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TO: Charles S. Coulter, Deputy Assistant Secretary for Single Family Housing, HU
Dane Narode, Associate General Counsel for Program Enforcement, CACC
Tanya E. Schulze

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

SUBJECT: MetLife Bank's Scottsdale, AZ, Branch Office Did Not Follow FHA-Insured Loan Underwriting and Quality Control Requirements

HIGHLIGHTS

What We Audited and Why

We audited the Federal Housing Administration (FHA)-insured loan process at MetLife Bank's (lender) branch in Scottsdale, AZ, to determine whether the lender underwrote FHA-insured loans and implemented a quality control plan in accordance with U.S. Department of Housing and Urban Development (HUD) requirements. We selected the lender because it had an FHA default rate of 7.41 percent for loans underwritten in Arizona between April 1, 2009, and March 31, 2011, more than double the average for Arizona (3.47 percent). The majority of the lender's loans that were in default for Arizona were underwritten through its Scottsdale branch.

What We Found

The lender did not follow HUD regulations and requirements when underwriting FHA-insured loans. Specifically, 24 of the 30 loans reviewed contained underwriting deficiencies, with 14 of the 24 containing significant

underwriting deficiencies that impacted the insurability of the loan. In addition, the lender did not follow HUD's quality control requirements when performing site reviews and reviewing loan files.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require the lender to (1) indemnify HUD for 12 FHA-insured loans with an estimated potential loss of more than \$1 million, (2) reimburse the FHA insurance fund \$101,555 for actual losses on 2 loans, and (3) support or repay the FHA insurance fund \$16,490 for claims paid as of September 30, 2011, on 2 loans. In addition, we recommend that HUD's Associate General Counsel for Program Enforcement determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act (31 U.S.C. (United States Code) 3801-3812), civil money penalties (24 CFR (Code of Federal Regulations) 30.35), or both against the lender, its principals, or both for incorrectly certifying to the integrity of the data or that due diligence was not exercised during the underwriting of 14 loans that resulted in actual losses of \$101,555 on 2 loans, partial claims of \$16,490 on 2 loans, and potential losses of more than \$1 million on 12 loans for a total loss of more than \$1.2 million, which could result in affirmative civil enforcement action of approximately \$2.5 million.

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

Auditee's Response

We provided the lender a discussion draft report on December 14, 2011, and held an exit conference with lender officials on December 22, 2011. The lender provided written comments on January 9, 2012. It generally disagreed with the report.

The complete text of the lender's response, along with our evaluation of that response, can be found in appendix B of this report. The lender provided additional documentation with their response. We did not include this in the report because it was too voluminous; however, it is available upon request.

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BACKGROUND AND OBJECTIVE

The Federal Housing Administration (FHA) created by Congress in 1934 is the largest mortgage insurer in the world. The homeowners pay into the FHA insurance fund through mortgage insurance. The U.S. Department of Housing and Urban Development (HUD) uses these funds to operate the FHA insurance program, providing lenders with protection against losses as the result of homeowners defaulting on home mortgages. In fiscal year 2010, FHA insured more than 1.75 million single-family mortgages totaling more than \$316 billion.¹

Various sanctions exist that allow the HUD Homeownership Centers and FHA the flexibility to respond appropriately to any noncompliance action by a direct endorsement lender or other program participant. HUD Homeownership Centers insure single family FHA mortgages, assure FHA mortgage quality, help homeowners & homebuyers through effective housing counseling, & oversee the selling of HUD homes. The Homeownership Centers objectives include (1) reducing the risk of defaults and claims to FHA, (2) improve lender performance, and/or (3) remove non-complying lenders from the program. The Homeownership Centers and the Mortgagee Review Board may impose the following sanctions: lender probation, withdrawal of direct endorsement status, withdrawal of FHA approval, indemnification agreements, civil money penalties, and sanctions against individual program participants.

MetLife Bank (lender) is a supervised lender² approved April 5, 2007, to originate FHA loans. The lender originates loans under the lender insurance program, which allows lenders to self-insure FHA loans and submit only those case binders (paper or electronic) required for review by HUD. The lender underwrites loans through MetLife Home Loans, which is a division of MetLife Bank. The lender's home office is at 334 Madison Avenue, Convent Station, NJ, and it has 237 FHA-approved active branches³ in all 50 States. Between April 1, 2009, and March 31, 2011, the lender underwrote 65,925 FHA-insured loans.

The Scottsdale branch is one of the lender's regional wholesale branches. The wholesale branches coordinate the underwriting, and closing, and funding of mortgage loans originated by third-party mortgage brokers. The Scottsdale branch serviced loans for six States; however, the lender closed the branch after the audit started.

Our objective was to determine whether the lender underwrote FHA-insured loans and implemented a quality control plan in accordance with HUD requirements.

¹ HUD monthly report to the FHA Commissioner: FHA portfolio analysis data as of September 2011.

² A supervised lender is a HUD-FHA-approved financial institution that is a member of the Federal Reserve System or an institution the accounts of which are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

³ According to Neighborhood Watch as of October 28, 2011

RESULTS OF AUDIT

Finding 1: The Lender Did Not Underwrite FHA-Insured Loans in Accordance With HUD-FHA Requirements

The lender did not follow HUD-FHA regulations and requirements for underwriting FHA-insured loans. Specifically, 24 of the 30 loans reviewed contained underwriting deficiencies, with 14⁴ containing significant underwriting deficiencies that impacted the insurability of the loan. This noncompliance occurred because the underwriters did not exercise sound judgment and due diligence in underwriting FHA-insured loans. As a result, the lender caused HUD to pay more than \$118,000 in claims and incur losses of more than \$101,000. In addition, the FHA portfolio remained at risk for losses of approximately \$1.1 million for loans that did not meet HUD requirements.

14 Loan Files Contained Significant Underwriting Deficiencies

The detailed review of 30 FHA-insured loans identified 14 with significant underwriting deficiencies that included inadequate determination and documentation of borrower income, credit, and assets. HUD Handbook 4155.1 provides the requirements for underwriting FHA-insured loans including the evaluation of the borrower's capacity to repay the loan (income), credit history, and assets available to close the loan (see appendix D). The lender inappropriately approved 14 loans based on an inadequate determination and documentation of these factors.

The table below lists the 30 FHA loan numbers reviewed and the deficient areas associated with each loan. The table also identifies the 14 loans for which we concluded that the underwriting was significantly deficient and, therefore, warranted indemnification. Appendix E provides underwriting details for each FHA loan considered to have significant underwriting deficiencies.

⁴ A deficiency is considered significant when it affects the loan approval decision.

FHA loan number	Underwriting deficiencies				No underwriting deficiencies	Technical underwriting deficiencies	Significant underwriting deficiencies
	Income	Credit	Assets	Other			
022-2044367				✓		✓	
022-2050283	✓	✓					✓
022-2217731	✓						✓
023-3195204		✓				✓	
023-3289796	✓	✓	✓			✓	
023-3302437	✓	✓		✓			✓
022-3312197		✓	✓				✓
023-3321334		✓	✓				✓
023-3324330	✓					✓	
023-3376945		✓				✓	
023-3380559		✓	✓				✓
023-3402161					✓		
023-3437647					✓		
023-3485534		✓	✓				✓
023-3515200		✓	✓				✓
023-3515994	✓	✓	✓				✓
023-3551691	✓	✓	✓				✓
023-3591501		✓	✓			✓	
023-3633965		✓				✓	
023-3789597		✓	✓				✓
023-3795557					✓		
023-3877294					✓		
023-3921398					✓		
023-3928685			✓			✓	
023-3948891		✓	✓				✓
023-3964148					✓		
023-4016633	✓					✓	
023-4023605	✓						✓
023-4188353	✓					✓	
023-4362539		✓	✓				✓
	10	17	13	2	6	10	14

Income

Five⁵ of the fourteen loans with significant underwriting deficiencies included the lender’s improperly calculating monthly income and not verifying the employment history for the most recent 2 full years.

For example, for FHA loan number 022-2050283, the borrower was self-employed, requiring the lender to calculate the monthly income using the average from the previous 2 years by using the adjusted gross income from the

⁵ Loans: 022-2050283, 022-2217731, 023-3302437, 023-3515994, and 023-3551691

tax return as stated in HUD Handbook 4155.1, REV-5, paragraph 2-9C. However, the lender instead used the net business profit from the tax return, which did not include the one-half of self-employment tax. As a result, the borrower's monthly income was overstated by \$547, and the total fixed payment-to-income ratio increased from 47.95 to 51.59 percent.

Credit

Twelve⁶ of the fourteen loans with significant underwriting deficiencies included improperly excluding the net rental loss in the liabilities and not obtaining a credit report for a nonpurchasing spouse.

For example, for FHA loan number 023-3380559, the lender calculated the net rental loss on the borrower's application but did not include the amount (\$217) in the automated underwriting system as a recurring debt. In addition, the rental agreement was not valid because it was not signed by any of the parties involved as required. Also, the check for the first month's rent and security deposit was questionable because it predated the rental agreement by almost 1 year (the check was dated May 18, 2008, and the rental agreement was for April 27, 2009, to May 30, 2010). This check also predated the borrower's move to Arizona by more than 2 months. As a result, the total fixed payment-to-income ratio increased from 50.53 to 85.46 percent.

Assets

Ten⁷ of the fourteen loans with significant underwriting deficiencies included the lender's improperly calculating assets, not properly documenting retirement funds used as qualifying assets, and not properly documenting the transfer of gifts. In addition, the lender did not ensure that a borrower made the required downpayment of 3.5 percent.

For example, for FHA loan number 023-3485534, the lender overstated the borrower's assets by \$7,473 because it did not properly document a retirement account that was used as a qualifying asset. Specifically, the lender did not document the terms and conditions for withdrawal or borrowing, indicating that the borrower was eligible for withdrawals, as required by HUD Handbook 4155.1, paragraph 5B(3)(a). As a result, the lender did not verify that the borrower had sufficient funds to close the loan. The lender only properly verified \$2,381 in assets, \$1,539 short of the funds required to close of \$3,920.

⁶ Loans: 022-2050283, 023-3302437, 022-3312197, 023-3321334, 023-3380559, 023-3485534, 023-3515200, 023-3515994, 023-3551691, 023-3789597, 023-3948891, and 023-4362539

⁷ Loans: 022-3312197, 023-3321334, 023-3380559, 023-3485534, 023-3515200, 023-3515994, 023-3551691, 023-3789597, 023-3948891, and 023-4362539

Ten Loan Files Also Contained Underwriting Deficiencies

In addition to the 14 loans that contained significant underwriting deficiencies, 10⁸ also contained technical underwriting deficiencies that violated HUD-FHA requirements. The technical underwriting deficiencies were minor underwriting deficiencies that, even if corrected, would not result in a significant increase in mortgage risk and did not impact the insurability of the loan. We did not recommend indemnification or reimbursement for loans that contained only technical underwriting deficiencies. Examples of these technical underwriting deficiencies include loan files that did not contain the deposit slips for gifts as required by HUD Handbook 4155.1, paragraph 5B(5)(b), and explanation of credit inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 4C(2)(c). The table above identifies the 10 loans that contained technical underwriting deficiencies.

Lack of Due Diligence Increased Risk of Loss to the FHA Insurance Fund

Because the lender did not follow HUD-FHA requirements when underwriting, it inappropriately approved 14 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. The lender had established underwriting policies and procedures and was aware of HUD-FHA requirements; however, the lender's underwriters did not follow these when it approved the 14 loans that had significant underwriting deficiencies. The underwriters incorrectly certified to the integrity of the data used to determine the quality of the loan for 12 automated loans and incorrectly certified that due diligence was used in underwriting 2 manually underwritten loans. 24 CFR 203.255 requires a direct endorsement lender to certify that the proposed loan complies with HUD underwriting requirements.

Also, the lender did not follow HUD's quality control requirements, which contributed to the underwriting deficiencies (see finding 2). Specifically, if the quality control reviews had been performed in a timely manner, the lender may have corrected systemic underwriting deficiencies. As a result, the FHA insurance fund was at increased risk for losses on 12⁹ loans and realized losses

⁸ Loans with technical underwriting deficiencies include 022-2044367, 023-3195204, 023-3289796, 023-3324330, 023-3376945, 023-3591501, 023-3633965, 023-3928685, 023-401633, and 023-4188353.

⁹ Loans with potential losses include 022-2050283, 022-2217731, 023-3302437, 023-3312197, 023-3321334, 023-3515200, 023-3515994, 023-3551691, 023-3789597, 023-3948891, 023-4023605, and 023-4362539.

for 2¹⁰ loans. The losses resulted when the properties that secured the two loans were sold and the insurance claims and other expenses incurred by HUD exceeded the sales proceeds.

Conclusion

The lender's noncompliance with HUD-FHA requirements placed the FHA insurance fund at additional risk for losses. There were 14 loans that did not meet the requirements for FHA insurance. Twelve of these loans had a total unpaid mortgage balance of more than \$1.8 million with an estimated loss to HUD of more than \$1 million.¹¹ In addition, HUD paid claims of \$118,045¹² on four loans with an actual loss of \$101,555 for two of the loans (see appendixes A and C).

Recommendations

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

- 1A. Indemnify HUD against losses for the 12 FHA-insured loans with significant underwriting deficiencies in the amount of \$1,858,937. The estimated loss to HUD is \$1,096,774.
- 1B. Reimburse the FHA insurance fund for the \$101,555 in actual losses incurred from two loans¹³ with significant underwriting deficiencies.
- 1C. Support or repay the FHA insurance fund \$16,490 for the partial claims paid as of September 30, 2011, on two loans¹⁴ with significant underwriting deficiencies. If HUD has taken title to the property or sold it rather than seeking repayment of the partial claims paid, the repayment amount should be adjusted to the amount of FHA's loss. If the property is later conveyed to HUD and sold, the loss amount should be adjusted to reflect any amounts repaid pursuant to this recommendation.

¹⁰ Loans with realized losses include 023-3380559 and 023-3485534.

¹¹ This amount was calculated based on 59 percent of the unpaid mortgage balances (according to Neighborhood Watch as of September 30, 2011). The 59 percent indemnification rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2010 based on actual sales.

¹² According to Neighborhood Watch as of September 30, 2011

¹³ 023-3380559 and 023-3485534

¹⁴ 023-3312197 and 023-3321334

In addition, we recommend that HUD's Associate General Counsel for Program Enforcement

- 1D. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act (31 U.S.C. (United States Code) 3801-3812), civil money penalties (24 CFR (Code of Federal Regulations) 30.35), or both against the lender, its principals, or both for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of 14 loans that resulted in actual losses of \$101,555 on two loans, partial claims of \$16,490 on two loans, and potential losses of \$1,096,774 on 12 loans for a total loss of \$1,214,819, which could result in affirmative civil enforcement action of approximately \$2,534,638.¹⁵

¹⁵ Double damages for actual loss amounts related to 2 loans, partial claims on 2 loans, and potential losses related to 12 loans ($\$118,045 + \$1,096,774 = \$1,214,819$) plus fines of \$7,500 each for the 14 loans with material underwriting deficiencies ($\$1,214,819 \times 2 + (\$7,500 \times 14) = \$2,534,638$)

Finding 2: The Lender Did Not Follow HUD's Quality Control Requirements

The lender did not follow HUD's quality control requirements when performing site reviews and reviewing loan origination files. It was notified of these issues before our audit started through its internal audit report, dated April 2011. We determined that the lender disregarded HUD's quality control requirements, allowing branch reorganizations and insufficient staffing levels to impact the site reviews and quality control reviews. As a result, the FHA insurance fund was placed at an increased risk of loss.

