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MEMORANDUM FOR: Vicki B. Bott, Deputy Assistant Secretary, Single Family, HU

Dane M. Narode, Associate General Counsel for Program Enforcement, CE

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

SUBJECT: Assurity Financial Services, LLC, Englewood, CO, Did Not Properly Underwrite a Selection of FHA Loans

INTRODUCTION

We performed a review of 20 Federal Housing Administration (FHA) loans underwritten by Assurity Financial Services, LLC (Assurity). Our review objective was to determine whether Assurity underwrote the 20 loans in accordance with Federal Housing Administration (FHA) requirements. This review is part of Operation Watchdog, an Office of Inspector General (OIG) initiative to review the underwriting of 15 direct endorsement lenders at the suggestion of the FHA Commissioner. The FHA Commissioner expressed concern regarding the increasing claim rates against the FHA insurance fund for failed loans.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the review.

We provided our discussion draft memorandum report to Assurity's two owners/senior managers and asked them to provide written comments on our discussion draft memorandum. Their attorney provided written comments on their behalf on July 1, 2010, in which they disagreed with the report. The complete text of the response, along with our evaluation of that response, can be found in appendix C of this memorandum

SCOPE AND METHODOLOGY

Assurity is 1 of 15 direct endorsement lenders we selected from the U.S. Department of Housing and Urban Development's (HUD) publicly available Neighborhood Watch[1] system (system) for a review of underwriting quality. These direct endorsement lenders all had a compare ratio[2] in excess of 200 percent of the national average as listed in the system for loans endorsed between November 1, 2007, and October 31, 2009. We selected loans that had gone into claim status. We selected loans for Assurity that defaulted within the first 30 months and were (1) not streamline refinanced, (2) not electronically underwritten by Fannie Mae or Freddie Mac, and (3) associated with an underwriter (usually an individual) with a high number of claims.

We performed our work from January through April 2010. We conducted our work in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information systems controls of Assurity, consider the results of previous audits, or communicate with Assurity's management in advance. We did not follow standards in these areas because our objective was to aid HUD in identifying FHA single-family insurance program risks and patterns of underwriting problems or potential wrongdoing in poor-performing lenders that led to a high rate of defaults and claims against the FHA insurance fund. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our review results.

BACKGROUND

Assurity was an FHA-approved non-supervised mortgage lender headquartered in Englewood, CO between May 2005 and March 2010. Assurity was approved to originate FHA loans as a non-supervised loan correspondent on March 21, 2002, and was approved to underwrite FHA loans under HUD's direct endorsement program on May 20, 2005. However, Assurity ceased lending operations on February 26, 2010, and did not renew its FHA approval as of March 31, 2010. As a non-supervised mortgage lender, Assurity was allowed to underwrite and close FHA loans without HUD's prior review or approval with the obligation to follow HUD regulations and requirements.

FHA, created by Congress in 1934, is the largest mortgage insurer in the world aimed at helping low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers that might not be able to meet conventional underwriting requirements by protecting the lender against default. The direct endorsement program simplifies the process for obtaining FHA mortgage insurance by allowing lenders to underwrite and close the mortgage loan without prior HUD review or approval. Lenders are responsible for complying with all applicable HUD regulations and required to evaluate the borrower's ability and willingness to repay the mortgage debt. Lenders are protected against default by FHA's

[1] Neighborhood Watch is a system that aids HUD/FHA staff in monitoring lenders and its programs. This system allows staff to oversee lender origination activities for FHA-insured loans and tracks mortgage defaults and claims.

[2] HUD defines "compare ratio" as a value that reveals the largest discrepancies between the direct endorser's default and claim percentage and the default and claim percentage to which it is being compared. FHA policy establishes a compare ratio of more than 200 percent as a warning sign of a lender's performance.

mutual mortgage insurance fund, which is sustained by borrower premiums. The mortgage insurance fund pays claims to lenders in the event of a homeowner default.

The goal of Operation Watchdog is to determine why there is such a high rate of defaults and claims. The 15 lenders selected for our review endorsed 183,278 loans valued at $31.3 billion during the period January 2005 to December 2009. These same lenders submitted 6,560 FHA insurance claims with an estimated value of $794.3 million from November 2007 through December 2009. During this time, Assurity endorsed 6,831 loans valued at more than $1.21 billion and submitted 183 FHA insurance claims with an estimated value of more than $32.7 million.

Our objective was to determine whether the selected loans were properly underwritten and if not, whether the underwriting reflected systemic problems.

RESULTS OF REVIEW

Assurity did not follow HUD requirements when underwriting 8 of the 20 FHA-insured loans. The loans reviewed contained significant underwriting deficiencies that impacted the insurability of the loans. This noncompliance occurred because the lender failed to exercise due diligence in underwriting these loans. As a result, FHA's insurance fund suffered actual losses totaling $968,954 for six loans and estimated potential losses of $212,043 for two loans, as shown in the following table.

FHA loan number	Closing date	Number of payments before first default	Original mortgage amount	Loss to HUD
023-2343260	04/14/06	18	$ 219,037	$ 153,517
023-2397348	10/16/06	20	236,495	170,120
043-7406274	05/31/07	2	187,267	138,524
052-4159366	09/28/07	0	167,475	147,831
052-4311569	04/11/08	1	103,377	60,829[3]
094-5402355	04/09/08	1	255,526	151,214[3]
095-0485724	10/31/07	11	212,135	165,306
095-0539086	12/28/07	3	310,000	193,656
Totals			**$ 1,691,312**	**$ 1,180,997[4]**

[3] We estimated the loss to HUD for these loans because the foreclosed-upon properties have not been resold by HUD. The estimated loss was calculated based on 60 percent of the unpaid principal balance (according to Neighborhood Watch). The 60 percent severity rate was the average loss published in the FHA Annual Management Report for Fiscal Year 2009.

[4] $1,180,997 = $968,954 for six loans with actual HUD loss + $212,043 for two loans with estimated HUD loss.

Significant Underwriting Deficiencies

The loan file review of 20 FHA-insured loans identified eight with significant underwriting deficiencies that included improper calculation of income, inadequate documentation of income, inadequate determination of liabilities, and inadequate compensating factors when the debt-to-income ratios exceeded HUD's minimum requirements. Assurity did not underwrite the eight loans as required by HUD Handbook 4155.1, REV-5, which states, "the lender must establish that the borrower has the ability and willingness to repay the mortgage debt. This decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout this Handbook and must be supported by sufficient documentation." The eight loans, which totaled more than $1.655 million in unpaid mortgage balances, were approved based on many factors that included reported monthly income, recurring debt obligations, assets, and/or compensating factors. However, Assurity closed many of the loans based on inadequate determination and evaluation of these factors. See appendix A for a schedule of material deficiencies and appendix B for a detailed narrative of each of the eight loans. The following table summarizes the material deficiencies that we identified in the eight loans.

Area of noncompliance	Number of loans
Income	4
Liabilities	2
Excessive ratios	8
Credit	2

Income

Assurity did not properly verify borrowers' income or determine income stability for four loans. For example, for loan number 052-4311569, Assurity did not adequately support the borrower's income through standard or alternative documentation standards and should have questioned the borrower's income stability and likelihood of continued employment. Without adequate verification and income support, the lender should not have used the borrower's stated income for qualifying purposes.

For loan number 121-2399761, the underwriter did not calculate the borrower's bonus income correctly. The lender determined that there was $519 in bonus income per month by taking a 2-year average of bonus income as listed in the verification for 2005 and 2006. However, the verification detailed bonus income information for 2007 until the middle of December, almost a complete year. Although the lender used 2 years to average bonus income as required, the lender should have used 2007 and 2006 instead of 2006 and 2005, reflecting more current earnings. We determined a bonus income of $397 per month, a difference of $122 per month.

Liabilities

Assurity did not properly assess the borrowers' financial obligations for two loans. For example, for loan 094-5402355, Assurity failed to adequately consider rental property to be included as income or as a recurring liability. The gross rental amount should have been reduced by 25 percent (to account for vacancies and maintenance), then subtracted by the mortgage amount on the existing property. If the outcome is positive, it can be considered effective income. If it is negative, it is considered a recurring liability. We determined a recurring liability of $211.75 (gross income of $1,375 reduced by 25 percent is $1031.25. We then subtracted the mortgage amount of $1,243 to arrive at $211.75).

For loan 095-0539086, a recurring liability in the amount of $1,565 was inappropriately excluded. Although the recurring debt had less than 10 months of payments, it could impact the borrower's ability to pay the FHA mortgage in the first few months. Since the borrower had zero cash assets or reserves, the lender should have included the debt.

Excessive Ratios and Compensating Factors

Assurity improperly approved eight loans without adequate compensating factors or failed to correctly calculate qualifying ratios. For example, Assurity approved loan number 052-4159366 when the borrower's mortgage payment-to-income and debt-to-income ratios exceeded FHA's requirements of 31 and 43 percent, respectively. The mortgage payment-to-income ratio and total debt-to-income ratio were 37.70 and 51.38 percent, respectively. Assurity provided five compensating factors; however, all but one were determined to be inadequate. The single ratio was not enough to overcome excessive qualifying ratios.

Credit

Assurity did not properly analyze the borrower's credit for two loans. For example, for loan number 023-2343260, Assurity failed to obtain letters of explanation for delinquent accounts identified in the credit report. Included in the delinquent accounts was an automobile loan charge-off in the amount of $9,139. The underwriter did not conduct due diligence in analyzing the borrower's ability to manage debt and failed to adequately address and explain delinquent accounts.

Lack of Due Diligence

Because Assurity did not follow HUD regulations and requirements when underwriting and closing FHA loans, it inappropriately approved eight loans that had significant underwriting deficiencies. The lender did not exercise both sound judgment and due diligence when it submitted these loans for FHA insurance. As a result, the FHA insurance fund was at increased risk for losses on three loans with significant underwriting deficiencies totaling $212,043 in unpaid principal mortgage balances. The FHA insurance fund has already realized losses of $968,954 on six inappropriately approved FHA loans. The losses resulted when the properties that secured these six loans were sold and the insurance claims and other expenses incurred by HUD exceeded the sales proceeds.

RECOMMENDATIONS

We recommend that HUD's Associate General Counsel for Program Enforcement

1A. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against Assurity and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of eight loans that resulted in losses to HUD totaling $1,180,997, which could result in affirmative civil enforcement action of approximately $2,421,992[5].

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

1B. Take appropriate administrative action against Assurity and/or its principals for the material underwriting deficiencies cited in this report once the affirmative civil enforcement action cited in recommendation 1A is completed.

Schedule of Ineligible Cost 1/

Recommendation number	Amount
1A	$1,180,997
Total	$1,180,997

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. The amount shown represents the actual loss HUD incurred when it sold the affected properties.

[5] Double damages plus a $7,500 fine for each of the eight incorrect certifications.

APPENDIXES

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Underwriting deficiencies			
	Income	Liabilities	Qualifying ratios	Credit
023-2343260	x		x	x
023-2397348			x	
043-7406274	x		x	
052-4159366			x	
052-4311569	x		x	
094-5402355		x	x	
095-0485724	x		x	
095-0539086		x	x	x
Significant deficiency totals	4	2	8	2

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number: 023-2343260

Mortgage amount: $219,037

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: April 14, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: 18

Loss to HUD: $153,517

Summary

We found material underwriting deficiencies relating to the borrower's income, credit history, excessive ratios, and compensating factors.

Income

Assurity used excessive overtime as part of effective income. The lender based the borrower's overtime calculation on an average overtime pay of $766 per month, which was based on 3 years' performance ($7,556 in 2004, $12,713 in 2005, and $407 through 3 months in 2006.) However, the borrower's overtime pay significantly decreased in 2006, indicating a decline in the earnings trend. The lender did not provide sound rationalization for included overtime income before the decline. Based on this decline, the lender should have used an average of current overtime earnings, or $136 ($406 divided by 3 months), to reflect the borrower's current earning potential.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-7(A), states that both overtime and bonus income may be used to qualify if the borrower has received such income for the past 2 years and it is likely to continue. An earnings trend also must be established and documented for overtime and bonus income. If either type shows a continual decline, the lender must provide a sound rationalization in writing for including the income for borrower qualifying.

