's QC program did not fully achieve its intended purposes, which include, among other things, protecting HUD and itself from unacceptable risk, guarding against fraud, and facilitating timely and appropriate corrective action. These issues occurred because CMG had insufficient controls over its QC program, including that its QC plan and policies did not always cover HUD requirements and that CMG was not always familiar with key requirements. If CMG updates its QC plan and related procedures, and demonstrates that it has updated training for its staff and management, it will help ensure that its QC program complies with requirements and better achieves its intended purposes going forward.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require CMG to

1A. Update its QC plan and related processes and procedures to align with requirements for loan selection, including maintaining data and documentation showing how sample sizes and loan selections were determined.

1B. Update its QC plan and related processes and procedures to align with requirements for (1) loan file reviews and reverifications of borrower information, (2) mitigation of findings, and (3) reporting findings to HUD when required.

1C. Demonstrate that its training for staff and management has been updated to reflect changes made to its QC plan and related processes and procedures in response to recommendations 1A and 1B, and to cover the underlying HUD requirements for lender QC programs, and provide proof of training to HUD.

1D. Conduct up to 588 additional post-closing QC reviews to meet sample size and composition requirements and submit the results to HUD, including all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate. If required, CMG should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1E. Review the 276 EPD loans not previously selected for review and submit the results to HUD, including all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.[17] If required, CMG should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1F. Evaluate its QC files for the 242 loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with

[17] While we identified 320 EPD loans that CMG did not review during our audit period as required, we reduced this figure to 276 to account for those loans that were terminated without a claim, such as when a loan is paid in full.

any other material findings that its records did not show have been acceptably mitigated.[18] If required, CMG should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1G. Provide indemnification agreements or documentation to support the eight loans in which it identified fraud, material misrepresentations, or other material findings that it did not acceptably mitigate or self-report to HUD. Implementation of this recommendation will protect the FHA insurance fund from an estimated loss of $639,397.[19]

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[18] While we identified 271 loans in which CMG had identified material findings and might need to self-report them, we reduced this figure to 242 to account for those loans that were terminated without a claim, such as when a loan is paid in full.

[19] This amount was based on the unpaid balances of the loans, which totaled more than $1.8 million, and FHA's average loss experience of about 34 percent.

Scope and Methodology

We performed our audit work between February 2023 and April 2024. We did not conduct onsite fieldwork for this audit. Our audit covered the period October 2020 through September 2022, and was expanded to include loan statuses as of August 2024.

To accomplish our objective, we

- reviewed relevant requirements, including handbooks and mortgagee letters;
- reviewed the lender's QC plan and related policies, procedures, and other relevant documentation to obtain sufficient background information on the program and lender;
- reviewed monthly QC summary reports from the lender covering the 2-year audit period;
- reviewed the lender's QC data for pre-closing, post-closing, and EPD reviews;
- compared the lender's QC data and data from HUD's Single Family Data Warehouse (SFDW) to determine whether the lender reviewed the correct quantity of loans; whether the reviews were performed in a timely manner; and whether the lender obtained new credit reports, reverifications, and appraisal field reviews for the correct quantity of loans each month;
- compared the lender's QC data and data from HUD's Loan Review System (LRS) to identify loans in which the lender could have missed material deficiencies during its QC reviews, failed to properly categorize or correct deficiencies identified, or failed to self-report the loans to HUD;
- reviewed loan data from Neighborhood Watch;
- reviewed training records, including logs listing training received by staff and management; and
- interviewed key lender officials to obtain an understanding of its operations, data, and documentation and to discuss potential issues identified during the audit.

For the period October 2020 through September 2022, CMG performed QC reviews on 2,135 loans, including 264 loans that were not originated or underwritten by CMG. We selected a targeted sample of 20 loans based on various factors, such as whether the loans were currently or previously in default, especially those 6 months or more delinquent or in foreclosures; the default reason listed in HUD's SFDW system; when the loans closed; and the highest lender finding level. For each of the 20 loans, we reviewed the lender's QC and loan files to determine whether CMG looked at all required QC elements, missed any significant deficiencies, reasonably categorized deficiencies identified, mitigated deficiencies, took appropriate corrective action, self-reported loans to HUD if required, and completed its review and followup in a timely manner. When considering whether deficiencies identified or missed by CMG would have affected loan approval and insurance eligibility, we considered information in FHA's Defect Taxonomy. Our results were limited to the loans in our sample and cannot be projected to the universe.

Of the 1,871 loans that CMG originated or underwrote and for which it conducted QC reviews, HUD had reviewed 151 loans as of May 2023. We identified eight loans in which HUD found indemnifiable deficiencies despite the lender's not having self-reported the loans. We performed limited scope reviews of the eight loans to confirm whether the lender found the deficiencies identified by HUD, how it categorized and corrected the findings, and whether it self-reported the loans to HUD.