Site Reviews Were Not Performed in 2010

According to the lender, a contractor conducted site reviews of all of its branches between October 2008 and June 2009; however, none was performed in 2010. Although annual visits are not required for every branch, the lender did not perform an analysis to determine whether any of its branches had high early default rates, sudden increases in volume, or past problems. These specific issues would require an annual visit as stated in section 3 of the lender's own quality control policy and HUD Handbook 4060.1, REV-2 section 7-3G. In response to the internal audit report, lender officials stated that the site reviews were not performed in 2010 because of branch reorganizations. However, according to the lender, several branch site reviews were conducted during the audit, and a site review plan was being developed.

Quality Control Reviews Were Not Performed in a Timely Manner

HUD Handbook 4060.1, REV-2, section 7-6A, requires lenders to review loans routinely selected for quality control review within 90 days from the end of the month in which the loan closed. The purpose of the requirement is to ensure that the lender identifies problems not previously identified before loan closing. We reviewed 15 quality control files and determined that 14¹⁶ were completed approximately 11 months after the month in which the FHA-insured loan closed. In response to the internal audit report, lender officials stated that

¹⁶ Seven of the fourteen quality controls files that were not performed in a timely manner were part of the underwriting sample in finding 1: 023-3289796, 023-3321334, 023-3402161, 023-3437647, 023-3795557, 023-3877294, and 023-3921398.

the quality control reviews were not performed within the required timeframes because of insufficient staffing levels. According to the lender, additional staff was hired to complete the quality control reviews within the required timeframe.

Nine of the fourteen quality control files were early payment defaults. HUD regulations do not indicate a timeframe for the completion of early payment default reviews; however, HUD Handbook 4060.1, REV-2, section 7-2, states that one of the basic overriding goals of quality control is to ensure swift and appropriate corrective action. Therefore, prudence would dictate that these loans be reviewed shortly after being identified as early payment defaults.

Conclusion

The lender did not perform site reviews and review loan files in accordance with HUD's requirements. This condition occurred because the lender disregarded HUD's quality control review requirements. As a result, the FHA insurance fund was placed at an increased risk of loss because the deficient quality control reviews may have prevented correction of systemic underwriting deficiencies that contributed to significant deficiencies identified in 14 of 30 loans reviewed (see finding 1). This report does not include any recommendations for this finding because the lender closed its forward home loan business on January 10, 2012.

SCOPE AND METHODOLOGY

Our audit period covered loans with beginning amortization dates from April 1, 2009, to March 31, 2011. We selected the lender's Scottsdale branch office (2449201022) because approximately 82 percent of the lender's loans that were in default for Arizona were underwritten through this branch. We conducted our fieldwork of the Scottsdale branch office between May and October 2011.

We used Neighborhood Watch, HUD's online information system for FHA-insured loans, to identify all loans underwritten by the lender and its branches in Arizona. During our audit period, the lender's Scottsdale branch office underwrote 3,659 FHA-insured loans in Arizona, with a total mortgage balance of more than \$611 million. We selected a sample of 30 FHA-insured loans selected nonstatistically based on the following factors:

- Loans that were seriously delinquent or had claims (18 loans),
- Loans with loan-to-value ratios over the maximum limit¹⁷ (6 loans), and
- Loans delinquent in the first 6 months (6 loans).

To perform our quality control file review, we requested a listing from the lender of all quality control reviews performed of loans underwritten by the Scottsdale branch office during our audit period. However, the lender had only completed quality control reviews for April 2009 to November 2010. There were a total of 335 quality control reviews of FHA-insured loans during this period. We selected a nonstatistical sample of 15 quality control reviews to examine. We selected the quality control reviews that were part of our audit sample for the review of the lender's underwriting process. This process resulted in six quality control reviews. We then selected nine quality control reviews based on auditor judgment. Five were randomly selected from the most recent completed month (November 2010) and four were randomly selected based on if a significant finding was identified during the lender's quality control review.

To accomplish our objective, we

- Reviewed HUD regulations and reference materials related to single-family requirements,
- Reviewed 30 of the lender's FHA-insured loan files,
- Interviewed appropriate management and staff,

¹⁷ The maximum loan-to-value ratio is 96.5 percent for proposed/existing construction as of January 1, 2009. Prior to this date, the maximum loan-to-value ratios was 97.15 percent for States with average closing costs at or below 2.1 percent of the sales price and for properties with values/sales price in excess of \$125,000.

- Reviewed the quality control plan,
- Reviewed 15 of the lender's quality control reviews,
- Interviewed borrowers when available, and
- Performed employment verifications.

We used the source documents in the loan origination files to determine the income, employment history, assets, and liabilities for borrower(s). For the loans underwritten by an automated underwriting system, we reviewed the FHA and lender loan files to determine whether they contained the documentation to support the integrity and accuracy of the data used by the automated underwriting system to recommend approval of the loan. For the manually underwritten loans, we reviewed the loan documents to determine whether they supported the underwriting decision and complied with HUD Handbook 4155.1.

We used the data maintained by HUD in Neighborhood Watch to obtain the unpaid mortgage balances and claims paid for each of the loans (as of September 30, 2011). HUD paid claims on four of the loans¹⁸ that we determined had significant underwriting deficiencies and incurred actual losses on two those loans.¹⁹

We also used data maintained by HUD in its Neighborhood Watch system to obtain background information and to identify the universe of loans. We did not rely on the data to reach our conclusions; therefore, we did not assess the reliability of the data.

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

¹⁸ Loans with claims paid: 023-3312197, 023-3321334, 023-3380559, and 023-3485534

¹⁹ Loans with actual losses: 023-3380559 and 023-3485534

INTERNAL CONTROLS

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

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Policies and procedures intended to ensure that the lender underwrites (approves) FHA-insured loans in accordance with HUD-FHA requirements (finding 1).
- Policies and procedures intended to ensure that the lender implements a quality control program that complies with HUD's requirements (finding 2).

We assessed the relevant controls identified above.

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

Significant Deficiencies

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

- The lender did not have adequate controls to reasonably ensure that loans were underwritten in accordance with HUD-FHA requirements (finding 1).
- The lender did not have adequate controls to ensure that its quality control program complied with HUD's quality control requirements (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Funds to be put to better use <u>3/</u>
1A			\$1,096,774
1B	\$101,555		
1C		\$16,490	

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowed by law; contract; or Federal, State, or local policies or regulations. The ineligible costs are HUD's actual losses for two loans²⁰ that had significant underwriting deficiencies (see appendix C). The losses resulted when the properties that secured these two loans were sold and the insurance claims and other expenses incurred by HUD exceeded the sales proceeds.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. The unsupported costs are the partial claims paid by HUD for two loans²¹ that had significant underwriting deficiencies (see appendix C).

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. If HUD implements our recommendations to indemnify loans not approved in accordance with HUD-FHA requirements, it will reduce FHA's risk of loss to the insurance fund. The amount noted reflects HUD's calculation that FHA loses an average of 59 percent of the unpaid principal balance when it sells a foreclosed-upon property (see the estimated loss to HUD in appendix C). The 59 percent loss rate is based on HUD's Single

²⁰ 023-3380559 and 023-3485534

²¹ 023-3312197 and 023-3321334

Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2010 based on actual sales.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

<p>MetLife Home Loans 4000 Horizon Way, Suite 100, Irving, TX 75063</p> <p style="text-align: right;">MetLife®</p> <p style="text-align: center;">January 9, 2012</p> <p style="text-align: center;"><u>VIA ELECTRONIC MAIL AND FEDERAL EXPRESS</u></p> <p>Ms. Tanya E. Schulze Regional Inspector General for Audit U.S. Department of Housing and Urban Development Office of the Inspector General Region IX 611 West Sixth Street Suite 1160 Los Angeles, California 90017-3101</p> <p style="text-align: center;">RE: MetLife Bank, N.A. HUD OIG Draft Audit Report</p> <p>Dear Ms. Schulze:</p> <p>MetLife Bank, N.A. ("MetLife Bank" or the "Bank") is in receipt of the Draft Audit Report ("Report"), dated December 14, 2011, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of Inspector General ("OIG"). The Report is based on a review of the Bank's former Scottsdale, Arizona, wholesale branch office conducted between May and October of 2011. The audit reviewed Federal Housing Administration ("FHA") loans originated by this branch during the period between April 1, 2009, and March 31, 2011.</p> <p>The Report states that its objective was to determine whether MetLife Bank complied with HUD requirements in the origination and Quality Control review of FHA-insured loans underwritten by the Scottsdale branch during the audit period. The Report contains two findings, alleging significant underwriting deficiencies in 14 adversely selected cases and concerns with the implementation of quality control reviews over its underwriting process during the review period. Based on these findings, the Report recommends that HUD: (1) require the Bank to indemnify or reimburse the Department in connection with 14 loans involving underwriting findings; (2) require the Bank to perform the Quality Control functions already set out in MetLife Bank's existing policies to ensure that Quality Control reviews are completed in a timely manner; and (3) in connection with the Bank's underwriting certifications, determine the legal sufficiency of claims under—and, if legally sufficient, pursue remedies under—the Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801 <i>et seq.</i> ("PFCRA").</p> <p>DA-3223753 v2 0309475-00026 <small>MetLife Home Loans is a Division of MetLife Bank, N.A.</small></p>

Ms. Tanya E. Schultze
January 9, 2012
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Comment 1

The OIG provided MetLife Bank with an opportunity to submit written comments for inclusion in the final report. This response summarizes MetLife Bank's history and operations and addresses the individual findings in the Report. We appreciate this opportunity to comment on the OIG's findings and recommendations. That said, we understand that final audit reports routinely include auditors' comments about the audited lender's written response, but that the company is not provided an opportunity to respond to these additional comments. Often, these comments include substantive allegations or statements that were not a part of the draft audit report provided to the company. To the extent that the OIG makes such additional substantive comments in this instance, we respectfully request an opportunity to respond to these additional statements to ensure that a full picture of the audited issues is presented in the final report.

I. BACKGROUND

MetLife Bank, a subsidiary of MetLife, Inc., was incorporated in February 1999, and is chartered as a national banking association by the Office of the Comptroller of the Currency. It received approval to participate in HUD's FHA mortgage insurance programs in April 2007, and it received unconditional DE underwriting approval on October 22, 2008. Headquartered in Convent Station, New Jersey, the Bank is an approved lender not only for FHA, but for Fannie Mae, Freddie Mac, Ginnie Mae, the Department of Veterans Affairs, and the U.S. Department of Agriculture. MetLife Bank currently has 232 FHA-approved branch offices and approval for both Direct Lending and Lender Insurance. It acts as an Authorized Agent for 352 Principals, and as a Principal for 12 Authorized Agents. FHA lending constitutes approximately one quarter of MetLife Bank's current mortgage business. According to Neighborhood Watch, for the two-year period ending June 30, 2011, the Bank originated 35,367 FHA-insured mortgage loans (with a beginning amortization date between July 1, 2009 and June 30, 2011), only 35 of which have resulted in claims to HUD, and it has a default/claim compare ratio of only 88%.

Within the next six months, MetLife Bank will exit the forward mortgage origination business and consequently cease originating FHA-insured forward loans. Nevertheless, the Bank takes its responsibilities under the FHA program seriously. We strive to comply with applicable rules and regulations and are committed to educating and training our employees on issues of FHA compliance. In addition, MetLife Bank is dedicated to fair lending and to providing excellent customer service. We have aimed to make the lending process as simple as possible for borrowers and work closely with each individual applicant to ensure that he or she receives the type of financing that best fits his or her needs. Throughout our existence, we have endeavored to provide

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dependable and professional service and have repeatedly demonstrated our commitment to borrowers and allegiance to the FHA Program.

As previously noted, MetLife Bank received FHA approval in mid-2007; however, it was not until after September 2008 when it acquired the residential mortgage origination and servicing business of First Tennessee Bank National Association ("First Tennessee"), a subsidiary of First Horizon, and its receipt of DE approval in October 2008, that the Bank began to originate FHA-insured residential mortgages in its own name. Significantly, the loans cited in the Notice were originated during this time of great change within the Bank. While MetLife Bank had personnel experienced in FHA lending and had inherited staff from First Tennessee, MetLife Bank was just entering the FHA business and subsequently made a variety of adjustments, including significant procedural and personnel changes and enhancements, to accommodate the new business concerns. For example, MetLife Bank augmented its third party originator ("TPO") performance monitoring program to provide for the termination of TPOs that consistently produce underperforming loans. By the end of 2010, MetLife Bank had terminated TPOs whose originations represented the highest concentrations of FHA delinquencies in MetLife Bank's portfolio in 2008 and 2009, which included 47% of its TPO relationships nationwide and accounted for over 50% of the Bank's delinquent FHA loans during that same time period. MetLife Bank continues to engage in active TPO oversight and monitors all active TPOs in the normal course of its business.

We believe it is important to note that the FHA-insured loans cited in the Report were originated in a single branch office of the Bank located in Scottsdale, Arizona, which has been closed. Given these circumstances, we believe that many, if not all, of the issues raised in the Report have effectively been resolved.

Comment 2

II. RESPONSE TO THE FINDINGS

The Report contains two findings in which it alleges that MetLife Bank did not originate 14 adversely-selected loans in accordance with HUD requirements and did not follow its Quality Control procedures to ensure the timely identification and resolution of underwriter performance issues. It bears emphasis at the outset that the audit evaluated 30 loans out of 3,659 FHA-insured loans originated by the Scottsdale branch during the audit period in which the OIG anticipated finding deficiencies and yet only identified underwriting issues in 14 of those loans. The OIG found no deficiencies in 6 cases and only minor technical omissions that the OIG acknowledges did not affect the insurability of the loans in 10 cases. Below we respond to the individual matters identified as significant in the Report, evidence our adherence to FHA requirements in connection with the cited loans, and set forth our opposition to the OIG's recommendations regarding action under PFCRA and calculating estimated losses.

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Comment 4

Upon receipt of the draft Report, MetLife Bank conducted a thorough review of the findings and loan files and examined applicable HUD/FHA guidelines and internal Bank procedures at the time these loans were originated in an effort to provide pertinent information and documentation with this response. Our review indicated that the allegations made in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. While we recognize that there is always room for improvement, at no time did the Bank intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. Where a deficiency existed, we have acknowledged it and strengthened our policies and procedures to assure compliance with HUD's requirements.

We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate MetLife Bank's general compliance with HUD/FHA requirements and adherence to prudent lending standards in the loans at issue, as well as our efforts to enhance policies and procedures to ensure strict adherence to HUD requirements and improvement in overall loan performance.

A. FINDING 1 – METLIFE BANK COMPLIED WITH HUD'S UNDERWRITING REQUIREMENTS

Finding 1 of the Report asserts that the Bank did not underwrite 14 of the 30 loans reviewed in compliance with HUD requirements. Specifically, the Report asserts that these loans involved deficiencies in: (1) income assessment; (2) debt assessment; and (3) asset documentation, including, among other issues, gift fund documentation. We address the individual assertions made in these 14 loans below.

The draft Report also asserts that 10 loans contained "technical underwriting deficiencies" that were not serious enough to negatively impact loan approval. As MetLife Bank addressed these issues throughout the OIG's review, and the auditors determined that these findings do not warrant further action by HUD, we have not provided individual responses to these 10 cases herein. However, for loans in which the Report asserts that significant underwriting deficiencies were present, Appendix E to the draft Report confusingly lists both these alleged significant deficiencies intermixed with the same minor, technical violations that OIG acknowledges did "not result in a significant increase in mortgage risk and did not impact the insurability of the loan."¹

Comment 5

¹ The Report identifies the following allegations as minor, technical omissions: (1) the omission of deposit slips for gift funds from the loan file, see HUD Handbook 4155.1, ¶ 5B.5.b; and (2) the omission of explanations for credit inquiries within 90 days of the completed credit report, see HUD Handbook 4155.1, ¶ 4C.2.c.

