



All Western Mortgage, Inc., Las Vegas, NV

FHA Loan Origination



Issue Date: May 22, 2013

Audit Report Number: 2013-LA-1005

TO: Charles S. Coulter, Deputy Assistant Secretary for Single Family Housing, HU

Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region 9, 9DGA

SUBJECT: All Western Mortgage, Las Vegas, NV, Did Not Fully Comply With FHA Program Requirements Concerning Outside Employment and Timeliness of Quality Control Reviews

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of All Western Mortgage, Inc.

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, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.



May 22, 2013

All Western Mortgage, Las Vegas, NV, Did Not Fully Comply With FHA Program Requirements Concerning Outside Employment and Timeliness of Quality Control Reviews

Highlights

Audit Report 2013-LA-1005

What We Audited and Why

We audited the Federal Housing Administration (FHA)-insured loan process at All Western Mortgage's Las Vegas, NV, home office as part of our efforts to improve the integrity of the single-family insurance programs. We selected All Western Mortgage because it is one of the top 10 originators in Nevada and the U.S. Department of Housing and Urban Development's (HUD) Quality Assurance Division had not performed a review since 2005. The objective of our review was to determine whether All Western Mortgage complied with HUD's regulations, procedures, and instructions in the origination of FHA-insured loans and whether its quality control plan met HUD's requirements.

What We Recommend

We recommend that HUD (1) require All Western Mortgage to submit updated policies and procedures related to outside employment, and (2) review quality control reports to ensure that All Western Mortgage completes quality control reviews in a timely manner.

What We Found

All Western Mortgage, as a former loan correspondent and current nonsupervised lender, generally met HUD requirements for the origination of FHA-insured single-family loans. However, All Western Mortgage did not follow HUD requirements concerning unallowable outside employment and timely quality control reviews.

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BACKGROUND AND OBJECTIVE

The Federal Housing Administration (FHA) is the Federal Government's single largest program to extend home ownership to individuals and families who lack the savings, credit history, or income to qualify for a conventional mortgage. The homeowners pay into the FHA insurance fund through mortgage insurance. The U.S. Department of Housing and Urban Development (HUD) uses these funds to operate the FHA insurance program. The insurance provides lenders with protection against losses as the result of homeowners defaulting on home mortgages. HUD handbooks and mortgagee letters provide detailed processing instructions and advise the mortgage industry of major changes to FHA programs and procedures.

All Western Mortgage is an FHA-approved nonsupervised¹ mortgage company. All Western Mortgage was an FHA loan correspondent² before becoming an approved nonsupervised lender on February 10, 2011. All Western Mortgage's home office is located at 8345 West Sunset Road, Suite 380, Las Vegas, NV.

We selected All Western Mortgage because it is one of the top 10 originators in Nevada and HUD's Quality Assurance Division has not performed a review since 2005. All Western Mortgage originated 2,812 FHA-insured loans totaling more than \$484 million between January 1, 2008, and December 31, 2012, with more than \$7.4 million in claims paid by HUD on 33³ loans.

The objective of our review was to determine whether All Western Mortgage complied with HUD's regulations, procedures, and instructions in the origination of FHA-insured loans and whether its quality control plan met HUD's requirements.

¹ A nonsupervised lender is a financial institution that has as its principal activity the lending or investment of funds in real estate mortgages. A nonsupervised lender may originate, purchase, hold, and service FHA-insured loans and submit FHA applications for insurance.

² A loan correspondent is a lender, which has as its principal activity the origination of FHA-insured loans for sale or transfer to its sponsor(s) for underwriting. A loan correspondent may originate and sell FHA-insured loans and submit applications for insurance. Mortgagee Letter 2010-20 implemented the Final Rule F.R 5356-F-02 regarding HUD's elimination of loan correspondent approval for single family programs as of December 31, 2010. In place of HUD's loan correspondent approval system, loan correspondents were permitted to continue participation in FHA programs as sponsored third party originators by establishing a sponsorship relationship with an FHA-approved mortgagee.

³ All 33 claims occurred before All Western Mortgage became a nonsupervised lender.

RESULTS OF AUDIT

Finding: All Western Mortgage Did Not Follow HUD Requirements for Outside Employment and Quality Control Reviews

We did not identify loan origination issues attributable to All Western Mortgage;⁴ however, All Western Mortgage inappropriately allowed employees involved in FHA transactions to actively participate in real estate. This condition occurred because All Western Mortgage did not have written policies in place concerning outside employment restrictions, increasing the possibility of a conflict of interest, which could result in employees manipulating the loan origination process. In addition, All Western Mortgage did not complete any of the quality control reports reviewed in a timely manner as all nine of the reports reviewed were completed more than 90 days after closing. This deficiency occurred because All Western Mortgage switched to a paperless system that caused management to submit late loan listings to its quality control contractor. As a result, All Western Mortgage could not ensure that it identified problems left undetected as early after closing as possible, increasing the risk to the FHA insurance fund.