Credit

Assurity did not properly analyze the borrower's credit history. Four accounts were listed under collection accounts, including a charge-off of $9,139 in March 2005. The lender failed to obtain the borrower's written explanation for the derogatory credit and failed to provide written explanations for the 11 inquiries shown on the credit report in the last 90 days. Additionally, the lender did not provide analysis or documentation explaining the recent home equity loan in the amount of $63,931 taken out in March 2006. Given the lack of information regarding the recent home equity loan, the derogatory credit, and the lack of written explanations for the 11 inquiries shown on the credit report in the last 90 days, it appears that the lender did not perform a satisfactory mortgage credit analysis for this borrower.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. If the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan. When delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including delayed mail delivery or disputes with creditors. Major indications of derogatory credit–including judgments, collections, and any other recent credit problems–require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3(C), states that FHA does not require that collection accounts be paid off as a condition of mortgage approval. Collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness, with the lender documenting its reasons for approving a mortgage when a borrower has collection accounts or judgments.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income and total debt-to-income ratios were 35.71 and 43.39 percent. However, as recalculated after considering the excessive overtime, the mortgage payment-to-income and total debt-to-income ratios were 42.14 and 51.20 percent. The ratios were excessive under each scenario and required strong compensating factors.

Assurity included four compensating factors: 10 percent equity in property (not a valid compensating factor), reducing mortgage payment, steadily increasing income, and clean credit history in the past 12 months. The mortgage payment was not being reduced, as it only appeared as a reduction based on a home equity loan taken out by the borrower 1 month before closing. The verification of employment indicated a decline in the earnings rate. Lastly, although the borrower had made timely payments on revolving accounts during the past 12 months, the credit

history did not indicate a conservative attitude toward credit (as illustrated by collection and charge-off accounts).

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record in the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

HUD Handbook 4155.1, REV-5, paragraph 2-13(G), states that "assets" such as equity in other properties and the proceeds from a cash-out refinance are not to be considered as cash reserves.

Loan number: 023-2397348

Mortgage amount: $236,495

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: October 16, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: 20

Loss to HUD: $170,120

Summary

We found material underwriting deficiencies relating to the borrowers' qualifying ratios and compensating factors.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. The borrowers' mortgage payment-to-income ratio and total debt-to-income ratio of 48.17 percent exceeded HUD's allowable ratios of 31 and 43 percent. The lender did not provide adequate compensating factors, as required, to overcome excessive ratios.

The lender provided the following compensating factors on the HUD Form 92900[6]: high credit scores and no credit late payments with exception of disputed medical collection accounts (part of a valid compensating factor), no history of mortgage late payments (not a valid compensating factor), job stability (not a valid compensating factor), and 10 percent home equity (not a valid compensating factor). Only one of the compensating factors are acceptable according to HUD Handbook 4155.1, REV-5, paragraph 2-13. However, the borrowers did not demonstrate an ability to accumulate savings, which is required along with a conservative attitude toward the use of credit. The loan file did not contain supporting documents to indicate accumulated savings or assets. Although 28 derogatory public records or collections were filed, the borrower had exhibited a conservative attitude towards credit evidenced by zero balances on revolving accounts and no derogatory accounts aside from the medical collections. Housing expenses had significantly increased by 22 percent. The borrowers' original housing expenses were $1,471 but had increased by $323 to $1,717. The borrowers had not successfully demonstrated the ability to pay increased housing expenses equal to or greater than the proposed monthly housing expenses for the new mortgage over the past 12-24 months. Lastly, the borrowers did not have a documented potential for increased earnings, as indicated by job training or education in the

[6] The Mortgage Credit Analysis Worksheet is used to determine borrower eligibility and credit worthiness.

borrowers' profession. The borrowers' income remained the same, while their housing expenses had significantly increased.

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record in the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

HUD Handbook 4155.1, REV-5, paragraph 2-13(C), states the borrower has demonstrated an ability to accumulate savings and a conservative attitude toward the use of credit.

HUD Handbook 4155.1, REV-5, paragraph 2-13(I), states that the borrower has a potential for increased earnings, as indicated by job training or education in the borrower's profession.

HUD Handbook 4155.1, REV-5, paragraph 2-13(G), states that "assets" such as equity in other properties and the proceeds from a cash-out refinance are not to be considered as cash reserves.

Loan number: 043-7406274

Mortgage amount: $187,267

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: May 31, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Two

Loss to HUD: $138,524

Summary

We found material underwriting deficiencies relating to the borrower's income, excessive ratios, and compensating factors.

Income

Assurity inappropriately used unverified self-employment income as effective income. Although a 2006 tax return and transcripts for 2005 were included in the loan file, the lender did not include a profit and loss statement and a balance sheet for the current year to date (the loan closed on May 25, 2007). Without information on the profit and loss for the first 5 months of the current year the lender should have been unable to determine whether the business could be expected to continue to generate sufficient income for the borrower's mortgage needs.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-9(B)(3), requires the lender to obtain a year-to-date profit and loss statement and balance sheet.

HUD Handbook 4155.1, REV-5, paragraph 2-9(C), states that the lender must analyze carefully the business's financial strength, the source of its income, and the general economic outlook for similar businesses in the area to determine whether the business can be expected to continue to generate sufficient income for the borrower's needs.

Additionally, the lender adjusted the borrower's annual income for depreciation, meals, home office expenses, and other without providing an analysis or explanation for inclusion or subtraction. Without a reasonable explanation or analysis, the lender should only have added back depreciation. Therefore, income should have been $36,677 ($35,181 plus $3,188 depreciation) in 2005 and $43,039 ($39,851 plus $3,188 depreciation) in 2006. As an average,

the monthly income used for qualifying should have been $3,322 ($36,677 plus $43,039 divided by 24 months), a difference of $576 from the $3,898 used by the lender.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-9(C)(1), states that the amount shown on the Internal Revenue Service (IRS) Form 1040 as "adjusted gross income" must be increased or decreased, based on the lenders' analysis of the individual tax returns. The sole proprietorship income calculated on schedule C is business income. Depreciation or depletion may be added back to adjusted gross income.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income and total debt-to-income ratios were both 38.77 percent. However, as recalculated after considering the recalculated self-employment income, the mortgage payment-to-income and total debt-to-income ratios were both 45.48 percent. Originally, only the mortgage payment-to-income ratio was excessive. After recalculation, both ratios were excessive. Both scenarios required compensating factors.

Assurity included five compensating factors: lowering the interest rate from 6.5 to 6 percent fixed (not a valid compensating factor), $171 in monthly savings (not a compensating factor since the debt consolidation included liens, judgments, and collections), 639 Fair Isaac Corporation (FICO) score (not a valid compensating factor), paying off all derogatory credit (not a valid compensating factor), and 23-month clean mortgage history (valid compensating factor). Given the borrower's derogatory credit history, the single compensating factor of clean mortgage history was not sufficient.

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record in the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Loan number: 052-4159366

Mortgage amount: $167,475

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: September 28, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $147,831

Summary

We found material underwriting deficiencies relating to the borrower's excessive ratios and compensating factors.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. The borrower's mortgage payment-to-income ratio was 37.70 percent, and the total fixed payment-to-income ratio was 51.38 percent. Both ratios exceeded the required maximums of 31 and 43 percent. The lender did not document sufficient compensating factors to justify ratios that are significantly above the limits.

Assurity included five compensating factors: length of time employed (not a valid compensating factor), no mortgage late payments (valid compensating factor), $472 per month savings (not a valid compensating factor), increasing income with potential earnings of $7,100 per month (not a valid compensating due to lack of supporting documentation showing potential for increased earnings), and spouse earns income not included as effective income (not supported, as combined tax returns indicate losses for 2005 and 2006 due to the spouse's business).

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines.

Underwriters must record in the “remarks” section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

HUD Handbook 4155.1, REV-5, paragraph 2-13(I), states that the borrower has a potential for increased earnings, as indicated by job training or education in the borrower's profession.

Loan number: 052-4311569

Mortgage amount: $103,377

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: April 11, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: $60,829 (estimated)

Summary

We found material underwriting deficiencies relating to the borrower's income, excessive ratios, and compensating factors.

Income

Assurity did not properly verify the borrower's income or determine income stability. The lender failed to adequately support the borrower's income through standard or alternative documentation standards, and it should not have been used as effective income without additional support. Since the lender failed to obtain a written verification of employment, it was obligated to obtain a telephone verification, pay stubs covering the most recent 30-day period, and IRS Forms W-2 from the previous 2 years. However, the lender failed to adequately satisfy alternative documentation requirements. The lender did not obtain a telephone verification of employment and only obtained a single pay stub covering a 14-day period and IRS Forms W-2 covering years 2005, 2006, and 2007.

Without adequate income support, the lender should have questioned the stability of the borrower's income. The absence of a verification of employment (written or telephone) makes it difficult to determine the likelihood of continued employment. The borrower's previous job history exhibited income and job instability. According to the uniform residential loan application and the IRS Forms W-2, the borrower had held employment at 11 different employers since 2005. In 2007, the borrower held employment at four different employers. According to the IRS Forms W-2, income was limited until the current employment. Additionally, employment was not always in the same line of work.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-6, states that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue.

HUD Handbook 4155.1, REV-5, paragraph 3-1(E), states that a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS Forms W-2 from the previous 2 years. The lender must also verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. The borrower's mortgage payment-to-income ratio was 47.29 percent, and the total fixed payment-to-income ratio was 49.55 percent. Both ratios exceeded the required maximums of 31 and 43 percent. The lender did not document sufficient compensating factors to justify ratios that are significantly above the limits. Based on this information alone, the loan should not have been approved. However, the lender also inappropriately included income that was not adequately supported (see Income section above).

Assurity did not include compensating factors. The borrower exceeded both qualifying ratios as originally calculated. We could not recalculate the ratios based on the unsupported income since the income should not have been used for qualifying calculations. To overcome the exceeded ratios, significant compensating factors should have been listed and documented. Based on the loan file, we determined the presence of only two compensating factors (conservative attitude toward credit and minimal increase in housing expense), which was determined not adequate to overcome excessive ratios, the lack of employment verification, and the borrower's unstable previous employment history

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record in the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Loan number: 094-5402355

Mortgage amount: $255,526

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: April 9, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: $151,214 (estimated)

Summary

We found material underwriting deficiencies relating to the borrower's liabilities, excessive ratios, and compensating factors.

Liabilities

Assurity did not correctly calculate the borrower's recurring liabilities. The lender included a recurring liability credit account with a monthly payment of $6 dollars. However, the credit report showed the credit account with an outstanding balance of $105 and a monthly payment of $20, indicating fewer than 10 months of payments remaining. Additionally, the lender failed to adequately consider rental property to be included as income or as a recurring liability. The gross rental amount should have been reduced by 25 percent (to account for vacancies and maintenance), then subtracted by the mortgage amount on the existing property. If the outcome is positive, it can be considered effective income. If it is negative, it is considered a recurring liability. A recurring liability of $211.75 should have been determined (gross income—$1,375 reduced by 25 percent is $1,031.25. We then subtracted the mortgage amount of $1,243 to arrive at $211.75).

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-11(A), states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing debt-to-income ratios, the lender must include the monthly housing expense and all recurring charges extending 10 months or more, including payments on installment accounts.

HUD Handbook 4155.1, REV-5, paragraph 2-7(M)(2), states that the gross rental amount must be reduced for vacancies and maintenance by 25 percent (or the percentage developed by the

jurisdictional Homeownership Center) before subtracting principal, interest, taxes, and insurance and any homeowners' association dues, etc., and applying the remainder to income (or recurring debts, if negative).

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income ratio was 41 percent and total debt-to-income ratio was 42 percent. However, as recalculated after considering the inappropriately excluded rental income liability, the total debt-to-income ratio increased to 44.77 percent. Both scenarios presented excessive qualifying ratios.

Assurity included one compensating factor, the borrower's ability to manage debt (valid compensating factor). However, the single compensating factor is not enough to justify mortgage approval. The borrower's mortgage on the new property more than doubled his previous mortgage, increasing from $1,280 to $2,530, further diminishing his ability to save, and the borrower's credit report indicated more than one previous mortgage loan with derogatory information.

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt–to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-5, states that there is a danger of "layering flexibilities" in assessing mortgage insurance risk and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. The lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record in the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

HUD Handbook 4155.1, REV-5, paragraph 2-13(C), states the borrower has demonstrated an ability to accumulate savings and a conservative attitude toward the use of credit.

HUD Handbook 4155.1, REV-5, paragraph 2-13(I), states that the borrower has a potential for increased earnings, as indicated by job training or education in the borrower's profession.

Loan number: 095-0485724

Mortgage amount: $212,135

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: October 31, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: 11

Loss to HUD: $165,306

Summary

We found material underwriting deficiencies relating to the borrower's income, excessive ratios, and compensating factors.