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MetLife Bank respectfully requests that the Report either omit these allegations from Appendix E or expressly identify them as minor allegations that do not relate to the Report's recommendations for indemnification or monetary relief.

1. Income Assessment

In six loans, the Report asserts that MetLife Bank's underwriting analysis as reflected on the Loan Underwriting and Transmittal Summary credited borrowers with more income than was documented in the file. MetLife Bank respectfully disagrees with the allegations in several of the cited loans, and our individual responses to a sample of the cases are set forth below.

a. FHA Case No. 023-4023605

In this loan, Appendix E asserts that: (1) the borrower's monthly income from his first job was overstated by \$101 because the Bank averaged the borrower's variable income over time instead of relying only on his year-to-date income; and (2) the borrower's monthly self-employment income was overstated by \$45 because the Bank did not deduct self-employment taxes in calculating effective income.

First, MetLife Bank understands and appreciates that the income used to evaluate a borrower's ability to pay the loan must be stable. See HUD Handbook 4155.1, ¶ 4.D.2.a ("The lender must analyze the income of each borrower who will be obligated for the mortgage debt to determine whether the borrower's income level can be reasonably expected to continue through at least the first three years of the mortgage loan."). There is no express guidance as to how a borrower's effective monthly income should be calculated when the borrower's base pay is variable.

In this case, MetLife Bank calculated the borrower's monthly income by averaging the borrower's annual income over the previous two years. Specifically, on the Loan Underwriting and Transmittal Summary, the underwriter calculated a monthly base income from wages and tips for the borrower of \$783 (**Exhibit A-1**). The underwriter reached this result by dividing the previous two years' earnings shown on the borrower's Forms W-2 for 2008 and 2009 (**Exhibit A-2**) by 24 months. By contrast, the borrower had earned a monthly average of \$690 for the first three months of 2010 (**Exhibit A-3**). A substantial portion of the borrower's wages as a pizza delivery driver derived from tips (**Exhibit A-3**). This long-term averaging method is required by HUD guidelines for borrowers with variable overtime and bonus income, see HUD Handbook 4155.1, ¶ 4.D.2.c ("A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year."), and for borrowers paid on commission, see HUD Handbook 4155.1, ¶ 4.D.2.g ("Commission income *must* be averaged over the previous two years."). Based on this

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guidance, it was appropriate for MetLife Bank to use the same two-year averaging method approved and required for borrowers with variable overtime, bonus, and commission income for a borrower whose base income was variable, as well.

Although the borrower's year-to-date income was slightly lower, it only covered three months' time; there is no reason to believe that that three-month period would be more representative than the previous twenty-four months. There is no HUD guideline or requirement that suggests that exclusive reliance on the borrower's year-to-date income is proper. MetLife Bank properly considered the borrower's two-year income history reflected on his Forms W-2 and correctly calculated the borrower's effective income from his job as a delivery driver.

Second, MetLife Bank understands and appreciates the importance of verifying and properly calculating a borrower's income in the underwriting process and recognizes that the applicable HUD Handbooks set out specific methods for calculating self-employment income. See, e.g., HUD Handbook 4155.1, ¶¶ 4.D.4.e, 4.D.5.b. The Bank's method of computing self-employment income complies with these requirements. As the Report notes, HUD guidelines start from the proposition that "[t]he amount shown on a borrower's Internal Revenue Service (IRS) Form 1040 as *adjusted gross income* (line 37) must either be increased or decreased based on the lender's analysis of the individual tax return and any related tax schedules." See HUD Handbook 4155.1, ¶ 4.D.5.a. One such adjustment is the assessment of business income: the same provision recognizes without qualification that "[s]ole proprietorship income calculated on schedule C is business income." See HUD Handbook 4155.1, ¶ 4.D.5.b. Nothing in the provisions governing income analysis directs the underwriter to exclude self-employment taxes from this business income; to the contrary, HUD's guidelines provide that "[o]bligations not considered debt, and therefore not subtracted from gross income, include . . . Federal, state, and local taxes." See HUD Handbook 4155.1, ¶ 4.C.6.b (emphasis added).

Comment 7

In this case, MetLife Bank calculated the borrower's self-employment income by averaging the net profit plus depreciation shown on Schedule C of the borrower's tax returns for the previous two years. In 2009, the borrower reported a profit of \$9,542 and claimed \$36 in depreciation (**Exhibit A-4**). In 2008, the borrower reported a profit of \$5,790 (**Exhibit A-5**). Therefore, consistent with the applicable Handbook provisions, MetLife Bank calculated monthly income of \$640 from self-employment on the basis of two-year average of the Schedule C profit plus depreciation. See HUD Handbook 4155.1, ¶ 4.D.5.b. The Report alleges that the Bank was required to deduct self-employment taxes from the borrower's Schedule C profit, but, as discussed above,

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there is no such requirement. Rather, "[s]ole proprietorship income calculated on Schedule C is business income." HUD Handbook 4155.1, ¶ 4.D.5.b.² MetLife Bank's method of calculating the borrower's self-employment income therefore complied with HUD's requirements.

Comment 9

Moreover, in this case, even crediting the borrower only with the reduced income referenced in the Report, the borrower's back-end ratio would have been 49%, which only slightly exceeds HUD's threshold percentage of 43%. See HUD Handbook 4155.1, ¶ 4.F.2.c. The Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guideline of 43% where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, ¶¶ 4.F.2.c, 4.F.3.b. The Department has professed that the "FHA does not set an arbitrary percent by which ratios may be exceeded but rather FHA relies on the underwriter to judge the overall merits of the loan application and to determine what compensating factors apply and the extent to which those factors justify exceeding the ratios." Mortgagee Letter 00-24 (emphasis added). Thus, where a potential borrower's qualifying ratios are high, an underwriter has to consider all relevant circumstances and exercise discretion in deciding whether to approve or reject a loan. The loan file in this case documented that the borrower had excellent credit, with a median credit score of 704 (**Exhibit A-6**), that the borrower earned nontaxable delivery reimbursements not considered in qualifying the loan (**Exhibit A-3**), and that the proposed mortgage represented a slightly decreased net housing payment (**Exhibit A-7**). Cf. HUD Handbook 4155.1, ¶ 4.F.3.b (identifying previous credit history, compensation not reflected in effective income, and minimal increase in housing expense as compensating factors). Together, even if the underwriter had considered only the income referenced in the Report, these factors would have more than compensated for the slight increase in the borrower's ratios.

Comment 10

In summary, MetLife Bank complied with HUD requirements in calculating this borrower's income, and there is no basis for the Report's request for indemnification. The case and these allegations should be removed from the Report.

Comment 11

² Indeed, Fannie Mae Form 1084, the Cash Flow Analysis form for self-employed borrowers, likewise omits any requirement for deducting self-employment taxes from the borrower's Schedule C profit in calculating self-employment income (**Exhibit A-8**).

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b. FHA Case No. 022-2050283

In this loan, Appendix E asserts that the borrower's monthly income was overstated by \$547 because MetLife Bank did not deduct self-employment taxes from the borrower's Schedule C business profit in calculating self-employment income.

As discussed above, MetLife Bank understands and appreciates the importance of verifying and properly calculating a borrower's self-employment income in a manner consistent with HUD's rules and guidance. See, e.g., HUD Handbook 4155.1, ¶¶ 4.D.4.e, 4.D.5.b. Contrary to the Report's assertion, the Bank's computation of self-employment income in this case was proper.

Comment 8

Specifically, MetLife Bank calculated the borrower's self-employment income by averaging the net profit plus depreciation shown on Schedule C of the borrower's tax returns for the previous two years. In 2008, the borrower reported a profit of \$95,800 (**Exhibit B-1**). In 2007, the borrower reported a profit of \$90,017 (**Exhibit B-2**). Therefore, consistent with the applicable Handbook provisions, MetLife Bank calculated monthly income of \$7,742 from self-employment on the basis of two-year average of the Schedule C profit plus depreciation. See HUD Handbook 4155.1, ¶ 4.D.5.b. The Report alleges that the Bank was required to deduct self-employment taxes from the borrower's Schedule C profit, but, as discussed above, there is no such requirement. Rather, "[s]ole proprietorship income calculated on Schedule C is business income." HUD Handbook 4155.1, ¶ 4.D.5.b. MetLife Bank's method of calculating the borrower's self-employment income therefore complied with HUD's requirements.

Comment 9

Moreover, even if the underwriter had considered only the reduced income calculated in the Report, the borrower's back-end ratio would have been 52%. See HUD Handbook 4155.1, ¶ 4.F.2.c. As stated above, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guideline of 43% where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, ¶¶ 4.F.2.c, 4.F.3.b. The loan file in this case documented that the borrower had excellent credit, with a median credit score of 715 (**Exhibit B-3**), and that the borrower had a longstanding history of timely payment of mortgage credit obligations—including a previous FHA-insured mortgage—dating back to 1979 (**Exhibit B-3**). Cf. HUD Handbook 4155.1, ¶ 4.F.3.b (identifying previous credit history and housing payment history). Together, these factors would alternatively have compensated for the increase in the borrower's ratios.

Comment 12

MetLife Bank complied with HUD requirements in calculating this borrower's income, and indemnification is unwarranted. The case and these allegations should be removed from the Report.

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c. FHA Case No. 023-3515994

In this loan, Appendix E asserts that: (1) the borrower's monthly income from her first job was overstated by \$70 because the Bank averaged the borrower's variable income over time instead of relying only on her year-to-date income; and (2) the borrower's monthly self-employment income was overstated by \$137 because the Bank did not deduct self-employment taxes in calculating effective income.

First, as stated above, MetLife Bank understands and appreciates that the income used to evaluate a borrower's ability to pay the loan must be stable. See HUD Handbook 4155.1, ¶ 4.D.2.a. MetLife Bank complied with this requirement by averaging the borrower's wages from her first job, as reflected on her Forms W-2, for the previous two years.

Specifically, on the Loan Underwriting and Transmittal Summary, the underwriter calculated a monthly base income from wages of \$1,374 (**Exhibit C-1**). The underwriter reached this result by dividing the previous two years' earnings shown on the borrower's Forms W-2 for 2007 (\$16,047) and 2008 (\$17,948) (**Exhibits C-2, C-3**) by 24 months. In performing this calculation, it appears that the underwriter misread a "6" as a "5" (**Exhibit C-4**); the correction calculation in fact yields a monthly average of \$1,416. By contrast, the borrower had earned an average of \$1,304 monthly for the first five months of 2010 (**Exhibit C-5**). A two-year average is required by HUD guidelines for borrowers with variable overtime, bonus, and commission income, see HUD Handbook 4155.1, ¶¶ 4.D.2.c & g. It was appropriate for MetLife Bank to use the same two-year averaging method approved and required for other forms of variable income for a borrower whose base income was variable.

Second, as with the previous loans, MetLife Bank understands and appreciates the importance of verifying and properly calculating a borrower's self-employment income in a manner consistent with HUD's rules and guidance. See, e.g., HUD Handbook 4155.1, ¶¶ 4.D.4.e, 4.D.5.b. The Bank's computation of self-employment income in this case was proper.

Specifically, MetLife Bank calculated the borrower's self-employment income by averaging the net profit shown on Schedule C of the borrower's tax returns for the previous two years. In 2008, the borrower reported a profit of \$26,814 (**Exhibit C-6**). In 2007, the borrower reported a profit of \$19,911 (**Exhibit C-7**). Therefore, consistent with the applicable Handbook provisions, MetLife Bank calculated monthly income of \$1,946 from self-employment on the basis of two-year average of the Schedule C profit. See HUD Handbook 4155.1, ¶ 4.D.5.b. The Report alleges that the Bank was required to deduct self-employment taxes from the borrower's Schedule C profit, but, as discussed above, there is no such requirement. Rather, "[s]ole proprietorship income

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Comment 15

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Comment 16

calculated on Schedule C is business income." HUD Handbook 4155.1, ¶ 4.D.5.b. MetLife Bank's method of calculating the borrower's self-employment income therefore complied with HUD's requirements.

Comment 9

Moreover, even if the underwriter had considered only the reduced income calculated in the Report, the borrower's front-end ratio would have been 46%, and the borrower's back-end ratio would have been 51%. As stated above, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guidelines where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, ¶¶ 4.F.2.c, 4.F.3.b. The underwriter specifically noted on the Transmittal Summary that the borrower's minimal use of credit and slight increase in housing payments (**Exhibit C-1**). Cf. HUD Handbook 4155.1, ¶ 4.F.3.b. Together, these factors would alternatively have compensated for the increase in the borrower's ratios.

Comment 17

Comment 18

In summary, MetLife Bank complied with HUD requirements in calculating this borrower's income, and indemnification would not be appropriate. The case and these allegations should be removed from the Report.

d. FHA Case No. 023-3302437

In this loan, Appendix E asserts that the borrower's monthly income was overstated by \$136 because MetLife Bank did not deduct self-employment taxes from the borrower's Schedule C business profit in calculating self-employment income.

Comment 8

As with the previous loans, MetLife Bank understands and appreciates the importance of verifying and properly calculating a borrower's self-employment income in a manner consistent with HUD's rules and guidance. See, e.g., HUD Handbook 4155.1, ¶¶ 4.D.4.e, 4.D.5.b. Contrary to the assertion in the Report, the Bank's computation of self-employment income in this case was proper.

Specifically, MetLife Bank calculated the borrower's self-employment income by averaging the net profit plus depreciation shown on Schedule C of the borrower's tax returns for the previous two years. In 2008, the borrower reported a profit of \$33,248 (**Exhibit D-1**). In 2007, the borrower reported a profit of \$13,676 (**Exhibit D-2**). Therefore, consistent with the applicable Handbook provisions, MetLife Bank calculated monthly income of \$1,955 from self-employment on the basis of two-year average of the Schedule C profit plus depreciation. See HUD Handbook 4155.1, ¶ 4.D.5.b. The Report alleges that the Bank was required to deduct self-employment taxes from the borrower's Schedule C profit, but, as discussed above, there is no such requirement. Rather, "[s]ole proprietorship income calculated on Schedule C is business income."

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HUD Handbook 4155.1, ¶ 4.D.5.b. MetLife Bank's method of calculating the borrower's self-employment income therefore complied with HUD's requirements.

Comment 9

Moreover, even if the underwriter had considered only the reduced income calculated in the Report, the borrower's front-end ratio would have been 33%, and the borrower's back-end ratio would have been 55%. As stated above, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guidelines where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, ¶¶ 4.F.2.b & c, 4.F.3.b. The loan file in this case documented that the borrowers had excellent credit, with median credit scores of 701 and 713 (**Exhibit D-3**), and that the proposed mortgage would represent a decrease in the borrowers' housing payment (**Exhibit D-4**). Cf. HUD Handbook 4155.1, ¶ 4.F.3.b. Together, these factors would alternatively have compensated for the increase in the borrower's ratios.

Comment 19

Comment 20

In summary, MetLife Bank complied with HUD requirements in calculating this borrower's income, and there is no basis for the Report's request for indemnification. The case and these allegations should be removed from the Report.

e. FHA Case No. 022-2217731

In this loan, Appendix E asserts that, due to a typographical error, the borrower's monthly income was overstated by \$218. MetLife Bank acknowledges that the underwriter in this case calculated a monthly income of \$1,820, but inadvertently used a number from a different calculation in calculating the borrower's qualifying ratios (**Exhibit E-1**).