We relied on computer-processed data provided by CMG as well as data contained in HUD's Neighborhood Watch system, SFDW, and LRS. We assessed the reliability of the computer-processed data and determined that the data were sufficiently reliable to achieve our audit objective. We also assessed the relevant internal controls to the extent necessary to determine whether they were logical, reasonably complete, and likely to deter or detect potential problems or indicators.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendixes

Appendix A – Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
1G	$639,397

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this case, if HUD implements our recommendation, it could avoid potential losses for eight loans in which CMG identified fraud, material misrepresentations, or other material findings that it did not acceptably mitigate or self-report to HUD. The amount above reflects that upon paying a claim on defaulted loans, FHA's average loss experience is about 34 percent based on statistics provided by HUD.

Appendix B – Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation – Auditee Comments

CMG MORTGAGE, INC NMLS 1820
CMG FINANCIAL | CMG HOME LOANS

December 2, 2024

Office of Inspector General | U.S. Department of Housing and Urban Development
451 7th Street SW
Washington, DC 20410

Dear Kimberly S. Dahl:

On behalf of CMG Mortgage, Inc., ("CMG") I submit this response to the draft audit report (the "Draft Report") prepared by the U.S. Department of Housing and Urban Development ("HUD") Office of Inspector General ("OIG") related to HUD OIG's recently completed audit of CMG's quality control ("QC") program for originated loans. CMG values its partnership with HUD and the Federal Housing Administration ("FHA") and is committed to maintaining a QC Program consistent with those requirements.

CMG has had a strong relationship with HUD since 1995. Our primary goal is to mitigate losses before insuring loans in our prefunding process, which includes conducting thorough fraud and QC reviews. We place a high priority on producing quality FHA loans to proactively minimize risks to the FHA insurance fund.

As described below, CMG worked to enhance its QC Plan and procedures to ensure it is appropriately reviewing FHA-insured loans and reporting material findings, fraud, and material misrepresentations to HUD. CMG is also currently undertaking lookback reviews to ensure that it will have completed QC reviews of the appropriate sample of FHA-insured loans beginning in January 2024. Therefore, CMG has already addressed HUD OIG's recommendation to make updates to its QC program on a go-forward basis and is in the process of remediating historical deficiencies by completing additional QC reviews for the audit period.

> **1A. Leverage technical assistance from HUD to update its QC plan and related processes and procedures to align with requirements for loan selection, including maintaining data and documentation showing how sample sizes and loan selections were determined.**

Comment 1 > CMG updated its QC Program August 8, 2023, to align with FHA's requirements for loan selection, including retention of the data and documentation that serves as the basis for its sampling population, and has enhanced its processes and procedures for document retention to ensure it maintains adequate records for its populations and sampling methodology.

CMG acknowledges that although it conducted pre-closing reviews for the appropriate number of loans to be insured by FHA (which the Draft Report confirms), prior to August 8, 2023, its post-closing QC review sample was calibrated to CMG's entire origination population rather than its FHA origination population. CMG updated its QC Plan on August 8, 2023, and, as of that date has been reviewing FHA loan sample sizes consistent with FHA guidelines.

Comment 2 > Although CMG should have been reviewing a larger population of loans in its post-closing QC, CMG disagrees with the Draft Report's finding that it needs "technical assistance" from HUD or that it did not maintain data and documentation showing how loans were collected for purposes of QC audits.

CMG Mortgage, Inc. | Corporate NMLS# 1820 | 3160 Crow Canyon Road, Suite 400 | San Ramon, CA 94583
Web: cmgfi.com • cmghomeloans.com | Phone: 1.925.983.3000

CMG Home Loans and CMG Financial are registered trade names of CMG Mortgage, Inc., NMLS# 1820 in most, but not all states. CMG Mortgage, Inc. is an equal housing lender. To verify our complete list of state licenses, please visit www.cmgfi.com/corporate/licensing and www.nmlsconsumeraccess.org.

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1B. Leverage technical assistance from HUD to update its QC plan and related processes and procedures to align with requirements for (1) loan file reviews and reverifications of borrower, (2) mitigation of findings, and (3) reporting findings to HUD when required.

Comment 3 >

CMG updated its QC processes on May 16, 2024, to address this finding. The updates reflect that CMG will expand its attempt to verify consumer assets via telephone as part of the reverification process. CMG also developed new procedures to ensure findings are mitigated appropriately and reported to HUD. It's important to note that banks do not accept asset reverification over the telephone; however, CMG will document all attempts made to obtain reverification.

1C. Provide annual training to its staff and management on HUD requirements for lender QC programs and provide proof of training HUD.