Income

Assurity did not adequately verify the borrower's employment and did not assess its stability. The lender failed to explain inconsistencies in the loan file regarding the borrower's current employment. The lender used a verbal verification of employment for 2007 wages, which extended to August 6, 2007, just 2.5 months before closing, instead of obtaining pay stubs from the borrower.

The borrower had four employers over the past 4 years according to the uniform residential loan application. Although they were in the same field of work, the reasons for ending employment indicated that employment may not have continued in the future. The verification of employment for the current employer did not comment on the probability of continued employment. A second verification for a different employer stated that the reason for leaving was "dissatisfied with work arrangements."

Due to the borrower's inconsistent employment history, current earnings evidenced by the pay stubs and not previous earnings should have been used for qualification. As stated by Assurity, average earnings were used to calculate income, which includes earnings from previous employment. The lender should have used the $18 hourly rate of the current employer as listed in the four paystubs in the loan file. Although the VOE for the current employer states an average of 30.25 hours per week, we used a conservative work week of 40 hours to reflect hours illustrated in the paystubs. We determined monthly earnings of $3,120 ($18/hour x 40 hours x 52 weeks divided by 12 months), a difference of $519 from the $3,639 used on the MCAW.

HUD/FHA Requirements

HUD Handbook 4155.1,REV-5, paragraph 3-1(E), states that a verification of employment and the borrower's most recent pay stub are to be provided.

HUD Handbook 4155.1, REV-5, paragraph 2-2, states the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue.

HUD Handbook 4155.1, REV-5, paragraph 2-7, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income and total debt-to-income ratios were 48.54 percent. Both ratios exceeded the acceptable maximums of 31 and 43 percent, respectively. As recalculated using the overstated income discussed above, the mortgage payment-to-income and total debt-to-income ratios are 56.61 percent. However, the qualifying ratios cannot be relied on since the lender did not adequately verify the borrower's employment and determine its stability or likelihood to continue.

Assurity included six compensating factors: 751 credit score (not a valid compensating factor), paying off all debt (not a valid compensating factor), savings of $438 per month (not a valid compensating factor), limited credit use (not a valid compensating factor as borrower consolidated debt paying off with refinance proceeds), clean mortgage history (valid compensating factor), and using conservative income (not a valid compensating factor—insufficient document support).

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to- income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-5 states that there is a danger of "layering flexibilities" in assessing mortgage insurance risk and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. The lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines.

Underwriters must record in the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Loan number: 095-0539086

Mortgage amount: $310,000

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: December 28, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Three

Loss to HUD: $193,656

Summary

We found material underwriting deficiencies relating to the borrower's liabilities, excessive ratios, compensating factors, and credit.

Liabilities

Assurity inappropriately excluded recurring liabilities from the borrower's mortgage credit analysis. The credit report identified a recurring liability in the amount of $1,565 with a monthly payment of $458. Although it appeared the liability had fewer than 10 months of payments remaining, lenders are required to include these liabilities if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing, especially if the borrower has limited or no cash assets after loan closing. The uniform residential loan application indicated that the borrower had zero cash assets and reserves. The $10,000 resulting from the cash-out refinance is not considered cash reserves. Therefore, the lender should have included the recurring liability of $1,565 at $458 per month.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-11(A), states that debts lasting fewer than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing, especially if the borrower will have limited or no cash assets after loan closing.

HUD Handbook 4155.1, REV-5, paragraph 2-11(A)(1), states that if the account shown on the credit report has an outstanding balance, monthly payments for qualifying purposes must be calculated at the greater of 5 percent of the balance or $10 (unless the account shows a specific minimum monthly payment).HUD Handbook 4155.1, REV-5, paragraph 2-13(F), states that "assets" such as equity in other properties and the proceeds from a cash-out refinance are not to be considered as cash reserves.

Excessive Ratios and Compensating Factors

Assurity approved the FHA loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income ratio was 34.89 percent, and total debt-to-income ratio was 43.99 percent. However, as recalculated after considering the inappropriately excluded recurring liability, the total debt-to-income ratio increased to 50.47 percent. Both scenarios presented excessive qualifying ratios, exceeding acceptable maximums of 31 and 43 percent. Significant compensating factors should have been listed by the lender.

Assurity included four compensating factors: clean mortgage history (valid compensating factor; however, the borrower's derogatory credit history made this compensating factor less impactful), savings of $289 per month (not adequately supported), lower mortgage payment (valid compensating factor; however, the borrower had no cash assets and the decrease was minimal—$192 ($2,803 - $2,611)), and low loan-to-value ratio (not a valid compensating factor).

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that if either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-5, states that there is a danger of "layering flexibilities" in assessing mortgage insurance risk and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. The lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record n the "remarks" section of the HUD Form 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Credit

Assurity did not obtain from the borrower a letter explaining two open collection accounts. The credit report indicated two open collection accounts: $189 and $138. The lender did not document its analysis on loan approval despite a number of derogatory accounts.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including delayed mail delivery or disputes with creditors. While minor

derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit–including judgments, collections, and any other recent credit problems–require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

APPENDIX C

LENDER COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation	Lender Comments

WEINER
BRODSKY
SIDMAN
KIDER PC

June 30, 2010

VIA OVERNIGHT MAIL

Ms. Tanya E. Schulze
Regional Inspector General for Audit, Region IX
U. S. Department of Housing and Urban Development
611 West sixth Street, Suite 1160
Los Angeles, Ca 90017-2101

Re: Draft Audit Report
Assurity Financial Services, LLC

Dear Ms. Schulze:

On behalf of our clients, [redacted] and [redacted]. We appreciate the opportunity to provide you with their response regarding the review performed by the Office of Inspector General ("OIG") with respect to 20 Federal Housing Administration ("FHA") loans underwritten by Assurity financial Services, LLC ("Assurity" or the "Company"), their former company.

Comment 1

At the outset, we respectfully submit that there is no legal basis for the OIG's recommendation that Assurity's principals be individually held liable under the Program Fraud Civil Penalties Act ("PFCPA") or be subject to any administrative action. This recommendation is legally inconsistent with Assurity's structure as a limited liability company. Assurity's principals are not Direct Endorsement (DE) underwriters, nor did they personally review or certify as individuals as to the integrity of the specific information in the 13 loans that resulted in losses to HUD.

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Washington DC Dallas TX Newport Beach CA

Comment 2

Comment 3

Comment 4

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BRODSKY
SIDMAN
KIDER PC

Assurity's principals certified to HUD-FHA on an annual lender renewal basis regarding the company's compliance with HUD-FHA requirements. This annual certification was based on information from Assurity's independent auditors that there were no findings of material non-compliance with HUD-FHA program requirements, routine quality control reports regarding the company's operations, and feedback from HUD-FHA in connection with on-site reviews of the Company, as applicable. The Company's principals exercised prudent oversight and due diligence with respect to ensuring compliance with HUD-FHA requirements. There is no evidence that they had any knowledge, or reason to know, of any deficiencies in the 13 specific loan files subject to the OIG's findings.

Assurity's principals properly relied on the Company's FHA approved DE underwriters to make credits decisions that are in compliance with HUD-FHA underwriting requirements on behalf of the Company. For the OIG to set a precedent in this case by attributing long-standing and generally accepted limited liability characteristics of corporations and limited liability companies to Assurity's principals and shareholders who have no involvement in making credit decisions would be disruptive to the FHA program, the housing industry, and without a legal basis.

The FHA program is based on HUD-FHA and its participating FHA lenders' reliance on individual DE underwriters. Assurity's owners had quality control processes and procedures, as well as extensive internal controls, in place to ensure that there was no material non-compliance with HUD-FHA programs and underwriting requirements. In its draft report the OIG stated that it did not consider the internal controls or information systems controls of Assurity in providing its audit findings and recommendations. Respectfully, OIG cannot now assert material non-compliance and systemic underwriting problems at Assurity.

WEINER
BRODSKY
SIDMAN
KIDER PC

Ms. Tanya E. Schultze 3 June 30, 2010

It is also important to put the 13 loans that are the subject of OIG's findings in perspective. These 13 loans represent less than two-tenths of one percent (0.2%) of Assurity's overall FHA loan production of 6, 831 FHA loans insured between November 2007 and December 2009. Assurity and its owners respectfully submit that it would not be proper for HUD-FHA to pursue enforcement or administrative action against the Company or its principals for the multiple reasons set forth in the Company's response to the OIG draft audit findings.

Comment 5

Our clients also have concerns with the manner in which the audit was performed. The sample loan population for the OIG audit was not statistically significant, nor was it randomly selected. This has caused OIG's audit results and conclusions regarding Assurity's overall underwriting quality to be artificially skewed. To not have reviewed a statistically significant and random sample of all loans underwritten by the Company's DE underwriters and to attempt to draw conclusions as to whether the Company had systemic underwriting problems constitutes flawed auditing methodology.

Comment 6

It is also of concern that the OIG, as stated in the draft report, did not follow generally accepted government auditing standards in conducting its audit. The OIG did not consider the internal controls or information systems controls of Assurity, did not consider the results of previous audits, or communicate with Assurity's management in advance. The OIG's statement in the draft report that it had an objective of "identifying FHA single-family insurance program risks and patterns of underwriting problems or potential wrongdoing" is not an acceptable reason for not following generally accepted government auditing standards.

Comment 7

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addition, the HUD press release and conference call of January 12, 2010, publicly indicating that the Company was being investigated along with 14 other lenders for potential fraud resulted in the Company's investors, credit providers, employees and customers to immediately begin terminating their relationship with the Company. Assurity's immediate failure ensued. The OIG's audit findings five months later found no existence of fraud.

Comment 8

Is also important to recognize that the 20 loans audited by the OIG were part of an older portfolio of Assurity's loans. The Company's FHA loan production dropped in 2009 and 2010 at a time when industry wide FHA loan production experienced a large growth. This created an artificial negative view of the multi-year default and claim rates regarding the Company's loan production relative to its peers who focused on FHA production. Accordingly, HUD's Neighborhood Watch data does not provide an accurate measurement of the Company's performance relative to Assurity's peer group.

Comment 9

It should be noted that Assurity has undergone several independent audits for compliance with HUD-FHA programs as well as HUD-FHA on-site revisions of fits FHA loan production in the past. These reviews did not reveal any material deficiencies. In a more recent review which was forwarded to the Mortgagee Review Board the Company updated its quality control plan to formally incorporate policies and procedures that the Company already had in place that were stand-alone policies and procedures not formally incorporated into the Company's Quality Control plan, since HUD-FHA's most current update of its requirements.

Comment 10

Finally, we note that the draft audit report incorrectly states that Assurity's FHA approval was terminated, and operations ceased on February 26, 2010. This statement leaves the impression that Assurity's FHA approval was terminated by HUD-FHA.

Comment 11

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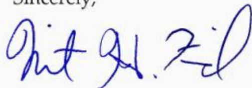
While Assurity ceased lending operations on February 26, 2010, the Company did not terminate its FHA approval at that time. With its FHA approval in good standing, Assurity notified HUD-FHA on March 30, 2010 that it elected not to renew its FHA approval as it had ceased its lending operations.

Once again, our clients appreciate the opportunity to submit their response to the OIG draft audit findings.

Sincerely,



Mitchel H. Kider

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Names redacted for privacy reasons.

June 30, 2010

VIA OVERNIGHT MAIL
Ms. Tanya E. Schulze
Regional Inspector General for Audit, Regional IX
U.S. Department of Housing and Urban Department of Urban Development
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

Re: Draft Audit Report
Assurity Financial Services, LLC

Dear Ms. Schultze:

This is in reference to your letter dated June 16, 2010, to the former principals of Assurity Financial Services, LLC regarding the review performed by the Office of the Inspector General ("OIG") of 20 Federal Housing Administration ("FHA") loans underwritten by Assurity Financial Services, LLC ("Assurity" or the " Company"). You have asked for the Company's written comments with respect to the draft audit report findings which are provided herein.

COMPANY'S COMMENTS ON OIG RECOMMENDATIONS

Comments 1, 2, and 3

Respectfully, the Company submits that there is no legal basis for the OIG's recommendation that Assurity's principals be individually pursued under the Program Fraud Civil Penalties Act ("PFCRA") or administrative action. This recommendation is also legally inconsistent with Assurity's structure as a limited liability company. Assurity's principals are not Direct Endorsement (DE) underwriters, nor did they personally review or certify as individuals to the

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integrity of the specific data in the 13 loans that resulted in losses to HUD. On an annual basis, Assurity's principals certified to the integrity of the data submitted to HUD/FHA in its annual lender renewal documents and based their certifications largely on annual feedback from the company's independent auditors that there were no findings of material non-compliance with HUD programs, combined with routine quality control reports and feedback from HUD/FHA itself via field reviews, when applicable. The company's principals not only demonstrated prudent oversight and due diligence with respect to ensuring compliance with HUD programs and FHA underwriting guidelines, but the company's owners and DE underwriters also made good faith attempts at compliance at every level.