Comment 21

This typographical error was, however, harmless. Applying the income amount actually calculated by the underwriter, the borrower's ratios increased slightly from 45% to just under 50%. These ratios are not significantly in excess of HUD's threshold percentages. See HUD Handbook 4155.1, ¶ 4.F.2.b & c. As stated above, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guidelines where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, ¶¶ 4.F.2.b & c, 4.F.3.b. The Department has professed that the "FHA does not set an arbitrary percent by which ratios may be exceeded but rather FHA relies on the underwriter to judge the overall merits of the loan application and to determine what compensating factors apply and the extent to which those factors justify exceeding the ratios." Mortgagee Letter 00-24 (emphasis added). Thus, where a potential borrower's qualifying ratios are high, an underwriter has to consider all relevant circumstances and exercise discretion in deciding whether to approve or reject a loan.

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Comment 22

In this case, several compensating factors were present. First, the loan was a refinance of an existing loan that resulted in a decreased housing payment for the borrower (**Exhibit E-2**) from a mortgage that the borrower had successfully paid for the previous 18 months (**Exhibit E-3**). Second, the underwriter noted that the borrower had a history of substantial overtime income not used in calculating the ratios and a probability of continuance of that income (**Exhibit E-1**). Third, the loan-to-value ratio for the FHA-insured mortgage was only 87% (**Exhibit E-4**). Fourth, the borrower's employment was highly stable: the written Verification of Employment ("VOE") showed that he had been employed by the same company for 11 years, and that his probability of continued employment was "excellent" (**Exhibit E-5**). Fifth, the borrower was a minimal user of credit and had no recurring liabilities aside from the mortgage (**Exhibit E-3**). Taken together, all these factors would have more than compensated for the increase in the borrower's ratios. Cf. HUD Handbook 4155.1, ¶ 4.F.3.b. For these reasons, indemnification would be inappropriate. We therefore request that these assertions be removed from the Report.

Comment 23

2. Debt Assessment

In twelve of the loans audited by OIG, the Report asserts that the Bank did not obtain a sufficiently complete picture of the borrowers' credit history. MetLife Bank respectfully disagrees with the allegations in several of the cases cited.

Comment 24

As an initial matter, in eight of the twelve loans,³ the Report notes in Appendix E that the Bank did not obtain a written explanation for each inquiry within the previous ninety days on borrowers' credit reports. The Report makes clear in the body of the Report that OIG considers such an omission a minor, technical issue that does not affect the insurability of the loan; nor does the Report predicate its requests for indemnification on any of these alleged omissions. MetLife Bank understands and appreciates the importance of obtaining a complete picture of a prospective borrower's credit and further understands that HUD requires FHA lenders to obtain a "[w]ritten explanation . . . for all inquiries shown on the credit report for the last 90 days." See HUD Handbook 4155.1, ¶ 4.C.2.c. It is MetLife Bank's policy and practice to do so, and the Bank has reminded its underwriters of the importance of obtaining such written explanations in all cases. It is confusing, however, to organize the Report such that these minor, technical omissions that do not relate to the insurability of the loan or the OIG's request for indemnification are intermixed with the issues that the OIG considers

³ Specifically, the Report makes this allegation in FHA Case Nos. 023-2050283, 023-3302437, 023-3312197, 023-3485534, 023-3515200, 023-3515994, 023-3551691, and 023-4362539.

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"significant" without clear delineation. MetLife Bank respectfully requests that the Report remove or separate these allegations from the remainder of Appendix E.

As to the remaining six loans, MetLife Bank understands and appreciates that, when determining whether a borrower qualifies for FHA financing, a lender must obtain a full picture of a borrower's recurring debt obligations to permit the calculation of an accurate and complete DTI ratio. See HUD Handbook 4155.1, ¶ 4.C.4.b; see also HUD Handbook 4155.1, ¶ 4.F.2.a. It is the Bank's policy and procedure to identify and include as monthly debts (1) the borrower's recurring installment and revolving debt obligations, child support and maintenance payments, and alimony, see HUD Handbook 4155.1, ¶ 4.C.4.b; (2) the borrower's net rental loss on real estate, see HUD Handbook 4155.1, ¶ 4.E.4.e; (3) the borrower's total projected housing payment, including projected real estate taxes, see HUD Handbook 4155.1, ¶¶ 4.F.2.b & d; and (4) the recurring liabilities of a borrower's non-purchasing spouse in a community property state such as Arizona, see HUD Handbook 4155.1, ¶ 4.A.5.b. MetLife Bank maintains that it complied with these requirements in the majority of the loans cited in the Report. Our individual responses to certain of the cases cited are set forth below.

a. FHA Case No. 023-3789597

In this loan, Appendix E asserts that MetLife Bank should have obtained the borrower's non-purchasing spouse's credit report.

The Bank understands and appreciates that "the debts of the non-purchasing spouse[] *must* be included in the borrower's qualifying ratios" in a community property state such as Arizona. See HUD Handbook 4155.1, ¶ 4.A.5.b. As noted above, it is MetLife Bank's policy and practice to do so.

In this case, however, the Bank had no realistic way of knowing that the borrower was married at the time the loan closed. The borrower consistently stated on his loan application that he was unmarried (**Exhibits F-1, F-2**). Indeed, the borrower's most recent tax return likewise stated that he was single (**Exhibit F-3**). The Bank was entitled, and arguably required, to rely on the borrower's statement of marital status on the Form 1003 Uniform Residential Loan Application. It is not clear that MetLife Bank even could have inquired further about a prospective borrower's marital status without running afoul of the Equal Credit Opportunity Act, 15 U.S.C. § 1691 *et seq.*, and its implementing Regulation B, 12 C.F.R. pt. 202. Regulation B specifically limits a residential mortgage lender to "inquir[ing] about the applicant's marital status . . . us[ing] only the terms married, unmarried, and separated." 12 C.F.R. § 202.6(d)(1). Further inquiry or investigation beyond the borrower's repeated assertions on Form 1003 that he was unmarried therefore may not have been permitted by Regulation B.

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b. FHA Case No. 023-3948891

Similarly, in this loan, Appendix E asserts that MetLife Bank should have obtained the borrower's non-purchasing spouse's credit report. Again, however, the Bank had no realistic way of knowing that the borrower was married at the time she applied for the loan.

Comment 26

The borrower consistently stated on her loan applications that she was unmarried (**Exhibits G-1, G-2**). The documentation that the Report suggests should have given rise to further inquiry shows only that the borrower was at some point in the past married: a Certificate of Naturalization to which the Report points was dated seven months before the loan closed (**Exhibit G-3**). The Bank was entitled, and arguably required, to rely on the borrower's statement of marital status on the Forms 1003 she completed and signed. It is not clear whether MetLife Bank even could have inquired further about the borrower's marital status without running afoul of the Equal Credit Opportunity Act, 15 U.S.C. § 1691 *et seq.*, and its implementing Regulation B, 12 C.F.R. pt. 202. Regulation B specifically limits a residential mortgage lender to "inquir[ing] about the applicant's marital status . . . us[ing] only the terms married, unmarried, and separated." 12 C.F.R. § 202.6(d)(1). Further inquiry or investigation beyond the borrower's consistent statements that she was unmarried therefore may not have been permitted by Regulation B.

c. FHA Case No. 023-3321334

In this loan, Appendix E asserts that MetLife Bank did not consider all recurring debts of the borrower's non-purchasing spouse. As discussed above, the Bank understands and appreciates that "the debts of the non-purchasing spouse[] *must* be included in the borrower's qualifying ratios" in a community property state such as Arizona. See HUD Handbook 4155.1, ¶ 4.A.5.b.

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In this case, contrary to the Report's suggestion, MetLife Bank did include and consider all of the non-purchasing spouse's debts in calculating the borrower's ratios and entering data into the automated underwriting system ("AUS"). The Report asserts that the Bank listed the non-purchasing spouse's total monthly recurring debt as \$264 and that the correct amount of recurring debt was \$405. In fact, the underwriter in this case correctly calculated the amount of the non-purchasing spouse's recurring debt: the credit report shows (1) \$211 monthly for a student loan due to Nelnet; (2) \$28 monthly for a second student loan; and (3) \$25 monthly for a revolving credit card account

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(Exhibit H-1).⁴ The total monthly obligations attributable to the non-purchasing spouse were therefore \$264. The only way to reach the number that the Report does is (1) to exclude the \$25 credit card payment and (2) to include a \$166 monthly payment for a third student loan that appeared on the credit report but reflected no account activity in the previous eight years and no outstanding balance (Exhibit H-1). The third student loan clearly did not represent a current debt, and the underwriter properly excluded it. The allegation should be removed from the Report.

Moreover, the Report does not assert this allegation as a basis for indemnification. Therefore, even if the OIG does not remove the allegation from the Report, MetLife Bank requests that the allegation at a minimum be removed from Appendix E or that the Report expressly note that the OIG does not contend that this allegation affected the insurability of the loan.

d. FHA Case No. 023-3515200

In this loan, the Report alleged that the monthly net rental loss was understated by \$120. Specifically, the OIG calculated a monthly net rental loss of \$1,038, whereas the underwriter calculated a monthly net rental loss of \$918.

MetLife Bank understands and appreciates the importance of accurately calculating net rental loss or profit for a borrower's rental properties. HUD guidelines set out two different methods of doing so, depending on when the borrower began renting the property. For properties rented during the previous year, the lender must rely on Schedule E to the borrower's IRS Form 1040. "Positive rental income [shown on Schedule E] is considered gross income for qualifying purposes, while negative income must be treated as a recurring monthly liability." See HUD Handbook 4155.1, ¶ 4.E.4.e. By contrast, for a new rental property that postdates the borrower's tax filing, rental income or loss is calculated on the basis of demonstrated rental income, a presumptive vacancy and maintenance rate, and the borrower's recurring financial obligations with respect to the rented property. Specifically, HUD Handbook 4155.1, paragraph 4.E.f.4 provides that the analysis begins with the gross rent receipts demonstrated by a (1) "current signed lease or other rental agreement," as (2) "reduce[d] . . . by 25% (or the percentage developed by the jurisdictional HOC) for vacancies and maintenance" and (3) less "PITI and any homeowners' association (HOA) dues." See HUD Handbook 4155.1, ¶ 4.E.f.4. The result of this calculation, if negative, is considered a recurring

⁴ The credit report also includes duplicate entries for each of the student loans and a joint account reflecting a \$397 monthly payment for a car loan. The car loan was already listed and considered on the borrower's credit report (Exhibit H-2).

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debt. See HUD Handbook 4155.1, ¶ 4.E.f.4. MetLife Bank properly calculated the net rental loss on the basis of these delineated procedures here.

In this case, the borrower began renting the property after the end of the previous tax year (**Exhibit I-1**); therefore, the method for calculating net rental loss is based on the "current signed lease or other rental agreement" rather than the borrower's Schedule E. The gross rental amount was \$1,200 monthly (**Exhibit I-2**), and, according to the borrower's credit report, the borrower's total monthly payments for the property were \$2,038 (**Exhibit I-3**). Because the rental property at issue was in Twin Falls, Idaho (**Exhibit I-2**), the applicable vacancy factor developed by the Department's Santa Ana HOC is 15%. See HUD Homeownership Center Reference Guide, ch. 2, at 2-21u ("All areas covered by Santa [Ana] HOC have a 15% vacancy rate."). After applying the 15% vacancy factor as allowed by the applicable Handbook provision to reduce the gross rental amount shown in the lease, the net rental loss is \$918, as calculated by MetLife Bank.⁵ For these reasons, indemnification is unwarranted and this assertion should be removed from the Report.

e. FHA Case No. 023-3302437

In this case, the Report alleges that the amount of the property taxes to be included in the borrowers' mortgage payment was understated by \$104. After careful examination of the loan file documentation, it appears that only half the projected property taxes may have been entered on the Transmittal Summary and used to calculate the borrowers' ratios due to a clerical error, as the property taxes for the property for 2008 were \$2,502.16, or \$208 monthly (**Exhibit D-5**).

Any such error was, however, harmless. The effect of this minor change to the projected payment amount would not have affected the approval of the loan and does not affect its insurability. After factoring in the corrected property tax escrows, the borrower's front-end ratio increases from 29% to 32%, and the borrower's back-end ratio increases from 50% to 53%. As stated above, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guidelines where significant compensating factors justify loan approval, and this borrower presented several recognized compensating factors. See, e.g., HUD Handbook 4155.1, ¶¶ 4.F.2.b & c, 4.F.3.b. As discussed above, the loan file in this case documented that the borrowers had excellent credit, with median credit scores of 701 and 713 (**Exhibit D-3**), and that the proposed mortgage represented a decrease in the

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⁵ It appears that OIG used a 25% vacancy factor; however, Handbook 4155.1, paragraph 4.E.f.4 clearly permits the use of the jurisdictional 15% vacancy factor.

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borrowers' housing payment (**Exhibit D-4**). Cf. HUD Handbook 4155.1, ¶ 4.F.3.b. Together, these factors would have more than compensated for the slight increase in the borrower's ratios resulting from the adjusted property tax escrows. For these reasons, indemnification would be inappropriate and this assertion should be removed from the Report.

3. Asset Documentation

In eight loans, the Report takes issue with the Bank's verification and documentation of the borrowers' funds used to close the loan. MetLife Bank respectfully disagrees with the allegations in these cases.

MetLife Bank understands and appreciates that a lender closing an FHA-insured loan must ensure that "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees, . . . come from acceptable sources and [are] verified and properly documented." See HUD Handbook 4155.1, ¶ 5.B.1.a. Different types of documentation are required for different assets. For example, the earnest money deposit ("EMD") must be verified and documented through "a copy of the borrower's cancelled check, certification from the deposit-holder acknowledging receipt of funds, or separate evidence of the source of funds" but only "if the amount of the [EMD] exceeds 2% of the sales price, or appears excessive based on the borrower's history of accumulating savings. See HUD Handbook, ¶ 5.B.2.a. By contrast, money held in a 401(k) or similar retirement plan may be counted in the underwriting analysis at 60% of its value, but "[r]edemption evidence is required," and evidence of liquidation is required if "more than 60% of the amount in the account is used." See HUD Handbook, ¶ 5.B.3.a. Crucially, regardless of the form of asset, a lender is only required to verify funds actually used to close the loan. See HUD Handbook 4155.1, ¶ 5.B.1.a. The Report acknowledges this fact implicitly by, in several cases, declining to assert that indemnification is proper despite noting a purported absence of documentation. As we have asserted throughout this response, the Bank respectfully requests that these purported omissions that do not affect the loans' insurability be removed from Appendix E, or, at a minimum, expressly denominated as non-significant in the Report.

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MetLife Bank complied with the documentation requirements in several of the cited cases. Our responses to each of the cited cases follow.

a. FHA Case No. 023-3312197

In this loan, the Report contends that the Bank overstated the borrower's assets by \$6,697 because it did not verify that the funds in the borrower's retirement account were subject to withdrawal.

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As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case.