Comment 4 >

CMG disagrees with this recommendation because, although the QC Plan prior to August 8, 2023, resulted in under-sampling of FHA loans as part of the post-closing QC process, employees did properly carry out CMG's QC Plan and implementing procedures. As noted above, CMG updated its QC Plan to address findings 1A and 1B and is currently carrying out sampling methodologies and QC post-closing reviews in a manner consistent with HUD guidelines. The above-noted concerns did not reflect a lack of training. The updated QC Plan, and accompanying enhanced policies and procedures suffice to satisfy these findings.

1D. Conduct up to 588 additional post-closing QC reviews to meet sample size and composition requirements and submit the results to HUD, including all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate. If required, CMG should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

Comment 5 >

While CMG strives to take a proactive approach, HUD OIG has indicated that HUD will notify CMG regarding the loans, up to 588, that must be reviewed to address any gaps identified in its previous sampling methodology. However, it is critical to note that CMG maintained a pre-funding review program that resulted in significantly more FHA loans being reviewed prior to closing than was required under HUD guidelines. Specifically, between October 1, 2020, and September 30, 2022, CMG's pre-funding reviews of FHA loans resulted in its review of 670 more loans than was required under HUD guidelines. These reviews were critical to ensuring that loans were properly closed and reduced the risk to the FHA insurance fund by identifying and remediating defects even before closing and endorsing loans for FHA-insurance. Nevertheless, CMG agrees to review loans identified by HUD, will report as required any findings to HUD pursuant to CMG's new self-reporting guidelines, and will engage with HUD upon the conclusion of any required self-reports to assess whether indemnification and/or reimbursement is appropriate based on the results of the review.

1E. Review the 276 EPD loans not previously selected for review and submit the results to HUD, including all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate. If required, CMG should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

Comment 6 >

CMG is reviewing the EPD loans identified in the Draft Report, however additional context is critical to make clear that there was not an issue with CMG's process for reviewing and selecting EPD loans.

During the relevant period, CMG conducted an appropriate review of all EPD loans identified to CMG by HUD through FHA's Neighborhood Watch Early Warning System profile. On April 26, 2024, CMG determined that its profile within the Neighborhood Watch system was set up to

CMG Mortgage, Inc. | Corporate NMLS# 1820 | 3160 Crow Canyon Road, Suite 400 | San Ramon, CA 94583
Web: cmgfi.com • cmghomeloans.com | Phone: 1.925.983.3000

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Comment 7 >

identify loans that CMG directly originated through its retail channel. However, HUD identified EPD loans that CMG originated, underwrote, and insured through other business channels. Lenders only have access to data on loans that have amortization start dates within the past 12 to 24 months in the FHA Neighborhood Watch system. Once HUD OIG supplies the additional EPD loans for review, CMG will thoroughly review these loans and report all findings to HUD as required.[1]

1F. Evaluate its QC files for the 242 loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its records did not show have been acceptably mitigated. If required, CMG should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

Comment 8 >

CMG respectfully disagrees with this finding, as HUD OIG has not provided CMG with a list of the 242 loans where CMG allegedly identified material findings and did not self-report such findings of fraud or material misrepresentation to HUD. While CMG is amenable to reviewing loans HUD OIG identifies to CMG consistent with this finding, CMG cannot agree with this finding absent additional information.

1G. Provide indemnification agreements or documentation to support the eight loans in which it identified fraud, material misrepresentations, or other material findings that it did not acceptably mitigate or self-report to HUD. Implementation of this recommendation will protect the FHA insurance fund from an estimated loss of $639,397.

Comment 9 >

Prior to the HUD OIG audit, CMG entered into indemnification agreements for the eight loans identified by HUD OIG for which material findings were not acceptably mitigated between May 2021 and September 2022.

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CMG appreciates the HUD OIG's time and attention to this matter, as well as its engagement throughout the audit process. While CMG does not agree with all of the findings in the Draft Report, CMG does acknowledge the validity of certain findings, and it has taken steps to significantly enhance the scope of its QC Plan and program. CMG is also committed to reviewing previously originated loans to assess whether there are additional material findings that should have been previously reported to HUD. With that said, CMG also notes that its pre-closing review encompassed significantly more loans than required by HUD guidelines, which would have had a material impact on reducing the number of findings post-closing.
Please do not hesitate to contact me with any questions regarding CMG's response.

Sincerely,

Tara Pettersen

Tara Pettersen
Chief Risk and Compliance Officer

[1] Note that, during the course of the HUD OIG audit, HUD OIG provided CMG a list of loans, but the list was inaccurate. Once CMG receives the accurate list it will conduct its review.

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OIG Evaluation of Auditee Comments

Comment 1 CMG stated that it updated its QC program to align with FHA's requirements for loan selection, including retention of data and documentation that serves as the basis for its sampling population. Further, CMG indicated that it enhanced processes and procedures for document retention to ensure that it maintains adequate records for its populations and sampling methodology. We acknowledge its efforts to address recommendation 1A and will work with CMG and HUD to resolve the outstanding items related to this recommendation during the audit resolution process.