Comments 2, 4, and 10

Despite any organization's bona fide attempts at compliance at every level, and even with the best management teams and internal control processes and procedures in place, origination shortcomings are inherent in the loan production process. It is management's responsibility to exercise prudent oversight and due diligence over the loan origination process to ensure that these inherent shortcomings do not approach a level of becoming "material" defects indicative of a "systemic" problem within the organization. Assurity's principals have exercised such systemic oversight and due diligence. They had no knowledge, or reason to know, of any deficiencies in the 13 specific loan files that are the subject of OIG's audit findings.

Assurity's owners, like the owners of any FHA approved lender, relied on the company's employees who individually possess their FHA approved underwriting authority to make credit decisions that are in compliance with FHA underwriting guidelines on behalf of the Company. For OIG to set a precedent

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Comments 2 and 3

Comment 12

Comment 5

Comment 13

in this case by attributing long-standing and generally accepted limited liability characteristics of corporations and limited liability companies to the principals and shareholders of such organizations who had no involvement in making credit decisions would be disruptive to the FHA program, the nation's banking system, the U.S. housing industry as a whole, and would be without a legal basis. The entire FHA program itself is predicated on HUD/FHA and its participating FHA lenders' reliance on individual DE underwriters who receive their DE underwriting authority directly from HUD/FHA itself, and not from the participating lenders, to make credit decisions. Assurity's owners had thoroughly documented quality control processes and procedures, as well as extensive internal controls, in place to ensure that there was no material non-compliance with HUD programs and FHA underwriting guidelines. OIG has stated that it "did not consider the internal controls or information systems controls of Assurity" in providing its audit results and recommendations. OIG cannot assert material non-compliance and systemic underwriting problems at Assurity without giving consideration to the internal controls that were in place. Importantly, putting the 13 loans that are the subject of OIG's audit findings into perspective, these 13 loans represent less than two-tenths of one percent of Assurity's overall FHA loan production of 6,831 FHA loans endorsed between November 2007 and December 2009. For the sake of example, conservatively assuming an average of $4,000 in combined up-front mortgage insurance premiums and monthly mortgage-insurance premiums paid to HUD/FHA on each of those 6,831 loans, HUD/FHA would have received over $27 million in insurance premiums to offset the $1.493 million in actual and estimated losses

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stated by OIG in its audit results. Furthermore, HUD/FHA continues to collect monthly insurance premiums from those loans that are still insured. Additionally, HUD/FHA has the added advantage of being able to keep unearned up-front mortgage insurance premiums as opposed to refunding them to FHA borrowers in instances where FHA borrowers have paid off their FHA loans by selling their homes or refinancing into a non-FHA loan before the applicable up-front mortgage insurance premium amortization / earning period has fully lapsed. This ability of HUD/FHA to collect and keep the up-front insurance premiums paid by FHA borrowers without being required to fully "earn" them as was the case in the past is uniquely advantageous at the present time and is often overlooked in discussions of the inner-workings of FHA loan programs and analyses of overall risk posed to the FHA insurance fund by participating lenders.

Comment 14

Assurity and its owners respectfully submit that HUD/FHA should not pursue remedies, enforcement action or administrative action against the company and/or its principals for the multiple reasons outlined in the Company's response to OIG's draft audit findings. To reiterate, management routinely demonstrated that it had proper internal controls in place and this, combined with feedback from third party independent auditors and HUD/FHA field reviews, demonstrates that Assurity's principals did not know, or have reason to know, of any specific loan-level deficiencies.

INTRODUCTION TO COMPANY'S COMMENTS

Assurity, as well as its limited liability company managing members (the "members", "owners" or "principals"), have been asked to respond to the U.S. Department of Housing and Urban Development ("HUD") Office of Inspector

General ("OIG") draft audit report resulting from the OIG's recently completed review of 20 Federal Housing Administration ("FHA") loans underwritten by Assurity's Direct Endorsement ("DE") underwriters.

After an approximately five month period to complete its review of the aforementioned 20 loans, OIG delivered its letter dated June 16, 2010, along with its preliminary findings, to Assurity on June 17, 2010. OIG has given the Company a deadline of July 1, 2010, or approximately nine business days, to provide its written response.

OIG issued the following instructions to the Company: "Notice – Use Restricted. This document . . . is a draft of a proposed audit report of HUD's Office of Inspector General. It is subject to revision, does not necessarily contain final conclusions, and is available only to officials responsible for its review and comment. Recipients of this draft must not show or release its contents for any purpose other than to review and comment. They must safeguard it to prevent premature publication or otherwise improper disclosure of the statements or information it contains. Reproduction of this draft without consent of the Office of Inspector General is prohibited."

COMPANY'S COMMENTS ON OIG SCOPE AND METHODOLOGY STATEMENTS

OIG has indicated that its review of 20 loans underwritten by Assurity's DE underwriters constitutes an audit. The subject line of the letter dated June 16, 2010 to Assurity's owners reads, "Discussion Draft Audit Report Assurity Financial Services, LLC". The letter is signed by Tanya E. Schulze, Regional Inspector General for Audit, and the closing paragraph of the letter reads, "If you

have any questions, please contact me, or Anthony Putzulu, Supervisory Forensic Auditor . . ."

Comments 4, 6, and 9

Respectfully, the Company submits that the sample population for OIG's audit was not statistically significant, nor was it randomly selected. This avoidance of statistically significant, random sampling techniques has caused OIG's audit results and conclusions from those results about Assurity's overall underwriting quality to be artificially skewed. OIG selected only loans that had gone into claim status and did not review a single performing loan. To not have reviewed a statistically significant and purely random sample of all loans underwritten by Assurity's DE underwriters and to then attempt to draw conclusions as to whether or not the Company had systemic underwriting problems constitutes flawed auditing methodology.

Comment 7

OIG did not follow generally accepted government auditing standards in conducting its audit. In its draft audit report, OIG makes the contradictory statement that, "We conducted our work in accordance with generally accepted government auditing standards except that we did not consider the internal controls or information systems controls of Assurity, consider the results of previous audits, or communicate with Assurity's management in advance. *We did not follow standards in these areas* . . ." (emphasis added). OIG cannot properly assert that it followed generally accepted government auditing standards while simultaneously listing the specific areas in which it did not follow these standards.

Comment 38

OIG's statement in its draft audit report that it had an objective of "identifying FHA single-family insurance program risks and patterns of underwriting problems or potential wrongdoing" is not an acceptable reason not to have

Comment 15

followed generally accepted government auditing standards. Standard operating procedure for an audit is to confidentially notify the FHA program participant that is the subject of the audit so that the participant can more easily comply with information requests, and to keep the details of an audit confidential until final audit results are released. The methodology by which OIG conducted its audit without standard communication with Assurity's management, concurrent with a highly publicized, nationwide conference call and press release on January 12, 2010, naming Assurity and 14 other companies as having been subpoenaed for loan files to be audited, caused Assurity, its owners, and its nearly 150 employees irreparable harm, leading to the company's failure within a matter of weeks.

Comment 8

The press release and conference call on January 12, 2010 included a statement by FHA Commissioner David Stevens that, "The Inspector General's initiative will help us determine whether there is fraud . . .". This baseless inference of fraud and the unorthodox public announcement that the Company was being investigated caused the Company's investors, credit providers, employees and customers to immediately begin exiting their relationships with Assurity. The Company's immediate failure ensued, equivalent to a "run" on a bank. Assurity has since been unable to satisfy its obligations to the Company's creditors, even after a public auction of the company's furniture, fixtures and equipment. Many of the Company's obligations were personally guaranteed by its owners, who have been personally unable to satisfy these obligations, as well, as they have lost their company, their jobs and their occupational livelihood. It is now immaterial to the Company as a going concern that OIG's ultimate audit findings five months later found no existence of fraud.

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Be Sure.

Comment 16

COMPANY'S COMMENTS ON OIG BACKGROUND STATEMENTS

In its draft audit report, OIG incorrectly states that Assurity was approved to begin underwriting FHA loans under HUD's direct endorsement program on March 21, 2002. Assurity obtained its FHA "mini-eagle", Type II non-supervised loan correspondent approval on March 21, 2002, and was required to submit all of its loan files to the Company's sponsoring lenders for underwriting approval. The company did not begin underwriting loans under HUD's direct endorsement program until it converted its Type II non-supervised loan correspondent approval to "full eagle", direct endorsement lender status on May 20, 2005. In converting its mini-eagle to full-eagle status, the company was required to pass a series of "test cases", whereby the company submitted several loan files to the regional FHA homeownership centers for prior underwriting approval to demonstrate the Company's DE underwriters' competency in adhering to FHA underwriting guidelines. The Company passed all of its initial test cases on the first attempt, and HUD/FHA did not require additional test cases prior to issuing the Company's FHA direct endorsement lender approval, which can be common with lenders that have inexperienced DE underwriters. The Company was also required to submit its written quality control plan as part of the direct endorsement lender approval process, which HUD/FHA also approved.

As a further point of clarification, Assurity was required for the first two years as a newly approved FHA direct endorsement lender to submit all of its loan files to the regional FHA homeownership centers for review prior to insurance endorsement. Some of the 20 files audited by OIG fall into this category of

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having been reviewed by HUD/FHA prior to insurance endorsement. It was not until after the required two year waiting period specified in Mortgagee Letter 2005-36 that Assurity was able to apply for the ability to self-insure its FHA loans without prior review and approval by HUD/FHA. Even after having been granted self-insuring status in 2007, the Company continued to have ongoing post-endorsement technical reviews of random samples of the Company's loan production performed by the regional HUD Homeownership Centers, ensuring the systemic integrity of the Company's underwriting and loan insuring activities.

Comment 10

OIG also incorrectly states that, "[Assurity's] FHA approval authority was terminated, and operations ceased on February 26, 2010." In addition to being factually inaccurate, this statement has the potential to give the reader the false impression that Assurity's FHA approval authority was somehow terminated or revoked by HUD/FHA. While Assurity did cease lending operations on February 26, 2010 due to the reasons mentioned above, the Company did not terminate its FHA approval at that time. With its FHA approval authority in good standing, Assurity notified HUD/FHA that it was winding down its business operations consistent with the notification requirements set forth in HUD Handbook 4060.1. Then, on March 30, 2010, Assurity further notified HUD/FHA that it was electing not to renew its FHA approval by the March 31, 2010 annual renewal deadline. The company's FHA approval authority was not "terminated"; rather, it simply expired as the Company elected in writing through its notification to HUD/FHA on March 30, 2010 not to renew its FHA approval authority. Clearly, the company would have no need to renew its FHA

Comment 11

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Comment 17

approval authority since it had ceased its lending operations on February 26, 2010 and was winding down.

In its draft audit report, OIG provides the generic background information on the creation of FHA by Congress in 1934, setting forth the goals of FHA and broadly discussing FHA mortgage insurance and the functionality of the direct endorsement program. However, OIG did not mention a material fact that is germane to any discussion of the background of FHA today. Namely, that FHA had a historically unprecedented capital reserve assessment in November 2009 as part of the agency's annual actuarial audit. FHA told Congress last November of 2009 (seven months ago) that its cash reserve fund has deteriorated to $3.6 billion or only 0.53% of FHA's insured mortgages. The significance of this is that this is the lowest capital reserve level in the agency's 75-year history, and below the 2% required by law, likely requiring FHA to approach Congress in the coming months for a taxpayer bailout. A *prima facie* argument can be made that a basis exists for FHA to place blame for the cash reserve fund's inadequate capital reserve level on the lenders, while perhaps overlooking the competing objectives of providing loans to the underserved and simultaneously attempting to maximize fiscal discipline at the agency.

HUD Secretary Shaun Donovan said in the annual report submitted to Congress that, "The story of FHA's financial status at the end of FY 2009 is then the tale of two portfolios. The older portfolio has high rates of delinquencies and is expected to have high rates of insurance claims in the future. The new portfolio, which soon will be larger than the older portfolio, is expected to have more modest claim rates over the life of the loan guarantees."