According to the HUD-1 Settlement Statement ("HUD-1"), the borrower paid a \$1,000 EMD and \$5,506.04 in an additional deposit toward closing costs, with \$291.84 due to the borrower at closing (**Exhibit J-1**). The \$1,000 EMD, which the borrower paid one month before closing, was properly verified by a receipt from the deposit-holder (**Exhibit J-2**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . certification from the deposit-holder acknowledging receipt of funds."). The source of the remaining \$5,506.04 was adequately documented in the file. Specifically, as of two weeks before the closing, the borrower's four bank accounts held a total of \$4,573.18 (**Exhibit J-3**). The borrower earned approximately \$1,100 in net pay, paid biweekly (**Exhibit J-4**), and was scheduled to be paid between the date on the bank statements and the closing. Therefore, the borrower could easily have saved the money needed to close the loan from her earnings. Moreover, one month before closing, the borrower also took a \$4,000 loan from her 401(k) plan (**Exhibit J-5**). According to the bank statements, those funds were not included in the bank balances totaling \$4,573.18. The loan file therefore adequately documented that the borrower had sufficient funds to close the loan and indemnification is not warranted. We request that this assertion be removed from the Report.

b. FHA Case No. 023-3515200

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In this loan, the Report contends that the Bank overstated the borrower's assets by \$7,981 because it did not verify that the funds in the borrower's retirement account were subject to withdrawal. The Report does not, however, contend that indemnification would be appropriate on the basis of the alleged overstatement.

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As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case.

According to the HUD-1, the borrower paid a \$4,000 EMD and \$221.50 in an additional deposit toward closing costs, with no additional money due at closing (**Exhibit I-4**). The \$4,000 EMD, which the borrower paid two months before closing, was properly verified by a receipt from the deposit-holder (**Exhibit I-5**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . certification from the deposit-holder acknowledging receipt of funds."). The remaining \$221.50 was similarly prepaid to the closing agent and verified by a receipt from the

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deposit-holder (**Exhibit I-6**). Moreover, the borrower's bank account also held in excess of the \$221.50 needed to close; the borrower's most recent statements, dated two weeks before closing, reflected a \$256 balance and \$2,700 in pending deposits (**Exhibit I-7**). MetLife Bank adhered to HUD requirements in this case and, thus, we request that this allegation be removed from the Report.

c. FHA Case No. 023-3551691

In this loan, the Report contends that the Bank overstated the borrower's assets by \$4,051 because it did not verify that the funds in two of the borrower's retirement accounts were subject to withdrawal. The Report does not, however, contend that indemnification would be appropriate on the basis of the alleged overstatement.

As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case.

According to the HUD-1, the borrower paid (1) a \$1,000 EMD and (2) \$1,996.08 in an additional deposit toward closing costs, with (3) no additional money due at closing (**Exhibit K-1**). The \$1,000 EMD, which the borrower paid two months before closing, was properly verified by a receipt from the deposit-holder (**Exhibit K-2**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . certification from the deposit-holder acknowledging receipt of funds."). The remaining \$1,996.08 was similarly prepaid to the closing agent and verified by a receipt from the deposit-holder (**Exhibit K-3**). Moreover, the borrower's bank accounts also held in excess of the \$1,996.08 needed to close; the borrower's most recent statements, dated one month before closing, reflected a combined balance of \$2,520 (**Exhibit K-4**). As the retirement account funds were not used to close, MetLife Bank was not required to document the withdrawal of these funds. The Bank complied with HUD guidelines in this case and, thus, these assertions should be removed from the Report.

d. FHA Case No. 023-3321334

In this loan, the Report contends that the Bank overstated the borrower's assets by \$253, and that, as a result, it did not properly verify that the borrower had the funds in his bank account needed to close the loan.

As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees"

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must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case.

According to the HUD-1, the borrower paid a \$2,000 EMD and \$5,875 in an additional deposit toward closing costs, with \$443.36 due back to the borrower at closing (**Exhibit H-3**). The \$2,000 EMD, which the borrower paid over a month before closing, was properly verified by a cancelled check drawn on the borrower's account (**Exhibit H-4**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . a copy of the borrower's cancelled check."). The remaining \$5,875 was similarly prepaid to the closing agent and verified by a receipt from the deposit-holder (**Exhibit H-5**). Moreover, the borrower's bank accounts and subsequent earned income together documented in excess of the \$5,875 needed to close. The Verifications of Deposit ("VOD") for the borrower's bank accounts, dated three weeks before closing, verify a total balance of \$5,727.58 (**Exhibit H-6**). The borrower was paid a \$461.75 bonus between the date of the VOD and the closing (**Exhibit H-7**), and the borrower's monthly base income was \$6,562 (**Exhibit H-8**). The borrower could therefore have easily saved \$147.42 from this income. Indeed, in light of the fact that the borrower received a payment of \$443.36 at closing, such a shortfall did not affect the funds needed to close this loan. The file adequately documented the funds necessary to complete this transaction and indemnification is thus unwarranted.

e. FHA Case No. 023-3380559

In this loan, the Report contends that the Bank overstated the borrower's assets by \$5,362 because it inadvertently counted the same bank account twice in verifying the borrower's assets. The Report does not, however, contend that indemnification would be appropriate on the basis of the alleged overstatement.

As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case.

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According to the HUD-1, the borrower paid a \$1,500 EMD and \$5,850 in an additional deposit toward closing costs, with no additional money due at closing (**Exhibit L-1**). The \$1,500 EMD, which the borrower paid over a month before closing, was properly verified by a receipt from the deposit-holder (**Exhibit L-2**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . certification from the deposit-holder acknowledging receipt of funds."). The borrower's bank accounts held well in excess of the \$5,850 needed to close; correctly recalculated, the borrower's most recent statements reflected a combined balance of \$16,493.85

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(Exhibit L-3). The file documented sufficient funds to close and, therefore, we request that this assertion be removed from the Report.

f. FHA Case No. 023-3789597

In this loan, the Report contends that the Bank overstated the borrower's assets by \$4,996 in the AUS because a \$3,000 gift was treated as not deposited when it had already been received by the borrower and the borrower's bank account listed a balance as \$6,000 when it was in fact \$4,004. Neither of these allegations, however, relates to the documentation of sufficient funds to close the loan. Accordingly, the Report does not contend that indemnification would be appropriate on the basis of the alleged overstatement.

As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case. According to the HUD-1, the borrower paid a \$3,000 EMD and \$2,150 in an additional deposit toward closing costs, with \$22.25 due back to the borrower at closing (**Exhibit F-4**). The \$3,000 EMD, which the borrower paid five months before closing, was properly verified by a cancelled cashier's check remitted by the borrower (**Exhibit F-5**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . a copy of the borrower's cancelled check."). The borrower's bank accounts held well in excess of the remaining \$2,150 needed to close; as the Report notes, the borrower's most recent statement, dated three weeks before closing, showed a balance of \$4,004 in the borrower's savings account alone (**Exhibit F-6**).

With regard to the assertion that the gift funds were improperly input into the AUS system, such that they appeared to have been separate funds when in fact they had been deposited into the borrower's account, the Bank respectfully disagrees. In the AUS utilized in this case, while the gift funds had previously been deposited into the borrower's account, the only way to demonstrate that gift funds were received is to list those funds separately in the category "Gift Funds – not deposited." Had the underwriter not selected this option, the AUS would not have recognized the gift funds in this case. The AUS instructions clearly indicate that, when gift funds have been deposited into a borrower's account, the gift should be listed separately in "Gift Funds – not deposited" and then subtracted from the balance of the asset into which the gift funds had been deposited. The underwriter adhered to these instructions in this case and, as discussed above, the loan file documented that the borrower had sufficient funds to close this loan. For these reasons, we request that this assertion be removed from the Report.

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g. FHA Case No. 023-3948891

In this loan, the Report contends that the Bank overstated the borrower's assets by \$2,328 apparently due to a data entry error in inputting information into the AUS. This allegation does not, however, relate to the documentation of sufficient funds to close the loan. Accordingly, the Report does not contend that indemnification would be appropriate on the basis of the alleged overstatement.

As set out above, MetLife Bank understands and appreciates that all "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. MetLife Bank properly verified all funds used to close the loan in this case.

According to the HUD-1, the borrower paid a \$2,000 EMD and \$4,164 in an additional deposit toward closing costs, with \$141.44 due back to the borrower at closing (**Exhibit G-4**). The \$2,000 EMD, which the borrower paid six weeks before closing, was properly verified by a receipt from the deposit-holder (**Exhibit G-5**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory documentation [of the EMD] includes . . . certification from the deposit-holder acknowledging receipt of funds."). The borrower's bank accounts held well in excess of the remaining \$4,164 needed to close; the borrower's most recent statement, dated two weeks before closing, showed a combined balance of \$5,200 in the borrower's checking and savings accounts (**Exhibit G-6**).

With regard to the assertion that funds were overstated in the AUS, MetLife Bank respectfully disagrees. The final AUS, dated March 30, 2011, documents that the borrower had \$7,841 in assets (**Exhibit G-7**), which Appendix E to the Report acknowledges was the amount properly verified and included on the final loan application and Transmittal Summary. For these reasons, this assertion should be removed from the Report.

h. FHA Case No. 023-3515994

In this loan, the Report asserts that the loan file did not contain proper verification of gift funds, as the file did not adequately document the deposit of one gift in the borrower's account. MetLife Bank respectfully disagrees.

MetLife Bank understands and appreciates that FHA guidelines require a lender to verify and document the transfer of gift funds used by a borrower. See HUD Handbook 4155.1, ¶ 5.B.5.a & b. The lender is required to obtain both (1) a gift letter "show[ing] the donor's name, address, telephone number; specify[ing] the dollar amount of the gift; and stat[ing] the nature of the donor's relationship to the borrower, and that

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no repayment is required," and (2) documentation that the transfer occurred, which varies depending on the form and time of payment. It is MetLife Bank's policy and practice to comply with these requirements, and it did so in this case.

The gift in this case was not made by check payable to the borrower but rather by wire transfer to the closing agent, and the wire transfer was documented in accordance with HUD requirements. Specifically, the borrower's uncle provided a gift of \$4,500. The accompanying gift letter properly states the donor's name, address, and telephone number; specifies the amount of the gift; explaining that the donor is the borrower's uncle, and makes clear that no repayment is required or expected (**Exhibit C-8**). The Report contends that the loan file does not contain proof that the funds were withdrawn from the donor's account and deposited in the borrower's account. That requirement only applies to transfers effectuated by check payable to the donor. See HUD Handbook 4155.1, ¶ 5.B.5.b. By contrast, where, as here, the gift is paid by "electronic wire transfer to the closing agent," then the donor need only "provide documentation of the wire transfer." See id. The wire transfer confirmation showing payment of \$4,500 by the donor to the closing agent for the benefit of the borrower was properly included in the loan file (**Exhibit C-9**). MetLife Bank adhered to HUD guidelines in this case and, thus, the allegation should be removed from the Report.

i. FHA Case No. 023-4362539

In this loan, the Report alleges that MetLife Bank did not adequately document the withdrawal of funds from the donor's account and the deposit of those funds in the borrower's account with respect to three distinct gifts totaling \$16,000.

MetLife Bank understands and appreciates that FHA guidelines require a lender to verify and document the transfer of gift funds used by a borrower. See HUD Handbook 4155.1, ¶ 5.B.5.a & b. The lender is required to obtain both (1) a gift letter "show[ing] the donor's name, address, telephone number; specify[ing] the dollar amount of the gift; and stat[ing] the nature of the donor's relationship to the borrower, and that no repayment is required," and (2) documentation that the transfer occurred, which varies depending on the form and time of payment. It is MetLife Bank's policy and practice to comply with these requirements.

As an initial matter, as we have discussed above, only "[f]unds used to cover the required minimum downpayment, as well as closing costs and fees" must be verified. See HUD Handbook 4155.1, ¶ 5.B.1.a. According to the HUD-1, the borrower paid a \$2,000 EMD and \$6,245 in an additional deposit toward closing costs, with \$1,059.00 due back to the borrower at closing (**Exhibit M-1**). The borrower paid \$1,000 toward the EMD six weeks before closing, which was properly verified by a receipt from the deposit-holder (**Exhibit M-2**). See HUD Handbook 4155.1, ¶ 5.B.2.a ("Satisfactory

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documentation [of the EMD] includes . . . certification from the deposit-holder acknowledging receipt of funds.”). With regard to the funds needed to close the loan, as the Report notes, the borrower obtained gift funds. While the loan file documentation referenced multiple gifts from three separate donors, in connection with this response, MetLife Bank contacted the borrower in this case, who confirmed that she received an \$8,000 gift from her brother-in-law, the funds from which she utilized to close the loan. The remaining gifts reflected in the file were, in one case, applied to outstanding indebtedness—the borrower’s car loan—and, in two cases, not realized (**Exhibit M-3**). The unrealized gifts were, as this response makes clear, unnecessary to close the loan. No documentation was required for the car loan payoff inasmuch as it was not “used to cover the required minimum downpayment” nor “closing costs and fees.” See HUD Handbook 4155.1, ¶ 5.B.1.a.

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With regard to the \$8,000 gift that was used to close the loan, the gift letter evidencing this gift was included in the loan file (**Exhibit M-4**). Of these \$8,000 in gift funds, \$6,245 was paid to the closing agent by cashier’s check, which the closing agent verified by providing a receipt and a copy of the official check (**Exhibit M-5**). While the file inadvertently omitted certain documentation regarding the receipt of this gift, in preparation of this response, MetLife Bank obtained copies of the donor’s bank statements, which clearly reflect that the money was withdrawn from the donor’s account in the form of a cashier’s check payable to the closing agent (**Exhibit M-6**). The donor’s bank statements further reflect that, the day before closing, the donor withdrew \$1,000 from his bank account in the form of a second cashier’s check payable to the closing agent (**Exhibit M-6**). In light of the \$1,059 refunded to the borrower at closing, this money was not used to close the loan and therefore need not have been verified, but this additional payment fully explains the variance between the \$2,000 EMD shown on the HUD-1 and the \$1,000 shown on the borrower’s EMD receipt. Although not all documentation was retained in the file, any omission in this regard constituted, at most, harmless error because, as the documentation we have provided in this response demonstrates, all “[f]unds used to cover the required minimum downpayment, as well as closing costs and fees” in fact derived from permissible sources. MetLife Bank adhered to HUD guidelines in this case and, thus, the allegation should be removed from the Report.

4. Recommendations

In addition to opposing several of the individual allegations contained in the Report, MetLife Bank strongly disagrees with certain aspects of the recommendations made in connection with the loans referenced. Specifically, the Bank takes strong exception to the recommendation that PFCRA remedies are appropriate in this case, disputes the calculation of potential losses to the Department in the loans at issue, and

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disagrees with the manner in which the Report discloses that all of the recommendations made in the Report are non-final suggestions to HUD and not the agency's conclusions.

a. Recommendations Regarding PFCRA Remedies

The Report asserts that, in the 14 loans at issue, the underwriter's certification that the data was complete or that underwriter used due diligence in underwriting these cases but did not do so. We understand that this allegation is predicated on the OIG's determination that these 14 cases contained underwriting deficiencies. The Report implies but does not expressly state that these underlying oversights demonstrate that the underwriter did not exercise due diligence in examining the loan file or ensure the loan file's data integrity and, as a result, the certification on the Addendum in these cases was incorrectly signed. The Report recommends in connection with these allegations that HUD's Associate General Counsel for Program Enforcement determine the legal sufficiency of and, if sufficient, pursue civil money penalties and/or remedies under the PFCRA for the purportedly inaccurate certifications in these cases. As discussed in detail above, MetLife Bank takes exception not only to the allegations that these loans contained underlying origination deficiencies, but also separately to the inflammatory recommendation to impose PFCRA penalties or civil money penalties in connection with this finding.

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HUD is authorized to impose civil penalties under PFCRA against persons who "make, submit, or present, or cause to be made, submitted, or presented, false, fictitious, or fraudulent claims or written statements to Federal authorities or to their agents." 24 C.F.R. § 28.1. The Report suggests that, because the OIG identified underwriting deficiencies in these eight cases, the underwriters' certifications that due diligence was used in underwriting these loans are inaccurate. As demonstrated in the above discussion, however, in the 14 cases cited, MetLife Bank substantially complied with HUD requirements and the underwriter made a reasonable decision to approve the loans after exercising due diligence in examining each of the files at issue. For these reasons, MetLife Bank disagrees with the recommendation of any penalty in connection with these loans, let alone the harsh sanctions of civil money or PFCRA penalties recommended in the Report.