All Western Mortgage Did Not Follow HUD Requirements for Unallowable Outside Employment

At least 4 of 166 All Western Mortgage loan officers participated in outside employment as real estate agents. According to HUD Handbook 4060.1, REV-2, paragraph 2-9(G), a lender may employ staff members full time or part time (less than the normal 40-hour workweek). They may have other employment including self-employment. However, such outside employment may not be in mortgage lending, real estate, or a related field. According to HUD's Frequently Asked Questions, the dual employment requirement applies to all employees of FHA-approved lenders who are involved in FHA transactions.

Two of the four All Western Mortgage loan officers worked on FHA loans while also employed as real estate agents. These two loan officers originated just three FHA loans, and all three were performing loans. We did not identify any instances in which the loan officers represented their clients as both real estate agents and loan officers for the same transaction.

⁴ See Scope and Methodology Section for more details on loans reviewed.

All Western Mortgage's Policies and Procedures Were Not Adequate

All Western Mortgage did not have written policies and procedures concerning outside employment. Thus, its managers had different interpretations of outside employment requirements. According to All Western Mortgage's operations manager, All Western Mortgage was strict on outside employment when hiring employees and did not allow it. However, All Western Mortgage's vice president of operations stated that he thought it was okay to have a loan officer with outside employment who worked only on conventional loans.

All Western Mortgage employees employed as real estate agents also provided different responses regarding outside employment requirements. Although three of four employees indicated that they were aware of the requirements, one of the three originated two FHA loans while employed as a real estate agent. The fourth employee stated that he was not informed about an outside employment restriction and also originated an FHA loan while employed as a real estate agent. Consequently, the lack of policies and procedures increased the risk that the loan origination process could be manipulated and create a conflict of interest with the loan transactions.

Due to our review, All Western Mortgage had taken steps to address this issue and had developed new procedures concerning outside employment. Once implemented, these procedures would inform employees of HUD regulations regarding outside employment.

All Western Mortgage Did Not Always Follow HUD Requirements Concerning Timely Quality Control Reviews

All Western Mortgage's quality control plan generally met HUD requirements. All Western Mortgage performed a preclosing quality control review of its loans in house and outsourced with Mortgage Compliance Advisors (MCA) for the postclosing reviews required by HUD. While MCA completed the quality control reviews, it did not complete the reviews in a timely manner. HUD Handbook 4060.1, REV-2, paragraph 7-6(A), states that loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected before closing are identified as early after closing as possible. All nine of the monthly quality control reports reviewed were more than 90 days from the end of the month in which the loan closed. The reviews ranged from 60 to 322 days late. For example, MCA did not

complete the quality control report for loans closed in November 2011 until January 2013.

All Western Mortgage Provided Late Loan Listings to Its Quality Control Contractor

The late quality control reports occurred because All Western Mortgage was transitioning to a paperless system, which made it difficult for All Western Mortgage to provide accurate and timely loan listings to its quality control contractor. All Western Mortgage was aware of the late reports and anticipated being caught up by the end of May 2013.

Conclusion

All Western Mortgage improperly allowed two employees to originate three FHA loans while actively participating in outside real estate employment. This condition occurred because All Western Mortgage did not have written policies in place concerning outside employment restrictions. All Western Mortgage's lack of policies and procedures regarding outside employment increased the risk that employees might manipulate the loan origination process and create a conflict of interest with the loan transaction.

In addition, All Western Mortgage completed nine postclosing quality control reports more than 90 days after closing, ranging from 60 to 322 days late. This deficiency occurred because All Western Mortgage switched to a paperless system, which caused management to submit late loan listings to its quality control contractor. As a result, All Western Mortgage could not ensure that it identified problems left undetected as early after closing as possible.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing

- 1A. Evaluate All Western Mortgage's updated policies and procedures and any corrective action taken to ensure that its employees who are real estate agents are not involved in FHA transactions as required by HUD.
- 1B. Monitor All Western Mortgage to ensure that it completes the required quality control reviews in a timely manner.

SCOPE AND METHODOLOGY

Our audit period covered January 1, 2008, to December 31, 2012, but was expanded when necessary. We conducted our fieldwork at All Western Mortgage's home office located at 8345 West Sunset Road, Suite 380, Las Vegas, NV, between January and April 2013.

To accomplish our objective, we

- Reviewed HUD regulations and reference materials for single-family requirements;
- Reviewed the lender's processing, underwriting, and closing policies and procedures;
- Reviewed documentation for eight FHA-insured loans;
- Interviewed appropriate staff;
- Reviewed the quality control plan; and
- Reviewed nine quality control review reports.