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The experience in the portfolio of loans underwritten by Assurity's DE underwriters has been the same as articulated by Secretary Donovan. The Company's portfolio of older loans – which all 20 loans that were the subject of OIG's audit fall into – have underperformed relative to the new loans. Furthermore, those loans from the older portfolio that have gone to claim status have generated high losses due to the abnormally high recent decline in housing prices. However, the material difference between Assurity's FHA loan production as compared to that of all loans insured by FHA is that the Company's FHA loan production dropped in 2009 and 2010 at a time when industry-wide FHA loan production experienced exponential growth. Unlike Secretary Donovan's forecast for the overall FHA program itself, Assurity's new loan portfolio will never be larger than the older loan portfolio for the simple fact that the Company is now out of business.

Comment 5

This has created an increasingly artificially negative view of the multi-year default and claim rates associated with the Company's loan production relative to its peers. For example, many companies that were focused on other loan products (such as subprime loan products) when Assurity categorically avoided such loan products due to the company owners' view of consumer loan product suitability issues, have recently obtained their FHA Direct Endorsement lender approval. Almost exclusively due to tighter industry-wide underwriting guidelines driven by secondary market investor acceptance, these lenders have only underwritten loans that fall into the category of the "new portfolio" that Secretary Donovan referred to in the annual report submitted to Congress. Examining exclusively the multi-year FHA loan production of such companies relative to that of Assurity in order to generate the multi-year "compare ratios"

Comments 5, 6, and 9

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publicly displayed through FHA's Neighborhood Watch system therefore does not fully provide an apples-to-apples comparison of Assurity's DE underwriters' performance relative to the Company's peer group. Furthermore, an examination of the Company's Neighborhood Watch multi-year compare ratios therefore does not, in and of itself, indicate systemic issues with the Company's DE underwriters' overall performance.

Finally, no discussion of the background leading up to OIG's audit of 20 loan files underwritten by Assurity is complete without mentioning that Assurity has undergone several independent audits for compliance with HUD programs as well as actual on-site HUD/FHA field reviews of its FHA loan production in the past. OIG has stated that its objective is to determine whether there were "systemic problems" with the adherence of Assurity's DE underwriters to FHA underwriting guidelines. Therefore, these previous audit and field review results cannot be omitted from consideration in making such a determination.

Also, as part of the Company's annual recertification process, Assurity was subjected to an annual audit by well respected independent CPA firms familiar with HUD programs that conducted a two part audit: An audit of the company's financial statements, and a separate audit of the company's compliance with HUD programs. Unlike OIG, these independent auditors conducted their audits in compliance with generally accepted government auditing standards, and certified to HUD, via the Lender Assessment SubSystem (commonly known as "LASS"), that Assurity was indeed in compliance with HUD programs and that no material deficiencies were found.

Comments 4, 7, and 10

Further, HUD/FHA's own on-site field reviews of Assurity in the past did not reveal any material deficiencies in the Company's compliance with FHA

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underwriting guidelines. Never did HUD/FHA mention in a field review that the Company had more than "minor deficiencies that were resolved on site" with respect to its underwriting decisions. Regarding the company's overall compliance with HUD programs, in a recent field review, which was referred to the Mortgagee Review Board, the Company updated its quality control plan to HUD/FHA's satisfaction to formally incorporate separate policies and procedures that the Company already had in place but that were stand-alone policies and procedures not formally incorporated into the Company's official quality control plan since HUD/FHA had updated its quality control plan requirements. This was done to fully cooperate with HUD/FHA and settle any outstanding field review findings to the parties' mutual satisfaction, with no admission of wrongdoing on the part of the Company, and is also not representative of any "material deficiency" in the Company's overall compliance with HUD programs.

COMPANY'S COMMENTS ON OIG RESULTS OF REVIEW

Attached as TAB A are the Company's detailed responses to the loans cited by the OIG in the draft audit report.

The Company appreciates the opportunity to respond to the draft audit report.

Sincerely,

Managing Member
Assurity Financial Services, LLC

Managing Member
Assurity Financial Services, LLC

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TAB A

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ASSURITY FINANCIAL SERVICES

Comment 18

Comment 19

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Case Number	0950539086
Loan Purpose	Refinance
Date of Loan Closing	December 28, 2007
HUD OIG Audit Period	January 2010-May 2010
HUD OIG Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's liabilities, excessive ratios, compensating factors and credit.	
HUD OIG Findings Response	
Liabilities	The borrowers' total monthly mortgage payment (PITI) was approximately $3,357 prior to the subject refinance. The total monthly mortgage payment was reduced by approximately $746; and consumer debt with monthly payments of $102 was also paid off. At the time of closing, the liability with a payment of $458 had two payments remaining. The borrower's total monthly debt was reduced by $848. Based upon this information, the payment of $458 was less than the $848 plus $458 ($1,306) that the borrower had been paying. Since the borrowers were able to manage this higher debt level, the exclusion of the $458 payment was reasonable. Although the application does not reflect asset accounts, the cash proceeds of $10,000 were also available to the borrower.
Excessive Ratios and Compensating Factors	The total monthly reduction in payment was greater than reflected on the Mortgage Credit Analysis Worksheet, because existing payment on the MCAW was for principal and interest, and did not include the taxes and insurance.

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	Although employment stability is not a compensating factor, both borrowers had been employed by the County for 19 and 20 years.
Credit	Collections dated 6/2004 for $138 and 7/2006 for $172 (Supra telecom and Nextel) are telephone service related and were paid at closing.

Comment 20

Case Number	023-2343260
Loan Purpose	Refinance
Date of Loan Closing	April 14, 2006
HUD OIG Audit Period	January 2010- May 2010
Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's income, credit history, excessive ratios, and compensating factors.	
RESPONSE TO HUD OIG FINDINGS	
INCOME	The overtime income was calculated using a 27 month average for the years 2004, 2005 and the first three months of 2006. The overtime earnings reflected an increase in 2005; and the Verification of Employment (VOE) completed by the borrower's employer also reflected an hourly wage increase. The paystubs reflect year-to-date earnings through March 18, 2006 (11 weeks). The Verification of Employment completed by the employer's Human Resource department reflects a 40 hour regular work week plus 9 hours of overtime. The employer also indicated that overtime was likely to continue. A time frame of 11 weeks, particularly in the first quarter of the year, cannot be conclusively relied upon to determine the earnings trend for the year, as the overtime may be subject to

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	seasonal fluctuation. Nor can it be conclusively determined that income was subject to a continual decline based on this timeframe, since the year over year earnings trend reflected an increase, and the borrower was receiving pay rate increases, in addition to premium time and overtime. Since it is not conclusive, the underwriter used a reasonable approach by averaging the earnings over the greater period of time. However, the underwriter should have obtained additional information from the employer to reconcile the discrepancy. The AUS (Fannie Mae Desktop Underwriter (DU) Automated Underwriting System – which accesses the FHA TOTAL Scorecard) loan condition for overtime and bonus income states that *"the income may be used to qualify the borrower if the borrower has received such income for approximately two years and there are reasonable prospects of continuance."* The borrower worked for Basha's, a large chain of grocery and specialty stores in Arizona that began in 1932. In 2005, Basha's was named *Retailer of the Year* by *Progressive Grocer* and was praised for its investment in its employees, community involvement, and Hispanic oriented merchandising. It had doubled in size in the previous ten years, had 14,000 employees, and a 700,000 square foot distribution center in Chandler, Arizona. Basha's continued to grow to 160 stores; however, it was affected by the economic downturn in 2007/2008 and began closing stores. Basha's eventually filed for bankruptcy in 2009 (after 77 years in business). The subject loan went into default 18 months after closing, the timing of which falls in line with the economic impact to the employer's business, which would have affected the

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	borrower's earnings and employment. At the time this loan closed in April, 2006, Basha's was doing very well in the market and the borrower's earnings level could be expected to continue based on this and the information provided on the VOE.
CREDIT	The credit profile dates back to 2/2005 and includes a mortgage, auto loan, installment loan, and a credit card with a balance of less than $1,000, which were paid as agreed. This profile does not represent an excessive use of credit based on a hierarchy of credit analysis, and the amount of unsecured credit is minimal. There was a settled collection for $65 (Alltel) that originated in 2001; a paid collection for $273 that originated in January 2002, and a paid auto loan charge off, with an opening date of March 2004. Given the satisfactory ratings for the borrower's other credit accounts, this may have been attributed to a lack of understanding of credit, rather than a disregard for credit. It is noted that the subject property is located in an underserved area. The auto loan was refinanced with a credit union loan indicating that the credit union found the borrower to be an acceptable risk. The underwriter should have obtained a written explanation from the borrower regarding the auto loan. The inquiries on the credit report range from January 13, 2006 to March 22, 2006. Six of the inquiries were clearly related to mortgage inquiries for the second mortgage obtained from Countrywide, and the subject loan transaction. One inquiry was from Direct TV. There were three unexplained inquiries in January 2006 and one in February 2006 which the underwriter should have reconciled. The borrower obtained a second mortgage for $60,000. The

Comment 22

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	proceeds from the loan were used to pay off the borrower's outstanding credit (including the current auto loan). The underwriter did not obtain an explanation for the purpose of the second mortgage; however, the lack of an explanation does not increase the loan risk, since the terms of the loan were disclosed. The second mortgage had a higher rate of interest and was paid off with the proceeds of the subject transaction.
EXCESSIVE RATIOS AND COMPENS ATING FACTORS	The borrower's mortgage payment (PI) increased by $337 from $976 to $1,313. The second mortgage paid off the borrower's outstanding credit. The underwriter included $317 in the calculation of the debt ratio, although the debts had been paid off. The net difference in the borrower's total debt payment represents a monthly increase of $20, which does not significantly impact the debt ratio. The underwriter considered the equity of 10% in the subject property as a compensating factor. This rationale was appropriate based on the fact that the subject transaction was a refinance and FHA considers a 10% down payment in a purchase transaction to be a compensating factor. The borrower's W2's and the VOE did reflect increased wages and a pay raise, which is considered a compensating factor.

Comment 23

Case Number	052-4311569
Loan Purpose	Purchase
Date of Loan Closing	April 11, 2008
HUD OIG Audit Period	January 2010- May 2010
Summary HUD OIG indicates material underwriting deficiencies relating to the	

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borrower's income, excessive ratios and compensating factors.	
RESPONSE TO HUD OIG FINDINGS	
INCOME	The underwriter documented the borrower's income via five means: 1.) Paystub; 2.) Bank statements with direct deposit details from the employer covering more than a 30-day period, inclusive of the deposit corresponding with the 14-day paystub in the file; 3.) Rapid Reporting income verification from prior years; 4.) IRS tax transcripts from prior years; and 5.) IRS form W-2 from prior years. The Rapid Reporting income verification in the file verifies the borrower's income for 2005 and 2006. IRS tax transcripts in the file further verify the borrower's income for 2005 and 2006. IRS form W-2 in the file verifies the borrower's income for 2006 and 2007. The 14-day paystub in the file is dated 2/22/08, and corresponds with evidence of several direct deposits into the borrower's account from her employer. As evidenced by the borrower's bank statements present in the file (pages 219-240 of the scanned file sent to OIG), these direct deposits from the borrower's employer were made on 2/8/08, 2/22/08 (corresponding to the 14-day paystub the examiner noted), 3/7/08, and 3/21/08, covering more than a 30-day period.
EXCESSIVE RATIOS AND COMPENS ATING	The borrower's conservative attitude toward credit was noted by the examiner as a compensating factor. Minimal increase in housing expense (less than 5%) is an additional compensating factor and should have been noted

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FACTORS	by the underwriter in the file. Reason for borrower default was noted as curtailment of borrower income.

Case Number	0950485724
Loan Purpose	Refinance
Date of Loan Closing	October 31, 2007
HUD OIG Audit Period	January 2010-May 2010

HUD OIG Summary

HUD OIG indicates material underwriting deficiencies relating to the borrower's income, excessive ratios, compensating factors and compensating factors

HUD OIG Findings Response

Comment 26

Income	There is an Employee Earnings Statement dated October 6, 2007. There are weekly paystubs (pay statements) dated 9/28/2007, 10/5/22007, 10/12/2007, and 10/19/2007. The borrower is an electrician and although there were job changes, there were no gaps in employment over the previous 28 months. The borrower was employed with one employer from 7/2002 through 2/2005. There was only one gap in employment from 2002 through 2007. The underwriter compared an average of the borrower's income for 2006 and 2007 (year-to-date) to the average earnings for 2007 and used the more conservative income figure to qualify the borrower. One Verification of Employment (VOE) indicated that it was an economic layoff. The borrower had

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Comment 27

	been with the employer for one month and immediately found new employment. One VOE indicated that the borrower was dissatisfied with work arrangements; however, the borrower had no gaps between employers. There were no negative comments or other comments from any of the previous employers. Income and employment was documented for the years 2002 through 2007.
Excessive Ratios and Compensating Factors	The underwriter conservatively calculated income. Recalculating an average of 2006 and 2007 income results in a ratio of 41%. The borrower's monthly housing expense prior to refinance was $2,322 (1st and 2nd mortgage payments, taxes and insurance, MIP).The refinance reduced the total monthly payment by $556. In addition, installment and revolving debt was paid in full, reducing consumer monthly debt payments by $535. The consumer debt consisted of one auto loan and one credit card. The borrower had no other outstanding credit other than the mortgages. The borrower demonstrated the ability to maintain a higher payment and debt level on the previous mortgage and consumer debt of over $1,000. The representative credit score for the borrower was 751, indicating an excellent credit history and the ability to manage debt. Based upon these factors, the ability to repay the loan was demonstrated and documented.