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Additionally, the Report does not allege, and there is no evidence to suggest, that MetLife Bank or its employees intended to circumvent HUD underwriting guidelines in these cases. Rather, the certifications in these 14 cases were executed by the underwriters after diligent review of the loan files in which these individuals made every effort to comply with FHA requirements. The certifications in these cases were executed in the belief that the borrowers qualified for FHA financing, which in fact they did in each case, rather than in an attempt to mislead the Department. The Report does

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not allege that MetLife Bank or its underwriters knowingly misrepresented facts to the Department or intentionally provided false information in the cases at issue. Before imposing penalties on FHA-approved lenders, HUD weighs a number of factors. While intentional violations or a disregard for HUD requirements can lead to severe sanction, such as PFCRA penalties, HUD traditionally imposes less severe consequences for deficiencies caused by unintentional error. Additionally, MetLife Bank maintains that the borrowers in the cited cases qualified for FHA financing. At worst, certain of these loans contained minor errors that did not affect the insurability of the loans. As indicated above, MetLife Bank believes that the final report should omit recommendations of administrative action in connection with many of these cases, making the recommendation of PFCRA penalties all the more severe under these circumstances.

We also note that, rather than cite new allegations, the PFCRA recommendation appears to be an attempt to pile on the allegations made against MetLife Bank's underwriting practices in this Report. Typically, OIG audit reports allege certain deficiencies in a company's FHA operations, and the company is given an opportunity to address the materiality and accuracy of the allegations. By also adding an incorrect certification allegation to these underwriting assertions, the OIG has created a situation where every misunderstanding of FHA requirements or oversight of a detail or document in a FHA loan could give rise to allegations of a false certification claim. Such actions will create a chilling effect on lenders who want to participate in the FHA Program. Enforcement actions are meant to reinforce HUD's rules and regulations, rather than discourage broad participation in FHA lending. For the sake of the Program, therefore, we believe the OIG should reconsider its approach to alleging false certifications and focus on the compliance with FHA rules and regulations.

b. Recommendations Regarding Potential Losses to the Department

The Report also recommends that the Department require the Bank to indemnify HUD for potential losses of \$1,096,774 in connection with the 12 active loans referenced. To derive these estimated losses, the Report indicates that it included 59 percent of the unpaid principal balance in these cases. According to footnote 11 of the Report, this multiplier was selected based on information provided by HUD showing that its losses on sales average 59 percent of the claim paid.

As set out above, MetLife Bank disagrees with the Report's conclusions that underwriting deficiencies were present in these cases. Otherwise, however, MetLife Bank does not take issue with the OIG's calculation of the Department's actual or potential losses in connection with loans for which claims have been made. The Bank does, however, take strong exception to inclusion of the \$1,096,774 in estimated losses in the 12 cited loans. First, we note that the \$1,096,774 figure does not represent a

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payment that the Report recommends MetLife Bank pay to HUD, but rather reflects a mere estimate of the losses the Department could incur if all 12 loans ultimately result in claims to HUD. The Report merely recommends that HUD request indemnification, but any amounts paid to HUD in connection with any indemnifications will be determined based on the actual losses to HUD upon resolution of the claim made to the Department, rather than the estimates included in this document.

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All 12 of these loans remain active. MetLife Bank appreciates that these loans may have entered default at some point; however, none of these loans have been foreclosed, terminated, or resulted in insurance claims to the Department. To date, HUD has not incurred any loss in connection with these cases and it is not possible to determine whether the Department will ever incur losses in these cases. Indeed, MetLife Bank's historical default/claim compare ratio is 88%. In fact, the Report acknowledges that, in eight of these loans, the borrowers are at present current with their mortgage payments. Moreover, in the event that HUD does pay a claim in any of these loans, there is no guarantee that the Department will sustain monetary loss, as HUD may be able to recoup the claim amount in the sale of the underlying property.

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Notwithstanding these facts, the Report suggests that the Department will experience losses in the amount of 59% of the unpaid principal balance of each one of these loans, and lists the financial risk to the Department, which it defines as "funds to be put to better use," as \$1,096,774. This calculation assumes that every one of the active loans will go into foreclosure and result in a claim to HUD. Such an assumption would be supportable if 100% of the loans that enter default resulted in claims to HUD; however, that percentage is significantly lower. Thus, there is no reason to believe that any of these loans, let alone all of them, will result in a claim or financial loss to the Department. Based on these facts, absent evidence that the 12 loans at issue will result in an actual claim to the Department, the potential loss figure is greatly inflated and does not paint an accurate picture of the risks associated with this matter. It appears that inclusion of such an inflammatory figure in the final report serves only as an attempt to justify the costs of the audit of this Bank, rather than portray the precise amount of the potential losses that HUD may incur in connection with these loans.

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Moreover, as noted above, this arbitrary monetary figure is included with a mere recommendation to the Department to require the Bank to indemnify it in connection with certain loans. Upon receiving the final report, the Department will have an opportunity to independently review the audit findings and make an independent determination of whether indemnification is warranted in any of these cases. As discussed at length earlier in this response, MetLife Bank disagrees that the great majority of the findings set forth in the Report warrant indemnification. HUD may also disagree with the Report's assertions and decide not to pursue indemnification in some

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or all of the cited cases. Notwithstanding the fact that these findings are preliminary, the OIG's recommendations assume that HUD will accept each allegation and pursue indemnification in each case.

The estimated loss figure is therefore unrepresentative of the Department's actual loss risk in connection with the 12 active loans cited in the draft Report. Inclusion of this overstated figure in the Report unfairly represents the loss exposure to HUD, and ultimately the Bank, as a result of this audit. Therefore, MetLife Bank strongly opposes the inclusion of this figure in the final report and requests that it be removed or amended to portray a more accurate picture of the potential losses in the active FHA loans cited in the Report. As the recommendation regarding these loans is that the Bank indemnify HUD, the Report should merely state this recommendation without including estimated losses that are difficult, if not impossible, to predict accurately in these loans. At the very least, if the final report continues to include the average claim loss paid for these 12 loans as the potential financial risk to HUD and the Bank, the Report should also clarify the percentage of defaulted loans that result in a claim to HUD and include the potential losses based on this significantly reduced number of loans. This figure would present readers with a more accurate and fair picture of the financial risks associated with the loans identified in the Report.

c. The Audit Conclusions Are Recommendations Only

In addition, while the audit process is still ongoing at the time the OIG issues its "final" report, the Report and the OIG's recommendations are made public on the OIG website. As a result, a lender's investors and peers are able to access the preliminary recommendations of the OIG before a final assessment as to their merit can be made by the Department. These entities often misinterpret the OIG's recommendations to be final actions by the Department, and also frequently misunderstand the potential losses cited to be the actual financial penalties assessed by HUD on the audited FHA lender. Under these circumstances, making these preliminary recommendations public and including (1) an inflammatory PFCRA estimate that is predicated on the unsupported suggestion that the loans identified involve misrepresentation and (2) a potential loss figure that is based on the erroneous assumption that every single loan at issue will result in a claim to HUD will have a material, adverse effect on the business of the audited FHA lender. If the OIG's goal is to present the reader with a full and accurate disclosure of the audit and its implications to the audited lender, the Report should include the following disclosure on the first page in bold, capitalized lettering:

THE REPORT FINDINGS REFLECT THE VIEWS OF THE OFFICE OF INSPECTOR GENERAL AND DO NOT CONSTITUTE A FINAL DETERMINATION OF THE MATTERS RAISED HEREIN BY THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT. THE FINAL DETERMINATION IN THIS MATTER WILL BE

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MADE BY THE REPORT'S ADDRESSEES, THE HUD ASSISTANT SECRETARY FOR HOUSING – FEDERAL HOUSING COMMISSIONER AND THE ASSOCIATE GENERAL COUNSEL FOR PROGRAM ENFORCEMENT, WHO WILL ULTIMATELY DECIDE WHETHER TO ACCEPT THE REPORT'S RECOMMENDATIONS IN WHOLE OR IN PART OR REJECT THEM.

Such a disclosure would substantially more accurately convey the status of the OIG's "final" report to the Bank's investors, customers, and the public.

B. FINDING 2 – METLIFE BANK ADHERES TO HUD'S QUALITY CONTROL REQUIREMENTS

In Finding 2, the Report alleges that the Bank did not effectively implement components of its Quality Control procedures relative to: (1) annual reviews of branch offices consistent with HUD guidelines and MetLife Bank's Quality Control Plan; and (2) timely completion of loan file Quality Control reviews pursuant to HUD guidelines and MetLife Bank's internal requirements. Finding 2 recommends that the Bank adhere to its existing Quality Control Plan to ensure that branch office reviews are conducted annually or on a defined risk basis and complete loan file Quality Control within 90 days from the end of the month in which the loan closed.

MetLife Bank adheres to a robust Quality Control Plan and consistently engages in stringent Quality Control and compliance activities to ensure the Bank identifies any potential areas of concern and takes swift action to implement corrective measures to redress any problems. See HUD Handbook 4060.1 REV-1, ¶¶ 6-1. MetLife Bank has a Quality Control Group within its Risk Office that is tasked with evaluating and monitoring the quality of the Bank's originated residential mortgage loans, servicing functions, and branch operations in accordance with MetLife Bank policies and the requirements of various secondary market institutions, private investors, and government agencies, including HUD/FHA. The Quality Control Group is sufficiently staffed and overseen by a Director, Loan Production Manager and Servicing Supervisor. Findings and results are documented in an electronic Quality Control database. Production staff is required to access the database and respond to all loans with findings within a prescribed time period. Quality Control Management reports results to Senior Management monthly, and Senior Management takes prompt and effective corrective actions on deficiencies identified. MetLife Bank also consistently monitors its Neighborhood Watch data.

MetLife Bank therefore practices strict Quality Control and adheres to a detailed Quality Control Plan. Of course, we continuously strive to improve the Bank's Quality Control department and have taken significant steps to enhance our Quality Control review procedures to ensure full compliance with HUD guidelines and to allow MetLife Bank's management to identify and remedy any issues that may affect loan quality or

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performance in a timely manner. With respect to the specific issues raised in the Report, MetLife Bank understands and appreciates that HUD guidelines set out certain requirements for the timing of branch site visits and loan filing reviews. Specifically, the Bank understands that:

[a]nnual visits are mandatory for offices meeting certain higher risk criteria such as high early default rates, new branches or new key personnel, sudden increases in volume, and past problems. Other sites must be reviewed to assure compliance with FHA's requirements at a frequency and in a manner determined appropriate by the mortgagee. The criteria used by the mortgagee to determine the frequency of on-site reviews must be in writing and available for review by HUD at the corporate office and any branch office that is not being reviewed annually.

HUD Handbook 4060.1, REV-2, ¶ 7-3(G)(2). MetLife Bank further appreciates that "[t]he review of a specific mortgage should be completed within 90 days of closing." See HUD Handbook 4060.1, REV-2, ¶ 7-3(G)(2).

The Report expressly states that Finding 2 is based on a review of Quality Control procedures and loan review reports that were in place or conducted in 2010. As the Report recognizes, the Bank's branches were in a period of significant transition in 2010, and the Bank began conducting additional branch reviews and a formal site review plan during the course of the OIG's audit in 2011. Moreover, as noted above and during the recent exit conference regarding this matter, MetLife Bank has changed its business plan and is actively seeking to reduce its presence in the mortgage origination business. To that end, the Bank anticipates exiting the forward mortgage origination business within the next six months, and will consequently cease originating FHA-insured forward mortgages. This change will likely occur before the Bank makes substantial changes to its Quality Control Plan; however, in the absence of forward mortgage originations, there will be no further requirement for the branch office site visits addressed in the Report, nor any ongoing need to review closed loan files.

We trust that these actions will effectively resolve the issues raised in Finding 2 and request that the Report be amended to acknowledge these circumstances.

III. CONCLUSION

MetLife Bank takes the matters raised in the draft Report seriously. Because FHA lending has comprised a significant portion of MetLife Bank's overall business operations, the Bank has maintained a commitment to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, MetLife Bank substantially complied

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with FHA underwriting requirements and made loans to qualified FHA borrowers. MetLife Bank's thorough review of the findings set forth in the Report indicated that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of MetLife Bank, or do not affect the underlying loans' insurability. The Bank substantially complied with FHA underwriting requirements in several of the loans identified in the Report and made loans to qualified FHA borrowers. Accordingly, we respectfully request that the OIG revise the allegations cited in the Report based on the information and documentation provided in this response and remove allegations for which MetLife Bank has demonstrated its compliance with HUD requirements.

Finally, MetLife Bank believes that the recommendations involving PFCRA penalties are unwarranted, as they suggest an intent to circumvent HUD requirements when the OIG knows full well that no such intention existed in these cases. MetLife Bank values its relationship with the Department and did not, in any manner, seek to misrepresent any information to HUD. MetLife Bank believes that the various remedies available to HUD, short of the severe sanctions under PFCRA, are commensurate to resolve any deficiency identified in the Report. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate that including these recommendations in the Report is unnecessary, inappropriate, and will needlessly damage reputation. We respectfully request that the OIG revise its recommendations to fit the facts of this case.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Phillip Schulman, at (202) 778-9027, or Krista Cooley, at (202) 778-9257.

Thank you for your kind consideration.

Sincerely,



Karen Crawford
Associate General Counsel

Enclosures

cc: Phillip Schulman, Esq.
Krista Cooley, Esq.

OIG Evaluation of Auditee Comments

- Comment 1** The lender requested an opportunity to respond to additional substantive comments made by the OIG. The purpose of presenting the lender's comments to the discussion draft report and the OIG's evaluation of the lender's comments is to factually present the lender's position and ensure accuracy and full disclosure. The lender will have the opportunity to provide further comments and supporting documentation to HUD during the audit resolution process.
- Comment 2** The lender commented that the loans cited in the report were from a single branch office which has been closed, resolving any issues. The background section of the report does recognize that the branch closed after the start of the audit; however, this did not resolve the reported violations nor did it remove the risk of losses that the significantly deficient loans pose to the FHA insurance fund. Similarly, the lender's plans to exit the mortgage origination business does not relieve it of any violations identified during our audit.
- Comment 3** Although 10 loans contained only technical deficiencies, they still indicate problems in underwriting. Combined, we identified 24 loans with underwriting deficiencies (both technical and significant), or 80 percent of our total sample. Our sample of 30 loans was selected based on loans that were seriously delinquent or had claims, had loan-to-value ratios over 96.5 percent (the maximum limit), and were delinquent in the first six months.
- Comment 4** We disagree with the lender's assertion that the report is in variance with the facts and the violations do not affect the insurability of the questioned loans. Our findings were based on interviews, detailed analysis, and thorough comparison to HUD rules and regulations. The questioned loans did not meet the threshold for insurability. As noted in the finding, we did not state the cause of the noncompliance was due to the lenders intentional disregard of HUD guidelines or knowingly misrepresenting information. We attributed the noncompliance to the fact that the underwriters did not exercise sound judgment and due diligence in underwriting FHA-insured loans.
- Comment 5** The lender requested the OIG to omit the technical underwriting deficiencies from Appendix E or to expressly identify them as minor allegations. The technical underwriting deficiencies are included to further illustrate the lack of quality control and present each questioned loan in its entirety. We did not revise the report as the introductory paragraph for each loan narrative clearly identifies the deficiencies the OIG is using as the basis for indemnification.
- Comment 6** We disagree with the lender's response that it was appropriate to use the same two-year averaging method approved and required for other forms of variable income because the borrower's base income was variable. HUD Handbook 4155.1, paragraph 4D(2)(g) applies to commission income. In this case the

borrower received both an hourly base income, which should be treated as regular income, and tips for his second job, which would be treated as bonus or commission income. The OIG determined it was more appropriate to calculate the borrower's monthly income based on the year-to-date pay from the most recent pay stub in the loan file and not include the tips because the lender did not document a two year history of the tips as is required with other forms of variable income. For overtime and bonus income, HUD Handbook 4155.1, paragraph 4D(2)(c) states the lender must establish and document an earnings trend for overtime and bonus income. For commission income, HUD Handbook 4155.1, paragraph 4D(2)(g) states it must be averaged over the previous two years and that if it shows a decrease from one year to the next then significant compensating factors are required before a borrower can be approved for the loan. Also, as stated in the report, the average monthly income was significantly different in the previous two years. The average monthly income for 2008 was \$531 while the average monthly income for 2009 almost doubled (\$1,035).