We selected a sample of eight loans nonstatistically based on the existence of loan defaults and claims. We used HUD's Single Family Data Warehouse and Neighborhood Watch System⁵, two of HUD's online information systems for FHA-insured loans, to identify all loans that were originated from All Western Mortgage's home office. During our audit period, 33 loans went into claim, and 182 loans went into default. Of these loans, we reviewed six claims and two loans in default. We selected the six claims by excluding refinance loans and selecting loans underwritten by the two undewriters with the highest number of claims in the universe. The two default loans were chosen based on nonrefinance loans with the most recent amortization dates. We did not identify loan origination issues attributable to All Western Mortgage. However, we identified potential underwriting issues with two loans underwritten by two of the sponsors; those are addressed through two separate audit memorandum reports.

For loans underwritten by an automated underwriting system, we reviewed the FHA loan file to determine whether it contained the documentation needed to support the integrity and accuracy of the data used by the automated underwriting system to recommend approval of the loan. For manually underwritten loans, we reviewed the loan documents to determine whether they supported the underwriting decision and complied with HUD requirements.

⁵ HUD's Single Family Data Warehouse is a large and extensive collection of database tables organized and dedicated to support the analysis, verification, and publication of Single Family Housing data. HUD's Neighborhood Watch System is intended to aid HUD staff in monitoring lenders and HUD programs, and to aid lenders and the public in self-policing the industry. The system is designed to highlight exceptions, so that potential problems are readily identifiable.

We relied on information from systems used by HUD (including Neighborhood Watch and Single Family Data Warehouse) to target loans for review and verified that the information submitted to HUD was consistent with the information in the lender's own files.

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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls 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.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Policies and procedures intended to ensure that the lender properly originates FHA-insured loans in accordance with HUD requirements.
- Policies and procedures to ensure that All Western Mortgage employees do not have unallowable outside employment.
- Policies and procedures established by management to ensure that the quality control plan has been implemented and related reviews are performed in accordance with HUD requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- All Western Mortgage lacked policies and procedures to ensure that its employees did not participate in unallowable outside employment (finding).

- All Western Mortgage did not have adequate controls in place to ensure that it adequately implemented its quality control plan (finding).

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

May 1, 2013

AWM did not follow HUD requirements for unallowable outside employment:

We understand we were lacking in our policies and procedures in regards to this issue. In the past we utilized email to communicate this policy and we now realize a more effective form of communication and enforcement is required. We have updated our policies and procedures in the following ways. An additional disclosure has been created outlining our policy which clearly forbids and Loan Officer who holds a Real Estate license from participating in any way shape or form in an FHA transaction. We have added an additional sub section to our standard Loan Officer contracts stating the same. We have included this topic in our company continuing education and new Loan Officer orientation. Our onboarding process for all employees was modified to determine if the new employee is in fact licensed as a realtor. Finally we have added a hard stop to our automated loan system that prohibits a user who is also a Real Estate agent from creating a government loan in the system.

Comment 2

AWM did not always follow HUD requirements concerning timely quality control reviews:

We recognize that our QC reports and review of such were behind schedule. Unfortunately we were at the mercy of the turn times provided by our external QC company Mortgage Compliance Advisors. They were severely behind and one point we discussed moving this process to another company. After assurances from MCA we decided that it was in our best interests to remain with MCA as faster turn times were promised and ultimately have been delivered. We now provide the previous months files within 10 days of months end and are seeing reports come back very quickly. We do not anticipate this being an issue in the future.

Comment 2

AWM late loan listings to MCA:

I am unaware of us providing late loan listing EXCEPT in the case where they were so many months behind we were shopping for a new company.



Christopher Biaggi
President/CEO

OIG Evaluation of Auditee Comments

- Comment 1** We commend All Western Mortgage for updating its policies and procedures. We reviewed the documentation provided including the statement of quality assurance, quality control plan, and the agreement titled “acknowledgement and agreement regarding prohibitions relating to real estate agents and loan transactions,” we consider these to be sufficient once implemented. We did not include this in the report because it was too voluminous; however, it is available upon request. All Western Mortgage can provide evidence to HUD that the updated policies and procedures have been fully implemented, including documentation signed by All Western Mortgage loan officers, during the audit resolution process.
- Comment 2** We acknowledge that All Western Mortgage was aware of the late quality control reports at the time of our review and is in the process of correcting this finding. However, we do not have evidence that the late quality control reports were a result of the quality control contractor not meeting its deadlines. Two employees directly involved in the quality control process stated that part of the reason the contractor fell behind on reports was due to All Western Mortgage not providing reports in a timely manner at the implementation of the new system. In addition, HUD Handbook 4060.1 Rev 2, paragraph 7-3 (B) 2 states that a mortgagee contracting out any part of its quality control function is responsible for ensuring that the outside source is meeting HUD's requirements. We did not make any changes to the report based on this comment.