Case Number	052-3849541

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Loan Purpose	Refinance
Date of Loan Closing	March 31, 2006
HUD OIG Audit Period	January 2010-May 2010
<u>HUD OIG Summary</u> HUD OIG indicates material underwriting deficiencies relating to the borrower's liabilities, excessive ratios, and compensating factors.	
HUD OIG Findings Response	
Liabilities	While the underwriter excluded a deferred student loan with a monthly payment of $75.00, a separate liability (Think FCU) with a balance of $834 (on the credit report) and a payment of $155 was included. The balance on the credit report was reflected as $834; however, 3 payments would be made by the first payment date of the mortgage, leaving a remaining balance of approximately $369. The credit report was dated 1/26/2006, the loan closed March 31, 2006, and the first payment was due May 1, 2006. This liability had approximately 2 payments remaining. The underwriter could have excluded this liability and included the $75 monthly payment for the student loan, resulting in a debt ratio of 43.01%. However, the

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	underwriter used the more conservative approach and included the $155 payment. Since the student loan was deferred, the payment would not have had an impact on the borrower's ability to pay the mortgage during the early months following loan settlement, even if it was not deferred for greater than 12 months, due to the payoff of the liability with a payment amount of $155. The borrower made 25 payments prior to the first default.
Excessive Ratios and Compensating Factors	The payment on the borrower's existing first mortgage was $1,209 (PI), and the payment on the second mortgage was $177, per the credit report. The borrower's total monthly payment prior to the refinance was approximately $1,551 and the new payment was $1,449. The loan being refinanced was an adjustable rate mortgage and the new loan was a fixed rate mortgage, providing a net tangible benefit to the borrower. As recalculated, the borrower's debt ratio was 43.01%. FHA does not require cash reserves; however, the borrower did have a 401(k) account reflecting contributions of $4,811.94 and a balance of $5,094.59. A 401(k) account

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	is a savings plan and documents the ability to accumulate savings. The borrower is an architect by profession and his earnings reflect increasing income and advancement through employment (employer) changes. The borrower changed employers resulting in an annual increase of $11,178 and also received an incentive signing bonus with the new employer in the amount of $2,000. The borrower's payment history for the first and second mortgages were rated as agreed for 28 and 26 months, respectively. The borrower's housing expense debt ratio minimally exceeds 31% and the overall debt ratio is within guidelines, as recalculated. The file does include compensating factors based on payment history, documentation of a savings plan, and the potential for professional advancement and increased earnings.

Case Number	0936106930
Loan Purpose	Refinance
Date of Loan Closing	April 6, 2007

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HUD OIG Audit Period	January 2010-May 2010
<u>HUD OIG Summary</u> HUD OIG indicates material underwriting deficiencies relating to the borrower's income, liabilities, excessive ratios, compensating factors and credit.	
HUD OIG Findings Response	
Income	There is an electronic verification of employment obtained via The Work Number reflecting employment of 9 years and 2 months as a claims adjuster with USAA group. Electronic verification via the Work Number is acceptable to FHA. The borrower's paystubs reflect regular pay, premium pay, and a performance bonus of $5,523.00. The Work Number VOE reflects the borrower's employment status as "active". Based upon this information, the borrower's stable employment and earnings would be expected to continue.
Liabilities	There is a credit report update dated March 19, 2007 indicating that the liability reflecting a balance of $4471 with monthly payments of $143 was closed 12/2004 and the account has a zero balance. Based upon this information, there was not a recurring liability and it was appropriately excluded from the debt ratio calculation.
Excessive Ratios and Compensating Factors	The borrower's VOE, W2's for 2005 and 2006, and year-to-date paystub reflect overtime and bonus earnings. Recalculating the income based upon an average of the earnings for 2005

Comment 29

Comment 30

Comment 30

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	of $52,116.46, 2006 of $53,044.70 and year-to-date 2007 of $13, 788.79 , results in a monthly average income of $4,664.70. Given the history of employment and documentation reflecting overtime premiums and performance bonuses, the income would be expected to continue at this level. The W2s reflect year-over-year increases in earnings. Recalculation of the debt ratios based on average income earnings results in ratios of 30.50% and 41.41%. The underwriter's comment regarding $125 monthly savings was meant to indicate the dollar amount of the monthly debt reduction (revolving) due to payoff of some consumer debt. The previous mortgage payment was $1,284 (PI) and the new mortgage payment is $1,040 (PI), resulting in a monthly payment reduction of $244. The borrower paid a higher mortgage payment with zero late payments for the previous 14 months which is a compensating factor. The reason for default on the subject loan record was reflected as "marital problems".
Credit	The charge off for $12,318 was included in a bankruptcy that was discharged in 2000, and is listed on the bankruptcy documents. There are three medical collections dated 5/2001 reflected, however, these reflect duplicate information and it is one account. The credit report states that the name on the account is unknown. The balance reflected as of 8/2002 is

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	$62. There is one additional medical collection with a balance of $55 dated 12/2005. It is unclear if this is the same collection and sold to another collection agency. There is a paid collection with Hollywood Video for $62 dated in 2002 and a Beneficial account that was included in the bankruptcy (last activity 5/2000). The collections originated shortly after the bankruptcy and are related to the same period of time. There was a 30 day late on a JC Penney account with a balance of $857 in 1/2007 for $44. There is also a charge account with a balance of $510 and a payment of $15 reflecting 2X30 in 2/2004. These accounts total $1,367 and were current. The previous bankruptcy and derogatory credit occurred in a previous marriage, and the spouse involved in the bankruptcy is deceased.

	052-4174471
Loan Purpose	Purchase
Date of Loan Closing	August 29, 2007
HUD OIG Audit Period	January 2010- May 2010
Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's excessive ratios, compensating factors, gift funds, and credit.	
RESPONSE TO HUD OIG FINDINGS	
EXCESSIVE	The underwriter's rationale was that there was minimal

RATIOS AND COMPENSATING FACTORS	increase in the borrower's housing expense (10% or less), and that the borrower had the potential for salary increases, as indicated by increases in pay from 2005 – 2007. The borrower also had child support income, which was in the underwriter's notes but should have been better documented by the underwriter in the file. These are all additional, positive compensating factors.
GIFT FUNDS	Gift funds were documented in the file. Pages 246-249 of the scanned loan file submitted to OIG contain the gift letter of the nationally well-known nonprofit downpayment assistance program, Ameridercam, which was an acceptable form of gift funds to HUD/FHA at the time the loan was underwritten. The gift funds from Ameridream are also shown on the certified copy of the HUD-1 settlement statement (page 37 of the scanned loan file submitted to OIG), verifying the actual deposit at escrow.
CREDIT	The $326 collection account from Sprint PCS was not considered by the underwriter because it was reported meeting FCRA requirements on the credit report as being disputed by the consumer. The $151 was a medical collection that occurred in March, 2004 (3.5 years before the loan was underwritten). Due to the age, size and nature of the collection, the underwriter considered it a minor, immaterial collection and therefore did not consider it.

Comment 31

Comment 31

Comment 31

Case Number	052-4197834
Loan Purpose	Purchase
Date of Loan Closing	October 29, 2007
HUD OIG Audit Period	January 2010- May 2010

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Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's gift funds and credit.	
RESPONSE TO HUD OIG FINDINGS	
GIFT FUNDS	Gift funds were documented in the file. A gift letter from nationally well-known nonprofit downpayment assistance program, "The Nehemiah Corporation", which was an acceptable form of gift funds to HUD/FHA at the time the loan was underwritten, evidences gift funds in the amount of $14,537.97 to the borrower for the purchase of the subject property. The gift funds from The Nehemiah Corporation are also shown on line 204 of the certified copy of the HUD-1 settlement statement, verifying the actual deposit of $14,537.97 at escrow.
CREDIT	The underwriter's rationale for not considering the below mentioned collection accounts is that each account fell into the category of immaterial or inaccurate due to either its age, size, nature, or a combination of the three. In the borrower's letter of explanation regarding the collection accounts, she indicated that, in addition to disputing the significantly aged collection accounts, she had health insurance through her employer of 13 years (Oracle) and therefore did not understand how she could have any valid medical collections; her medical insurance coverage would have covered any such expenses. The non-medical collections were significantly aged (6 years before the loan was underwritten) and the borrower had a plausible explanation for each one. The borrower's paystubs evidence the medical benefits from Oracle, and it is logical that the borrower would have such benefits for the majority of the 13 years employed.

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Comment 32

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	The collection in the amount of $348 from Xcel Energy was opened in November, 2001 (6 years before the loan was underwritten). Due to its age and size, combined with the borrower's explanation that she had experienced no issues or service interruption with Xcel Energy due to any such collection over the past 6 years, the underwriter considered this to be a minor, immaterial collection and therefore did not consider it. The collection in the amount of $86 from Dish Network was opened in June, 2001 (over 6 years before the loan underwritten). Due to its age and size, the underwriter considered this to be a minor, immaterial collection and therefore did not consider it. The collection in the amount of $89 from Quest Diagnostics was opened in April, 2002 (5 ½ years before the loan was underwritten). Due to its age, size, and nature (medical; the borrower had health insurance through her employer), the underwriter considered this to be a minor, immaterial collection and therefore did not consider it. The collection in the amount of $82 from Century Services is also a medical collection opened in February, 2003 (over 4 years before the loan was underwritten). Due to its age, size, and nature (medical; the borrower had health insurance through her employer), the underwriter considered this to be a minor, immaterial collection and therefore did not consider it. The medical collection in the amount of $5,429 was opened in

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	August, 2005 (over 2 years before the loan was underwritten). Due to its age and nature (medical; the borrower had health insurance through her employer), the underwriter did not consider it. Lastly, the reason for default on the loan was listed as "excessive obligations"; yet the borrower's mortgage payment-to income and total debt-to-income ratios were both 28.27% which were within FHA guidelines of 31% and 43%, respectively.

Case Number	023-2397348
Loan Purpose	Refinance
Date of Loan Closing	October 16, 2006
HUD OIG Audit Period	January 2010-May 2010
HUD OIG Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's qualifying ratios and compensating factors.	
HUD OIG Findings Response	
Excessive Ratios and Compensating Factors	The credit report reflects six medical collection accounts (for the spouse) in the amounts of $125, $101, $75, $35, $250, and $211. These accounts were duplicated on the credit report many times. The credit report also indicates that the account information was in dispute and met FCRA requirements. There was a paid education loan (collection) dated August 2001 (five years previous to the

Comment 33

	subject transaction) for the spouse. There were no derogatory trade lines, with the oldest trade line dating back to 1995. The credit report reflects many closed trade lines, auto loans and previous mortgages, all paid as agreed. The loan application did not list assets and assets were not verified (refinance transaction not requiring cash to the loan). We cannot state that the borrower had no ability to accumulate savings since there were no accounts statements upon which to make such a determination. The borrowers' total mortgage payment prior to this refinance was incorrectly reflected as $1,471; however, this figure did not include taxes, insurance or HOA dues. The payment with taxes, insurance and HOA dues was approximately $1,673.00. The new total payment was $1,717, resulting in an increase in the total monthly payment in the amount of $44. The purpose of the refinance transaction was to payoff first and second lien mortgage loans that were at a higher rate of interest; and to obtain cash to purchase an auto. The primary borrower is a technology consultant and had been with his employer, Avnet, for five years and 10 months. Avnet, founded in 1921, is one of the world's largest trans-national distributors of electronic parts, enterprise computing and storage products

	and embedded subsystems. The borrower is a technology consultant and the technology field provides many opportunities for advancement. Avnet has various internal training and internship programs for employees. The Verification of Employment reflects steadily increasing wage income with a salary for 2004 of $36,715; 2005 of $37,222; and 2006 of $44,699. The borrower's last wage increase was July 3, 2006 and the next wage increase was reflected as due in July 2007. The probability of continued employment was *"anticipated". The borrower's income did reflect steadily increasing income and the opportunity for advancement.* The underwriter also considered the equity of 10% in the subject property as a compensating factor. This rationale was appropriate based upon the fact that the subject transaction was a refinance and FHA considers a 10% down payment in a purchase transaction to be a compensating factor.