Comment 7 The lender incorrectly used HUD Handbook 4155.1, paragraph 4C(6)(b) to state taxes should not be subtracted from gross income. This specific provision applies to the borrower's debt and liabilities analysis and does not pertain to discussion of self employment income.

Comment 8 We disagree with the lender's method of computing self-employment income in that one-half of self-employment tax should not be excluded when calculating the borrower's self-employment income. HUD Handbook 4155.1, paragraph 4D(5)(a) states that for self-employed borrowers, the adjusted gross income must be either increased or decreased based on the lender's analysis of the individual tax return and any related tax schedules. HUD Handbook 4155.1, paragraph 4D(5)(b) details items from the individual tax return that may be added or must be subtracted from the adjusted gross income. On tax forms, one-half of self-employment tax is subtracted from business income to arrive at adjusted gross income. The handbook does not state that the one-half of self-employment tax may be added back to the adjusted gross income.

Comment 9 Exceeding the qualifying ratios, especially the total debt-to-income ratio, indicates a greater underwriting risk and must be analyzed carefully. HUD Handbook 4155.1, paragraph 4F(1)(b) states that simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting.

Comment 10 We disagree with the lender's assertion that the compensating factors listed were sufficient because they are either not valid or were not verified. HUD Handbook 4155.1, paragraph 4F(3)(b) does not state that excellent credit and nontaxable reimbursements are compensating factors that may be used to justify approval of mortgage loans that contain excessive qualifying ratios. Also, the decrease in net housing payment was not verified. The borrower

provided the amount of the present housing payment on the uniform residential loan application; however, this amount was not verified by the lender.

- Comment 11** We disagree that the lender complied with HUD requirements with respect to FHA case number 023-4023605. Therefore, the loan will remain in the report as significantly deficient and indemnifiable.
- Comment 12** We disagree with the lender's assertion that the compensating factors were sufficient as they were not valid. Excellent credit is not listed as a valid compensating factor according to HUD Handbook 4155.1, paragraph 4F(3)(b). Further, a history of timely mortgage payments was not a valid compensating factor because the proposed monthly housing payment for the new mortgage of \$1,835 was much higher than the present housing payment of \$814. To be a valid compensating factor, HUD Handbook 4155.1, paragraph 4F(3)(b) states that the borrower should have successfully demonstrated the ability to pay housing expenses greater than or equal to the proposed monthly housing expenses for the new mortgage over the past 12-24 months.
- Comment 13** We disagree that the lender complied with HUD requirements with respect to FHA case number 022-2050283. Therefore, the loan remains as in the report as significantly deficient.
- Comment 14** We disagree with the lender's response that it was appropriate to use the same two-year averaging method approved and required for other forms of variable income because the borrower's base income showed a continual decline. The OIG determined it was more appropriate to calculate the borrower's monthly income based on the year-to-date pay from the most recent pay stub in the loan file, which covered approximately five months, because, as stated in the report, the average monthly income had decreased each year, illustrating a declining earnings trend. The monthly income calculated by the lender was \$1,496, \$1,337, and \$1,296 for 2007, 2008, and 2009, respectively.
- Comment 15** The lender incorrectly referenced HUD Handbook 4155.1, paragraph 4D(2)(c) and (g) when making the case for averaging income over two years for borrowers with variable income. The cited reference applies to overtime, bonus, and/or commission income. In this instance, the borrower's income is not derived from overtime, bonus, or commission income. Therefore, the cited reference does not apply and the report remains unchanged.
- Comment 16** In addition to being calculated incorrectly, the lender's response did not address that the borrower's self-employment income should have been questioned because several issues were identified as noted in Appendix E on page 31 of the report.
- Comment 17** We disagree with the lender's assertion that the compensating factors listed were sufficient as they were not valid. The borrower's minimal use of credit

does not fully comply with HUD Handbook 4155.1, paragraph 4F(3)(b) because it states that the borrower has demonstrated an ability to accumulate savings and has a conservative attitude toward using credit. The loan file does document a minimal use of credit but does not document that the borrower has to ability to accumulate savings. Even with the borrower's conservative attitude toward using credit, the borrower had less than \$2,000 in their bank account. The lender's response noted that there was only a slight increase in the borrower's housing payments; however, this is not accurate as it increased by approximately 14 percent, from \$1,250 to \$1,424. Lastly, the amount of the present housing payment of \$1,250 on the uniform residential loan application was not verified by the lender.

Comment 18 We disagree that the lender complied with HUD requirements with respect to FHA case number 023-3515994. Therefore, the loan remains in the report as significantly deficient.

Comment 19 We disagree with the lender's assertion that the compensating factors listed were sufficient as they were either not valid or not verified. HUD Handbook 4155.1, paragraph 4F(3)(b) does not list excellent credit as a valid compensating factor. Although the decrease in the borrower's housing payment is a valid compensating factor, the previous housing payment on the uniform residential loan application was not verified by the lender. More importantly, even if verified, the decreased housing payment would not have been sufficient as a compensating factor to overcome a total fixed payment-to-income ratio of 55.18 percent, over 12 percent over the threshold.

Comment 20 We disagree that the lender complied with HUD requirements with respect to FHA case number 023-3302437. Therefore, the loan remains in the report as significantly deficient.

Comment 21 We disagree with the lender's assertion that the error was harmless. A total debt-to-income ratio of 50 percent is significantly in excess of HUD's threshold of 43 percent, requiring significant compensating factors. Exceeding the qualifying ratios, especially the total debt-to-income ratio, indicates a greater underwriting risk and must be analyzed carefully. HUD Handbook 4155.1, paragraph 4F(1)(b) states that simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. In this case, the loan doesn't even meet minimal standards.

Comment 22 We disagree with the lender's assertion that the compensating factors were sufficient as they were not valid. The lender's response noted that there was a decreased housing payment; however, this is not accurate because the uniform residential loan application indicated a present housing payment of \$857, lower than the proposed monthly payment for the new mortgage of \$908.

The second compensating factor listed in the lender's response states that the borrower had a history of substantial overtime income with a probability of

continuance. This is not accurate as the written verification of employment indicates that the borrower only received \$338 in overtime income for 2010, which covered approximately 8.5 months, \$73 for 2009 and \$0 for 2008. The verification also stated that overtime was not likely to continue. Therefore, this overtime income did not positively affect the borrower's ability to pay the mortgage as stated in HUD Handbook 4155.1, paragraph 4F(3)(b).

The third and fourth compensating factors listed in the lender's response states that the loan-to-value ratio was only 87 percent and the borrower's employment was highly stable. HUD Handbook 4155.1, paragraph 4F(3)(b) does not list these as valid compensating factors, therefore are not acceptable.

The last compensating factor listed in the lender's response states that the borrower was a minimal user of credit; however, this does not fully comply with the compensating factor stated in HUD Handbook 4155.1, paragraph 4F(3)(b) that the borrower has demonstrated an ability to accumulate savings and has a conservative attitude toward using. The loan file does document a minimal use of credit but does not document that the borrower has exhibited an ability to accumulate savings. Even with a conservative attitude toward using credit, the borrower had less than \$300 in her bank account.

- Comment 23** The report remains unchanged regarding FHA loan 022-2217731 due to excessive qualifying ratios and a lack of valid compensating factors.
- Comment 24** The issue of not obtaining a written explanation for credit inquiries is a technical issue on its own. However, it is presented in conjunction with the significant deficiencies to illustrate the lack of underwriting quality control and allow for a complete, factual presentation of each case. Therefore, the report remains unchanged; see also Comment 5.
- Comment 25** We disagree with the lender's response that there was no realistic way of knowing the borrower was married at the time the loan closed. Documents in the loan file, specifically a disclaimer deed and an instruction permit for the spouse, indicated that the borrower's marital status was married, inconsistent with what was reported on the uniform residential loan application. Given the inconsistencies in the loan file, we believe an inquiry of the questioned documents would not have violated the Equal Credit Opportunity Act. The underwriter should have resolved this discrepancy and provided an explanation in the loan file. In addition, the OIG interviewed the borrower during the audit, who stated that the person assisting them with the purchase of the property was aware that they were married.
- Comment 26** We disagree with the lender's response that there was no realistic way of knowing the borrower was married at the time the loan closed. A document in the loan file, specifically a certificate of naturalization, showed that the borrower's marital status was married, inconsistent with what was reported on

the uniform residential loan application. As stated above, given the inconsistencies in the loan file, we believe an inquiry of the questioned documents would not have violated the Equal Opportunity Act. The underwriter should have resolved this discrepancy and provided an explanation in the loan file.

Comment 27 We disagree with the lender's response that they did include and consider all of the non-purchasing spouse's debts. While the monthly payment of \$166 for a third student loan reflected no account activity for the previous eight years and the amount listed for the outstanding balance was blank, the credit report did list a monthly payment amount. Therefore, the underwriter should have resolved this issue and included an explanation in the loan file why this liability was not included in the borrower's qualifying ratios.

Comment 28 Although the qualifying ratios are still below FHA requirements after inclusion of the understated liabilities, the technical deficiency remains in the report to provide a complete, factual presentation of the loan and illustrate the lack of quality control exhibited when underwriting loans for mortgage insurance. See also Comments 5 and 24.

Comment 29 We agree with the lender's response that the net rental loss was properly calculated using the applicable vacancy factor as stated in Homeownership Center Reference Guide, Chapter 2. This has been removed from the report; however, it does not affect the OIG's recommendation for indemnification of this loan because, as stated in the report, the lender did not ensure that the borrower made the required downpayment.

Comment 30 The report explicitly details when a deficiency regarding the funds to close is used as a basis for indemnification. When the deficiency is technical, it is still appropriate to include in the report in order to provide a complete, factual presentation of each case. These technical deficiencies further illustrate the deviation from HUD rules and regulations and the lack of quality control. See also Comments 5 and 24.

Comment 31 We disagree with the lender's response that all funds used to close the loan were properly verified. Fannie Mae Underwriting Findings, item 29, required the assets to be verified by a verification of deposit, the most recent statement showing the previous month's balance, or the most recent 2 months' statements. Stating that the borrower took a \$4,000 loan from their 401(k) plan and could have easily saved the money needed to close with future earnings does not satisfy these requirements. However, the report will be modified to reflect that the lender properly verified \$5,573 because the \$1,000 in earnest money deposit was paid one month before closing.

Comment 32 We agree with the lender's response that all funds used to close the loan were properly verified. However, the borrower did not make the required

downpayment of 3.5 percent and the lender did not adhere to HUD requirements in determining the borrower's assets and overstated them by \$7,981, as stated in the report. This loan was approved through the automated underwriting system and the borrower's assets are considered in the mortgage evaluation.

Comment 33 We agree with the lender's response that the retirement account funds were not used to close the loan. However, the lender did not adhere to HUD requirements in determining the borrower's assets and overstated them by \$4,051 as stated in the report. This loan was approved through the automated underwriting system and the borrower's assets are considered in the mortgage evaluation. Additionally, the loan remains indemnifiable because the lender did not verify the borrower's employment history for two full years.

Comment 34 We disagree with the lender's response that all funds used to close the loan were properly verified. As stated in the report, Fannie Mae Underwriting Findings, item 30, required the assets to be verified by either a verification of deposit, the most recent statement showing the previous month's balance, or the most recent 2 months' statements. Stating that the borrower was paid a \$462 bonus between the date of the verification of deposit and closing and could have easily saved \$147 based on future earnings does not satisfy these requirements. Assumptions of future potential savings are not acceptable or adequate as verification.

Comment 35 We agree with the lender's response that all funds used to close the loan were properly verified. However, the lender did not adhere to HUD requirements in determining the borrower's assets and overstated them by \$5,362 as stated in the report. This loan was approved through the automated underwriting system and the borrower's assets are considered in the mortgage evaluation. The loan remains indemnifiable based on understated liabilities due to incorrectly calculating the borrower's net rental loss, resulting in an excessive total fixed payment-to-income ratio of over 85 percent.

Comment 36 The report does not state the gift funds were improperly input into the automated underwriting system; however, the report has been changed to more clearly identify that the borrower's assets were overstated because the checking account balance included the deposited gift but the gift was also listed separately. The lender should have subtracted the gift amount from the savings account balance. Even though all funds used to close the loan were properly verified the lender did not adhere to HUD requirements in determining the borrower's assets and overstated them by \$4,996 as stated in the report. This loan was approved through the automated underwriting system and the borrower's assets are considered in the mortgage evaluation. The loan remains indemnifiable based on the lender's inability to determine the borrower's liabilities.

- Comment 37** We agree with the lender's response that the borrower's assets were not overstated. This has been removed from the report; however, it does not affect the OIG's recommendation for indemnification of this loan because, as stated in the report, the lender did not determine the borrower's liabilities and did not ensure that the borrower made the required downpayment.
- Comment 38** We disagree with the lender's response that the gift was not made by check to the borrower but rather by wire transfer to the closing agent. While the loan file does contain supporting documentation of a \$4,500 wire transfer made on August 24, 2009, it also contains documentation supporting a \$4,500 deposit into the borrower's bank account on July 22, 2009. The gift letter was dated on July 22, 2009. In addition, the HUD-1 settlement statement showed the wire transfer to the borrower as a gift but also showed that gift funds were returned to the donor. The report remains unchanged as the lender did not obtain sufficient documentation.
- Comment 39** We disagree with the lender's response that no documentation was required for the car loan payoff. While it was not used to cover the funds required to close the loan, it was a gift to pay off a debt on behalf of the borrower. If the debt was not paid off with the gift from the borrower's cousin then the liability would have been used in determining the borrower's qualifying ratios. This liability was significant enough to negatively impact the total fixed payment-to-income ratio. The report has been modified to reflect that the borrower only received two gifts as noted in the lender's response; however, the gift used to pay off the borrower's debt remains a significant issue.
- Comment 40** We reviewed the supporting documentation that was omitted from the loan file and agree that part of the gift was properly supported but determined that the remaining balance of the gift was not. The documentation provided in the exhibits to the response does properly support \$6,245 of the \$8,000 gift from the borrower's brother-in-law; however, the borrower provides a statement in the exhibits that he received the remaining \$1,755 in cash. Therefore, as noted in the report, a copy of the withdrawal document showing that the withdrawal was from the donor's account and the borrower's deposit slip and bank statement showing the deposit were required. These documents were not in the loan file nor were they provided in the exhibits. The loan file does document the borrower had the remaining \$1,000 required to close the loan in his bank account. However, the loan file did not document when the gift of \$1,755 was provided to the borrower. Therefore, this gift may have been included in the borrower's bank account. The report has been modified to reflect that part of the \$8,000 was properly supported.