Comment 2 CMG agreed that it should have been reviewing more loans during its post-closing QC, but did not believe that it needs technical assistance from HUD or that it did not maintain data and documentation showing how loans were collected for purposes of QC audits. Based on discussions held with HUD, we removed references to technical assistance from the recommendations. If HUD later determines that such assistance is needed to help CMG make any additional updates needed to its QC plan and related processes, it can provide technical assistance at that time. As discussed on pages 3 and 4, CMG could not provide detailed information that would allow us to recreate its sample sizes, and it did not have an adequate process for documenting and maintaining data on its monthly sample selection. To fully address recommendation 1A, CMG will need to show HUD that the updates it made will ensure that it adequately documents the selection of loans each month.

Comment 3 CMG explained that it updated its QC processes and procedures to address HUD OIG's results related to (1) loan file reviews and reverifications of borrower information, (2) mitigation of findings, and (3) reporting findings to HUD when required. This included expanding its attempts to verify consumer assets and developing new procedures to ensure that findings are mitigated appropriately and reported to HUD. We acknowledge CMG's efforts to proactively address our finding and will work with CMG and HUD on closing recommendation 1B during the audit resolution process.

Comment 4 CMG disagreed that its staff and management need annual training on HUD requirements. It explained that although the QC Plan in effect during our audit period resulted in under-sampling of FHA loans for post-closing QC reviews, it was not due to a lack of training because its staff were carrying out its plan and procedures. HUD requires that lenders train all staff involved in QC processes to ensure that they know all current FHA requirements for which the lender is responsible.[20] We updated recommendation 1C to clarify that CMG should demonstrate that its training has been updated to reflect changes made to its QC plan and procedures in response to recommendations 1A and 1B, and to cover the underlying HUD requirements. This will help CMG ensure that its staff and management have sufficient training to carry out its QC plan and procedures, and are familiar with the underlying requirements for lender QC programs.

[20] HUD Handbook 4000.1, section V.A.2.b.i.(A)

Comment 5	We acknowledge that CMG completed more pre-closing reviews than required between October 2020 and September 2022, and that doing so assists overall quality control efforts. CMG agreed to also complete more post-closing reviews, which are more thorough and involve a deeper analysis using new credit reports, reverifications of borrower information, and appraisal field reviews when relevant based on the loan type. Doing so will help CMG address the gaps identified in its previous sampling methodology.
Comment 6	CMG stated that there was not an issue with its process for reviewing and selecting EPD loans, and explained that it had reviewed all EPD loans that it identified during the audit period through FHA's Neighborhood Watch. We disagree that there was not an issue. As discussed on page 4 of this report, CMG did not perform approximately 35 percent of the required EPD reviews primarily because its staff incorrectly excluded EPD loans that were originated by other lenders but underwritten by CMG. Although these loans originated by other lenders were available to it in the system, CMG acknowledged in its comments that prior to April 2024, CMG was identifying only EPD loans it originated. Even when using Neighborhood Watch to identify EPD loans, HUD's guidance requires lenders to review all EPD loans that it underwrote, even if the loans were originated by other lenders.
Comment 7	Regarding receiving a list of EPD loans from HUD OIG, in April 2024, we provided CMG with a list of the 320 EPD loans that it did not review, and updated the list in November 2024 to remove loans that had been terminated without a claim, such as when a loan was paid in full, since such loans no longer represent a risk to HUD. We believe CMG can begin reviewing its additional 276 EPD loans.
Comment 8	The list of 242 loans covered by recommendation 1F was created using CMG-provided QC data where CMG identified a material or critical deficiency. We then removed loans CMG had already self-reported to HUD and loans that had been terminated without a claim before providing CMG with the final list in November 2024. We believe CMG can begin reviewing these loans as well.
Comment 9	CMG asserted that prior to the HUD OIG audit, it entered into indemnification agreements for the eight loans covered by recommendation 1G. CMG reported the eight loans to HUD during the course of our audit. While HUD's Neighborhood Watch system shows that indemnification agreements were executed for six of the eight loans in June and July 2024, it does not yet show that indemnification agreements have been executed for the remaining two loans. We will work with HUD to close this recommendation once all eight agreements have been executed and recorded.

Appendix C – Summary of Significant Issues Identified

The table below shows whether significant issues were identified in key areas of CMG’s QC program.

Key area		Issue identified
Loan selection	Pre-closing reviews	
	Post-closing reviews	X
	EPD reviews	X
	Selection data	X
Loan reviews	Timeliness of reviews	
	Document review and reverification	X
	Identification of material deficiencies	X
Loan review findings	Assessment of risk	
	Mitigation and reporting of findings	X