Case Number	052-4152809
Loan Purpose	Purchase
Date of Loan Closing	August 13, 2007
HUD OIG Audit Period	January 2010-May 2010

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HUD OIG Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's income.	
HUD OIG Findings Response	
Income	An electronic verification of employment was obtained from The Work Number (reference number 341742990) reflecting that the borrower had been employed with Quest Diagnostics for 5 years and 1 month as a phlebotomist. The borrower's paystubs are from Quest Diagnostics and include an employee identification number (vs. a social security number), along with other identifying information. The paystubs are computer-generated, and Quest Diagnostics is a well know laboratory. There is a 2006 W2 from Quest Diagnostics reflecting wages of $30, 226.14; and an IRS letter along with a copy of a tax transcript obtained from the IRS for the year 2005, reflecting adjusted gross income of $28,330. FHA will consider all documents submitted in the case binder as the certified and true copies of the original documents. FHA does not require the lender to stamp or otherwise mark that the documents in the case binder are certified and true copies, nor submit any separate certification for the documents. The lender may submit in the case binder photocopies of the original documents or printed copies of imaged or electronic documents. The appropriate income documentation was obtained - Electronic Verification of Employment (acceptable to FHA), paystubs covering one month, previous W2, and IRS verification of W2 income.

Comment 34

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ASSURITY FINANCIAL SERVICES

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Case Number	0945402355
Loan Purpose	Purchase
Date of Loan Closing	April 9, 2008
HUD OIG Audit Period	January 2010-May 2010

HUD OIG Summary
HUD OIG indicates material underwriting deficiencies relating to the borrower's income, liabilities, excessive ratios, compensating factors and credit.

HUD OIG Findings Response	
Liabilities	The credit report reflects a revolving account with a balance of $105 and a monthly payment of $20. The underwriter calculated a minimum payment for this account, however, the inclusion or exclusion of this payment has minimal impact on the borrower's qualifying ratios. The underwriter calculated the rental income by reducing it by 25% and subtracting the PITI. This is reflected on the Mortgage Credit Analysis Worksheet; however, a mathematical error was made in the calculation.
Excessive Ratios and Compensating Factors	The borrower is retired and receives pension and social security income of $5,374 (net) per month. Using this figure (not grossed up), the borrower's residual income after all payments is $2,568 per month, which represents sufficient disposable income to offset the debt ratio. This was considered along with the borrower's ability to manage debt.

Comment 35

Comment 36

Case Number	052-4159366

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Comment 37

Loan Purpose	Refinance
Date of Loan Closing	September 28, 2007
HUD OIG Audit Period	January 2010-May 2010
HUD OIG Summary HUD OIG indicates material underwriting deficiencies relating to the borrower's income.	
HUD OIG Findings Response	
Excessive Ratios and Compensating Factors	The 2006 Federal Income Tax Return (Form 1040) reflects a loss of $4,658 on Schedule C; however, this is attributed to the borrower's husband's business "Gypsy's Cove". The borrower's spouse is not a co-borrower on the subject loan. The 2005 Tax Return (Form 1040) reflects a loss on Schedule C of $4,596 which is also attributed to the husband's business. The borrower's income is received from Spectra Services and is reflected on Schedule E of the 2006 and 2005 Federal Tax Returns (Form 1040), as well as Form 1120S. The tax returns and the profit and loss statement reflect year-over-year increased earnings. The first mortgage payment remained at the same level with this refinance; and the borrower's overall debts were reduced by payoff of liabilities in the amount of $29, 745.00, resulting in a reduction in monthly liabilities of $730.

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OIG's Evaluation of Lender Comments

Comment 1 Assurity disagrees with our recommendations. The fact remains that underwriting lapses did occur that should have affected the insurability of eight loans. We did not change our recommendations because the recommendations are appropriate based on the issues cited in the memorandum. Violations of FHA rules are subject to civil and administrative action. Title 31, United States Code, section 3801, "Program Fraud Civil Remedies Act of 1986," provides federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy to recompense such agencies for losses resulting from such claims and statements; to permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and to deter the making, presenting, and submitting of such claims and statements in the future.

Comment 2 Assurity asserts the principals had no way of knowing the eight loans (reduced from 13, see comments 18-37) contained deficiencies. The memorandum does not make any assertion that the principals had knowledge or should have had knowledge of underwriting deficiencies. The review specifically focuses and identifies eight loans with significant underwriting deficiencies. The recommendations were created as corrective action for a lack of due diligence when underwriting the specified loans.

Comment 3 Assurity states the OIG would set a precedent in this case by transferring liability for credit decisions from the company to its principals and shareholders, with significant negative results. We recommend that HUD determine the legal sufficiency for pursuing remedies under the Program Fraud Civil Remedies Act against Assurity and/or its principals for incorrect certifications, and take appropriate administrative action.

Comment 4 Assurity questions the basis for OIG's conclusions. The review identified 8 out of 20 loans with significant underwriting deficiencies and was appropriately reported as such. As stated in the report, the review work was completed according to generally accepted government auditing standards (GAGAS), see also comment 7. The scope was limited to identify underwriting deficiencies at lenders with high rates of default, based on a review of the loan files. Our targeted efforts and analysis were appropriate and fulfilled our review objectives. The limited scope does not take away from our conclusion that deficiencies should have been identified and/or explained by the underwriter and should have precluded FHA loan approval.

Comment 5 Assurity questions the materiality of OIG's findings, based on its overall loan portfolio. As stated in its response, Assurity's older portfolio did underperform. Our review focused on the time period between November 1, 2007 and October 31, 2009 due to risk factors indicating a higher rate of default and claim. The findings in the memorandum are limited to the eight loans identified with

significant underwriting deficiencies. Assurity's attempt to minimize the review results based on materiality does not take away from the fact that significant underwriting deficiencies were identified due to a lack of due diligence. The findings in the memorandum focuses on the 20 loans reviewed, regardless of the percentage those loans represent of Assurity's total loan production. The recommendations are focused squarely on eight loans and are intended to provide corrective actions in regards to those loans only.

Comment 6 Assurity questions the review methodology. We disagree, as the loan sample was not intended to be statistical or random. Our sample was the result of targeted analysis to specifically identify loans that are high risk and had gone into claim status. Our review does not project results to Assurity's universe of FHA loans, and limits conclusions to the eight FHA loans identified as having significant underwriting deficiencies. Nowhere in the memorandum are the findings referred to as systemic.

Comment 7 Assurity questions OIG's assertion that GAGAS was followed with the specific exceptions disclosed. As required by Government Auditing Standards, chapter 1.12(b) and 1.13, the report clearly states the applicable requirement(s) not followed, the reasons for not following the requirement(s), and how not following the requirements affected, or could have affected, the audit. The scope and methodology section of the report addresses all required aspects.

Comment 8 Assurity takes issue with the press release and conference call announcing OIG's initiative. The HUD press release on January 12, 2010 does not make any accusations or presumptions of fraud. Specifically, Inspector General Donohue stated, "The goal of this initiative is to determine why there is such a high rate of defaults and claims with these companies and whether there is wrongdoing involved." The main objective was to identify high risk loans that had failed and determine the reason for failure. Government Auditing Standards, chapter 7.30 states that in planning the audit, auditors should assess risks of fraud occurring that is significant within the context of the audit objectives. The detection and investigation of fraud is and always will be an objective of OIG audits and reviews.

Comment 9 Assurity questions the loan sample used. The review focused on a recent two year period between November 1, 2007 and October 31, 2009. All lenders were compared using the same period and selection criteria. The 20 Assurity loans selected, whether from an older portfolio, represents a period with a high rate of default and claim. Regardless of when the loans were underwritten, they should have been properly underwritten in accordance with HUD requirements.

Comment 10 Assurity states previous reviews and audits have not found material deficiencies. This OIG review is independent of all other reviews. Our objective was to review failed FHA loans and identify the root causes for

failure. The subject review identified loans with significant underwriting deficiencies.

Comment 11 Assurity disagrees with the FHA termination date. The report has been amended to show Assurity ceased lending operations on February 26, 2010 and therefore, did not renew its FHA approval as of March 30, 2010.

Comment 12 Assurity asserts internal controls were adequate and questions the basis of OIG's findings. As stated in the scope and methodology section of the memorandum, internal controls were not reviewed due to the limited scope and specific review of the underwriting of 20 targeted loans. See also comments 4 and 6.

Comment 13 The discussion of HUD's ability to collect up-front mortgage insurance premiums has no bearing on our findings and is not material to the issues identified.

Comment 14 Assurity requests HUD/FHA not pursue remedies or enforcement actions against the company and/or its principals for the multiple reasons in its response. We considered the information provided in Assurity's response and have reduced the number of loans with significant deficiencies from 13 to eight. However, the eight loans still present significant underwriting deficiencies that were caused by a lack of due diligence. See also comments 1 and 2.

Comment 15 Assurity questions the method of audit notification and attributes the publicity at the outset of our review with causing irreparable harm that lead to the company's failure. Our review was part of a national initiative targeted at identifying lenders with high rates of default and claim and FHA loans carrying high risk underwriting decisions. The press release and conference call on January 12, 2010 did not make accusations or presumptions of fraud; rather, facts were presented indicating an increasing risk to the FHA insurance fund based on high rates of claim and default. See also comment 8.

Comment 16 Assurity presented historical data on how it received its approval to originate FHA loans. We obtained the March 31, 2002 authorized date from HUD's publicly available Neighborhood Watch system, which did not disclose the detailed information stated by Assurity. After further research, we revised the Background section to clarify that Assurity was approved as a nonsupervised mortgage lender and could begin underwriting FHA loans under HUD's direct endorsement program on May 20, 2005. Although the information provided does serve as background data, it is not material to the underwriting deficiencies and lack of due diligence illustrated in the audit memorandum. The 20 Assurity loans we reviewed were endorsed by the FHA between 2006 and 2008. See also comment 10.

Comment 17 Assurity comments that a material fact germane to any discussion of the background of the FHA today is the recent decline in the FHA's capital reserve level. The decline was caused by the high rate of claims among FHA loans. As mentioned in comment 8, the goal of the OIG's initiative is to determine why there is such a high rate of defaults and claims.

Comment 18 For loan number 095-0539086, we disagree with Assurity's analysis on liabilities. According to the URLA, the monthly mortgage payment was reduced from $2,803 to $2,611, a reduction of only $192, not the $746 reduction stated by Assurity.

While we agree the borrower's debt was paid off prior to closing, it does not indicate the borrower's ability to manage debt. To the contrary, the debts paid off included two collection accounts and one derogatory account. Additionally, the lender failed to obtain explanation letters for the three derogatory accounts.

While only two payments remained of $458, it was significant enough to include because of the high dollar amount to be paid, the borrower's past derogatory credit, the slight reduction in the mortgage payment, and the lack of cash reserves. The $10,000 referenced by Assurity is from the refinance transaction and cannot be considered as cash reserves (HUD Handbook 4155.1 REV-5, chapter 2, paragraph 2-13(F)). Nothing in the loan file indicates the borrower's ability to handle a higher debt level.

Comment 19 For loan number 095-0539086, we disagree with Assurity's analysis on excessive ratios and compensating factors. While Assurity claims the original mortgage amount listed does not include taxes and insurance, documentation proving otherwise was not provided. Current housing expenses are listed as $2,803 on the URLA and FHA Connection application. Based on the documentation reviewed, our analysis stands.

As stated by Assurity, employment stability is not a valid compensating factor. We found only one compensating factor, which was not significant enough to overcome excessive qualifying ratios of 34.89 and 50.47 percent.

Comment 20 For loan number 095-0539086, we agree with Assurity's analysis on credit. We agree that the two collection accounts were paid off at closing, as evidenced by the settlement statement. The report has been updated accordingly. However, the loan file did not contain the required letters of explanation for the two collection accounts.

Comment 21 For loan number 023-2343260, we disagree with Assurity's analysis on income. Assurity should have considered the large decrease in overtime over the first quarter of 2006. Such a large decline from a quarterly average of $3,178 in 2005 to only $407 in the first quarter of 2006 is significant enough to warrant consideration. It is not reasonable to include overtime of the past two years if

there is such a large decline in the current and most important period. As noted by Assurity, a letter of explanation should have been obtained detailing the decrease in overtime earnings for the first quarter of 2006. Regardless of the financial position of the employer, a large decline in overtime earnings is significant and warrants consideration and documentation of analysis by the lender.

Comment 22 For loan number 023-2343260, we disagree with Assurity's analysis on credit. Combined, the derogatory credit, lack of explanation and analysis for collection accounts and inquires, and the recent second mortgage of $60,000 without adequate explanation indicates the lender did not complete a thorough and complete mortgage credit analysis.

To focus only on the three accounts that were paid as agreed is misleading and takes away the significance of analyzing credit where derogatory credit is involved. Although three of the collection accounts occurred more than two years prior to closing, the lender still failed to obtain an explanation for each collection account. However, the most significant account is the $9,139 auto loan charge-off, which occurred within a year of loan closing. FHA mortgage credit analysis is independent of the analysis other lenders on separate transactions may have performed in the past. Our analysis indicates a disregard for credit, evidenced by multiple collection accounts and a current high outstanding balance of $31,343 for three accounts. Having multiple derogatory accounts requires strong compensating factors and analysis from the lender, both which were absent.

As stated by Assurity, a letter of explanation for inquiries was not obtained. Regardless of the make-up of the inquiries, the lender is responsible for obtaining a letter of explanation for recent inquiries.

Comment 23 For loan number 023-2343260, we disagree with Assurity's analysis on excessive ratios and compensating factors. Neither the loan file or the Assurity response contain any documentation showing the $60,000 second mortgage obtained within a month of closing was used to pay off any outstanding debt. HUD Handbook 4155.1 Rev. 5, Chapter 2, Section 2-3 states, "The lender must ascertain the purpose of any recent debts…" The credit report ordered March 20, 2006 does not show the second mortgage listed in the URLA with a balance of $63,931 (the number of monthly payments remaining is not shown on the URLA).

According to the URLA, the borrower's mortgage payment actually went from $976 to $1,474, an increase of $498. Neither the loan file or the Assurity response contain documentation showing the second mortgage obtained within a month of closing was used to pay off any outstanding debt. Therefore, the revolving debt of $317 was appropriately included in the calculation of qualifying ratios.

The equity of 10 percent in the subject property from the refinance is not a valid compensating factor. The loan is a refinance transaction and, therefore does not include a downpayment. The compensating factor cited by Assurity only applies to a purchase transaction, HUD Handbook 4155.1, REV-5, paragraph 2-13(B). Although the potential for increased wages is a valid compensating factor, the loan file did not indicate this is the situation. The VOE shows a decrease in overtime earnings and the borrower's last pay increase, within a month of closing, to be only $0.40 per hour. There is nothing in the loan file that would have indicated the potential for increased earnings to lend itself as a compensating factor.

Comment 24 For loan number 052-4311569, we disagree with Assurity's analysis on income. We do not disagree with the way the lender has described how the underwriter documented the borrower's income. However, it continues to fall short of meeting required documentation standards for employment verification. The significance of employment verification is to verify the employer, earnings, stability, and likelihood of continuance. None of the documents provided verify stability or likelihood of continuance. Of the five documents provided by Assurity, only one (IRS W-2s for years 2005, 2006, and 2007) satisfies alternative documentation standards. However, no W-2 was provided for the current employer. The paystub did not cover a 30 day period. The bank statements are not a valid source of employment verification. The Rapid Reporting statement is no different than an IRS W-2 and is not a valid source of employment verification. The IRS tax transcripts, again, are no different than an IRS W-2.

Comment 25 For loan number 052-4311569, we disagree with Assurity's analysis on excessive ratios and compensating factors. The MCAW does not list any compensating factors, as required. The borrower's conservative attitude toward credit was identified in the report as a compensating factor. However, it was determined to be insufficient to overcome the excessive qualifying ratios, especially considering the borrower's volatile previous employment history.

We agree there was a minimal increase in the housing expense. The report has been revised to show it is a valid compensating factor. However, this does not change our decision. The lender failed to identify compensating factors on the MCAW. Even with two compensating factors, the loan should still not have received FHA loan approval due to the borrower's unstable previous employment and the significant lack of employment verification as discussed above.

Comment 26 For loan number 095-0485724, we disagree with Assurity's analysis on income. We agree with Assurity in that paystubs as stated were in fact provided in the loan file and the report has been updated accordingly. However, the loan file still exhibits inconsistencies that should have been cleared by the lender. The VOE for the current employer does not state the probability of continued

employment. Between June 20, 2005 and loan closing, the borrower held four different jobs, indicating job instability. An adequate explanation was not provided. There were W-2s for previous employer AFC for 2005 and 2006, however, the VOE indicates the borrower worked for AFC from December 1, 2006 through August 6, 2007.

Further analysis indicates the lender failed to properly calculate the borrower's income. Due to the borrower's inconsistent employment history, current earnings evidenced by the pay stubs and not previous earnings should have been used for qualification. As stated by Assurity, average earnings were used to calculate income, which includes earnings from previous employment. The lender should have used the $18 hourly rate of the current employer as listed in the four paystubs in the loan file. Although the VOE for the current employer states an average of 30.25 hours per week, we used a conservative work week of 40 hours to reflect hours illustrated in the paystubs. We determined monthly earnings of $3,120 ($18/hour x 40 hours x 52 weeks divided by 12 months), a difference of $519 from the $3,639 used on the MCAW.

Comment 27 For loan number 095-0485724, we disagree with Assurity's analysis on excessive ratios and compensating factors. Using the appropriately OIG recalculated income above, the mortgage payment-to-income and total fixed payment-to-income ratios are 56.61 percent, significantly excessive. As stated in the memorandum, only one compensating factor exists, the borrower's clean mortgage history, which is clearly not sufficient to overcome significantly excessive qualifying ratios.

Comment 28 For loan number 052-3849541, we agree with Assurity's analysis on liabilities. We agree with Assurity's analysis regarding the $834 liability. The loan has been removed from the memorandum, dropping the total loans identified with significant underwriting deficiencies to eight. Removal of the $155 monthly payment from the total fixed-to-income ratio results in a ratio of 43 percent, within acceptable limits. However, exclusion of the student loan is still inappropriate given the lack of documentation and continues to represent an underwriting deficiency.

Comment 29 For loan number 093-6106930, we agree with Assurity's analysis on income. We agree with Assurity's assessment citing the online verification as an adequate VOE. HUD Handbook 4155.1 REV-5, Chapter 3, Section 3-1 states the VOE may be faxed documents or printed pages from the Internet if they clearly identify their sources (e.g., contain the names of the borrower's employer). Therefore, this segment of the finding has been removed from the memorandum.

Comment 30 For loan number 093-6106930, we agree with Assurity's analysis on liabilities. We accept Assurity's assessment of the updated credit report. The recurring liability was appropriately excluded from qualifying ratio calculations. The

result is a total fixed payment-to-income ratio of 43.71 percent, not materially excessive. Therefore, the loan has been removed from the memorandum report and associated appendix. However, the loan still presents underwriting deficiencies of failing to explain the payment of debt and failing to obtain letters of explanation for derogatory credit accounts.

Comment 31 For loan number 052-4174471, after additional analysis, we determined the excessive mortgage payment-to-income ratio of 35.89 percent is not material because the total fixed payment-to-income ratio of 39.09 is four percent below the acceptable limit. Therefore, the loan has been removed from the report and associated appendix, dropping the total loans identified with significant underwriting deficiencies to eight. However, the loan still presents underwriting deficiencies in the areas of a lack of compensating factors for the excessive mortgage payment-to-income ratio, unexplained collection accounts and inadequately documented gift funds.

Comment 32 For loan number 052-4197834, we disagree with Assurity's conclusion that gift funds were adequately documented in the file. However, after further analysis, we determined the mortgage payment-to-income ratio and total fixed payment-to-income ratio of 28.27 were well within acceptable limits of 31 and 43 percent, respectively. Therefore, the loan has been removed from the memorandum report and associated appendix. However, the loan still presents underwriting deficiencies in the areas of unexplained collection accounts with a significant balance of $6,034 and inadequately documented gift funds.

Comment 33 For loan number 023-2397348, we disagree with Assurity's analysis on excessive ratios and compensating factors. Although the $125 and $35 collections appear repetitious, Assurity failed to obtain or provide documentation showing the numerous collection accounts were duplicates.

After further analysis, the borrower's conservative attitude towards credit could be a valid compensating factor. The appendix has been updated accordingly. However, it is still not considered a compensating factor because the HUD Handbook 4155.1, REV-5, paragraph 2-13(C) requirement states "the borrower has demonstrated an ability to accumulate savings and a conservative attitude toward the use of credit." Both factors must be present. The report states the borrowers did not demonstrate the ability to accumulate savings because of the lack of supporting asset documentation, agreed to by Assurity in its response. Therefore, this is not a valid compensating factor.

We disagree with Assurity's assessment of the borrower's housing expenses. The URLA shows the then current housing expense as $1,471 and the new housing expense as $1,717. The credit explanation letter provided by the borrower also stated that it was their understanding the housing expenses were increasing $223, from $1,471 to $1,717. Assurity did not provide additional documentation to indicate otherwise.

We disagree with Assurity's assessment of the borrower's potential future earnings. Although training opportunities could be present at the borrower's employer, the loan file does not contain documentation indicating enrollment or future enrollment. While the VOE does indicate a previous increase of three percent and a projected unknown increase in July 2007, this appears to be an annual wage increase and not reflective of a significant pay increase. Based on the documentation in the loan file, there is no evidence of the borrower's potential for increased earnings through job training or education. We disagree that 10 percent equity is an appropriate compensating factor. The loan is a refinance transaction and, therefore does not include a downpayment. The compensating factor cited by Assurity only applies to a purchase transaction, HUD Handbook 4155.1, REV-5, paragraph 2-13(B).

Comment 34 For loan number 052-4152809, we agree with Assurity's analysis on income, citing the online verification as an acceptable VOE, acceptable paystubs and W-2s. HUD Handbook 4155.1 REV-5, Chapter 3, Section 3-1 states the VOE may be faxed documents or printed pages from the Internet if they clearly identify their sources (e.g., contain the names of the borrower's employer). The qualifying ratios of 28.37 and 39.05 percent are within acceptable limits. Therefore, the loan has been removed from the memorandum report and associated appendix.

Comment 35 For loan number 094-5402355, Assurity has agreed with our position and stated the rental income was calculated incorrectly. Therefore, no changes were made to the memorandum or associated appendix.

Comment 36 For loan number 094-5402355, we disagree with Assurity's assessment of excessive ratios and compensating factors. The borrower'disposable income can only be considered a compensating factor if it is documented the borrower has the ability to accumulate savings and/or significant cash reserves as a result of the disposable income (HUD Handbook 4155.1 REV-1, chapter 2, paragraph 2-13(C) and 2-13(G)). The loan file did not contain documentation illustrating either compensating factor.

Comment 37 For loan number 052-4159366, we disagree with Assurity's assessment of excessive ratios and compensating factors. While we agree the 2005 and 2006 tax returns indicate increased year-over-year earnings, we conclude this is not a valid compensating factor. The loan file does not include any documentation to show the potential for increased earnings indicated by job training or education in the borrower's profession, as required by HUD Handbook 4155.1, REV-5, paragraph 2-13(I).

Assurity discussed the borrower's mortgage payment remaining at the same level with the refinance. We acknowledged in the report that no late mortgage payments satisfied the compensating factor requirement of successfully demonstrating the ability to pay housing expenses equal to or greater than the

proposed monthly housing expense for the new mortgage. However, this compensating factor is not sufficient to overcome significantly excessive qualifying ratios of 37.70 and 51.38 percent.

We disagree with Assurity's assessment on the reduction of debt as a compensating factor. According to the HUD-1 and the credit report, the

borrower only paid off $9,745 in debts, reducing the recurring liabilities by $408. However, $21,195 was still outstanding with a recurring liability of $659. The $659 was appropriately included in the calculation of the total fixed payment-to-debt ratio. The payoff of debts and total reduction of liabilities is not a valid compensating factor as this was incorporated into the calculation of the total fixed payment-to-income ratio which resulted in a significantly excessive percentage of 51.38 percent.

Comment 38 Assurity questions the basis of not adhering to all GAGAS requirements. We disagree as our review objective was the basis for the limited scope and the appropriate decision to target our review efforts on a review of underwriting and specific loan files. Our review was focused on underwriting and the associated risks to the FHA insurance program. It was not necessary to adhere to all aspects of GAGAS to accomplish our objective and maintain a complete and accurate reporting product. See also comment 7.