The second cashier's check of \$1,000 from the borrower's brother-in-law to the closing agent represented a gift in excess of the original \$8,000 gift. Therefore, another gift letter was required for this gift.

Comment 41 The lender disagrees with the recommendation of any penalty in connection with the loan that contained significant underwriting deficiencies. The OIG believes the recommendations are appropriate based on the results of our audit. Therefore, we did not remove any of the recommendations. However, during the audit resolution process HUD will provide its proposed management decision to OIG, at which time it will advise whether it concurs with the recommendation or proposes alternative corrective action.

Comment 42 Contrary to the lender's assertion, the report specifically stated that the lender did not perform due diligence when approving the questioned loans for mortgage insurance. We identified significant deficiencies that we believe allow for civil penalties. Nevertheless, as stated in Comment 41, HUD will advise OIG of its position during the audit resolution process.

Comment 43 The lender references a typical OIG audit report and states our report should be similar. Each audit is conducted and reported on its own merits. In this particular case, we identified a number of significant deficiencies, a serious lack of quality control, and lack of due diligence, that reached beyond simple errors and omissions. We believe enforcement actions and civil penalties are appropriate based on the facts presented.

Comment 44 The lender takes strong exception to the inclusion of the estimated losses for the 12 cited loans. As noted in their response, this amount reflects an estimate of the losses HUD could incur if the loans result in claims. The OIG included potential losses in the report as a remedy and to emphasize how indemnification of the questioned loans will reduce the risk of loss to the FHA insurance fund.

The lender's statement that the report acknowledges that, in eight of the questioned loans, the borrowers were current with their mortgage payments is not accurate. At the time of the report, seven of those loans were current with their mortgage payments. However, as of December 31, 2011, only five of those loans were current and of these, four had previously been delinquent (from 1 to 10 months).

Comment 45 We noted the lender's strong opposition to our recommendations. However, the report and its associated recommendation remain unchanged. Our recommendations are addressed to HUD and are reviewed and evaluated during the audit resolution process. Our recommendations are not based on assumptions, but on calculations that we determined are appropriate to quantify the level of risk and the remedy to decrease that risk to the FHA insurance fund.

Comment 46 The lender objected to the OIG's policy of making audit reports public before HUD makes a final determination on the recommendations. We acknowledge the lender's objection; however, we strongly disagree with their categorization

of the process and the way it suggests the process works. Our report is factual and accurate based on the records provided by the lender and our audit work performed. To further ensure the results of the audit are factually correct, we provide the auditee and HUD the opportunity to review the discussion draft report and advise us of any inaccuracies. Only after this occurs, is the report publicly distributed. In the Highlights section of the report, the reader can see that we reported what we found and have made recommendations to HUD on the proposed corrective action. HUD management officials are responsible for initiating action to evaluate and resolve reported findings and recommendations after report issuance.

Comment 47 The lender requested the report to be amended to acknowledge that it anticipates exiting the forward mortgage origination business. The OIG has learned that MetLife Bank closed its forward home loan business on January 10, 2012. Accordingly, the recommendation for finding 2 has been removed from the report.

Appendix C

LOAN DETAILS FOR SIGNIFICANT UNDERWRITING DEFICIENCIES

The table below contains the actual, if known, and estimated losses to HUD corresponding to the loans recommended for indemnification under finding 1.

FHA loan number	Unpaid mortgage balance	Claim paid	Actual loss to HUD	Estimated loss to HUD (59%) ²²
022-2050283	\$262,506			\$154,879
022-2217731	116,535			68,756
022-3302437	133,479			78,753
023-3312197	150,164	\$15,490 ²³		88,597
023-3321334	243,558	1,000 ²³		143,699
023-3380559		61,229	\$61,229	
023-3485534		40,326	40,326	
023-3515200	124,089			73,213
023-3515994	182,633			107,753
023-3551691	86,813			51,220
023-3789597	119,970			70,782
023-3948891	182,112			107,446
023-4023605	56,606			33,398
023-4362539	200,472			118,278
	\$1,858,937	\$118,045	\$101,555	\$1,096,774

²² Amounts were calculated based on 59 percent of the unpaid mortgage balances.

²³ Partial claim. The total of the partial claims paid is \$16,490 (\$15,490 + \$1,000).

Appendix D

CRITERIA

1. HUD Handbook 4060.1, REV-2, Paragraph 7-3G

2. Frequency. Technology enables mortgagees to conduct effective Quality Control remotely. Annual visits are mandatory for offices meeting certain higher risk criteria such as high early default rates, new branches or new key personnel, sudden increases in volume, and past problems. Other sites must be reviewed to assure compliance with FHAs requirements at a frequency and in a manner determined appropriate by the mortgagee. The criteria used by the mortgagee to determine the frequency of on-site reviews must be in writing and available for review by HUD at the corporate office and any branch office that is not being reviewed annually.

2. HUD Handbook 4060.1, REV-2, Paragraph 7-6A

Loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected prior to closing are identified as early after closing as possible.

3. HUD Handbook 4155.1, paragraph 2A(2)(c)

(HUD Handbook 4155.1, REV-5, section 1-7)

The borrower must make a down payment at least equal to 3.5 percent of the lesser of the appraised value of the property or the sales price.

4. HUD Handbook 4155.1, paragraph 4C(2)(c)

(HUD Handbook 4155.1, REV-5, paragraph 2-3B)

Lenders must determine the purpose of any recent debts as the indebtedness may have been incurred to obtain the required cash investment. A borrower must provide a satisfactory explanation for any significant debt that is shown on the credit report, but not listed on the loan application. Written explanation is required for all inquiries shown on the credit report for the last 90 days.

5. HUD Handbook 4155.1, paragraph 4A(5)(b)

(HUD Handbook 4155.1, REV-5, paragraph 2-2D)

Except for obligations specifically excluded by state law, the debts of non-purchasing spouses must be included in the borrower's qualifying ratios, if the borrower resides in a community property state or the property being insured is located in a community property state.

6. HUD Handbook 4155.1, paragraph 4A(5)(c)

(HUD Handbook 4155.1, REV-5, paragraph 2-2D)

The non-purchasing spouse's credit history is not considered a reason to deny credit. However, the non-purchasing spouse's credit report that complies with the requirements of HUD 4155.1 4.C.2 must be provided in order to determine the debt-to-income ratio.

7. HUD Handbook 4155.1, paragraph 4D(1)(b)

(HUD Handbook 4155.1, REV-5, section 2-6)

To be eligible for a mortgage, FHA does not require a minimum length of time that a borrower must have held a position of employment. However, the lender must verify the borrower's employment for the most recent two full years, and the borrower must explain any gaps in employment that span one or more months and indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim such as college transcripts or discharge papers.

The TOTAL [Technology Open to All Lenders] Scorecard Accept recommendation does not require an explanation for gaps in employment of six months or less, during the most recent two years.

8. HUD Handbook 4155.1, paragraph 4D(4)(e)

(HUD Handbook 4155.1, REV-5, paragraph 2-9C)

When qualifying a [self employed] borrower for a mortgage loan, the lender must establish the borrower's earnings trend from the previous two years using the borrower's tax returns. If the borrower provides three years of tax returns, the lender may average the income over the three years.

9. HUD Handbook 4155.1, paragraph 4D(5)(a)

(HUD Handbook 4155.1, REV-5, paragraph 2-9C)

The amount shown on a [self employed] borrower's IRS [Internal Revenue Service] Form 1040 as adjusted gross income must either be increased or decreased based on the lender's analysis of the individual tax return and any related tax schedules.

10. HUD Handbook 4155.1, paragraph 4E(4)(a)

(HUD Handbook 4155.1, REV-5, paragraph 2-7M)

Rent received for properties owned by the borrower is acceptable as long as the lender can document the stability of the rental income through a current lease, an agreement to lease, or a rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).

11. HUD Handbook 4155.1, paragraph 4E(4)(d)

(HUD Handbook 4155.1, REV-5, paragraph 2-7M)

Analysis of the following required documentation is necessary to verify all borrower rental income: IRS Form 1040 Schedule E, as described in HUD 4155.1 4.D.5.b, and current leases/rental agreements, as described in HUD 4155.1 4.E.4.f.

12. HUD Handbook 4155.1, paragraph 4E(4)(e)

(HUD Handbook 4155.1, REV-5, paragraph 2-7M)

The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss. Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

13. HUD Handbook 4155.1, paragraph 4E(4)(f)

(HUD Handbook 4155.1, REV-5, paragraph 2-7M)

The borrower can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.

14. HUD Handbook 4155.1, paragraph 4F(2)(b)

(HUD Handbook 4155.1, REV-5, paragraph 2-12A)

The relationship of the mortgage payment to income is considered acceptable if the total mortgage payment does not exceed 31 percent of the gross effective income. A ratio exceeding 31 percent may be acceptable only if significant compensating factors, as discussed in HUD 4155.1 4.F.3, are documented and recorded on the mortgage credit analysis worksheet.

15. HUD Handbook 4155.1, paragraph 4F(2)(c)

(HUD Handbook 4155.1, REV-5, paragraph 2-12B)

The relationship of total obligations to income is considered acceptable if the total mortgage payment and all recurring charges do not exceed 43 percent of the gross effective income. A ratio exceeding 43 percent may be acceptable only if significant compensating factors, as discussed in HUD 4155.1 4.F.3, are documented and recorded on the mortgage credit analysis worksheet.

16. HUD Handbook 4155.1, paragraph 5B(3)(a)

(HUD Handbook 4155.1, REV-5, paragraph 2-10K)

Up to 60 percent of the value of assets such as IRAs [individual retirement accounts], thrift savings plans, 401(k) and Keogh account may be included in the underwriting analysis, unless the borrower provides conclusive evidence that a higher percentage may be withdrawn, after subtracting any Federal income tax and withdrawal penalties.

TOTAL Scorecard Accept or Reject recommendations require the lender to document the terms and conditions for withdrawal and/or borrowing, and that the borrower is eligible for these withdrawals.

17. HUD Handbook 4155.1, paragraph 5B(5)(b)
(HUD Handbook 4155.1, REV-5, paragraph 2-10C)

The lender must document the transfer of the gift funds from the donor to the borrower. If the gift funds are in the borrower's account then obtain a copy of the withdrawal document showing that the withdrawal is from the donor's account and the borrower's deposit slip and bank statement showing the deposit.

18. HUD Handbook 4155.1, paragraph 5B(2)(b)
(HUD Handbook 4155.1, REV-5, paragraph 2-10B)

A VOD [verification of deposit], along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in an account, or the account was recently opened, the lender must obtain from the borrower a credible explanation of the source of the funds.

TOTAL Scorecard Accept and Refer recommendations require that the lender obtain an explanation and documentation for recent large deposits in excess of 2 percent of the property sale price and verify that any recent debts were not incurred to obtain part, or all, of the required cash investment on the property being purchased.

Appendix E

NARRATIVE LOAN SUMMARIES FOR SIGNIFICANT UNDERWRITING DEFICIENCIES

The following narratives provide the details for the significant underwriting deficiencies noted in the table contained in finding 1.

1. FHA loan number: 022-2050283

Loan status: Active

Requesting indemnification: Yes

Default status: First legal action to commence foreclosure

We are seeking indemnification based on the revised total fixed payment-to-income ratio, which reflects the allowable qualifying income as calculated by OIG in accordance with HUD-FHA requirements. After recalculation, the total fixed payment-to-income ratio increased from 47.95 to 51.59 percent.

Income

The lender overstated the borrower's monthly income by \$547. The borrower was self-employed, requiring the lender to calculate the monthly income using the average from the previous 2 years by using the adjusted gross income from the tax return as stated in HUD Handbook 4155.1, REV-5, paragraph 2-9C. However, the lender instead used the net business profit from the tax return, which did not include the one-half of self-employment tax.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, REV-5, paragraph 2-3B.

2. FHA loan number: 022-2217731

Loan status: Active

Requesting indemnification: Yes

Default status: Ineligible for loss mitigation

We are seeking indemnification based on the revised mortgage payment-to-income and total fixed payment-to-income ratios, which reflect qualifying income as calculated by OIG. After recalculation, the mortgage payment-to-income and total fixed payment-to-income ratios increased from 44.90 and 44.90 percent to 48.24 and 48.24 percent, respectively.

Income

The lender overstated the borrower's monthly income by \$218. The loan file did not contain an explanation or analysis of how the lender calculated the monthly income.

Since the borrower did not work a consistent number of hours per week, OIG calculated the monthly income using the year-to-date regular pay from the most recent pay stub divided by the number of months that it covered.²⁴

3. FHA loan number: 023-3302437

Loan status: Active

Requesting indemnification: Yes

Default status: Reinstated by borrower without loss mitigation claim

We are seeking indemnification based on the revised mortgage payment-to-income and total fixed payment-to-income ratios, which reflect the allowable qualifying income and proposed monthly mortgage payment as calculated by OIG in accordance with HUD-FHA requirements. After recalculation, the ratios increased from 29.38 and 50.38 percent to 33.39 and 55.18 percent, respectively.

Income

The lender overstated the borrower's monthly income by \$136. The borrower was self-employed, requiring the lender to calculate the monthly income using the average from the previous 2 years by using the adjusted gross income from the tax return as stated in HUD Handbook 4155.1, REV-5, paragraph 2-9C. However, the lender instead used the net business profit from the tax return, which did not include the one-half of self-employment tax.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, REV-5, paragraph 2-3B.

Other

The lender understated the borrower's proposed monthly mortgage payment by \$104 because it listed the property taxes at only \$104 on the automated underwriting system report. The initial escrow account disclosure statement in the loan file was dated before the loan closed and showed that the property taxes were \$2,502 per year (or \$208 per month).

4. FHA loan number: 023-3312197

Loan status: Active

Requesting indemnification: Yes

Default status: Reinstated by borrower without loss mitigation claim

We are seeking indemnification based on the lender's not properly verifying the required assets available for closing.

²⁴ \$12,921 divided by 7.16 months equals \$1,805 per month.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, REV-5, paragraph 2-3B.

Assets

The lender overstated the borrower's assets by \$6,697 because a retirement account that was used as a qualifying asset did not include the terms and conditions along with evidence that the account allowed for withdrawals and that the borrower qualified for withdrawal or borrowing as required by the Fannie Mae Underwriting Findings, item 32. The automated underwriting system report showed that \$6,514 was required for closing; however, the lender only properly verified \$5,573. Therefore, the required assets for closing were not properly verified.

5. FHA loan number: 023-3321334

Loan status: Active

Requesting indemnification: Yes

Default status: Delinquent

We are seeking indemnification based on the lender's not properly verifying that the borrower had the required funds available for closing.

Credit

The lender understated the borrower's assets by \$141 because it improperly listed the nonpurchasing spouse's monthly debt as \$264 on the automated underwriting system report. The credit report in the loan file showed that the monthly debts totaled \$405. HUD Handbook 4155.1, REV-5, section 2-2D requires the debts of the nonpurchasing spouse to be included in the borrower's qualifying ratios if the borrower resides in a community property State or the property to be insured is located in a community property State such as Arizona.

Assets

The lender overstated the borrower's assets by \$253 because it improperly verified the borrower's checking account balance. The lender used a printed page from the borrower's checking account that was dated March 19, 2009; however, the printed page did not show the previous month's balance and did not provide all of the transactions for the month, listing only one transaction. The Fannie Mae Underwriting Findings, item 30, requires the assets to be verified by either a verification of deposit, the most recent statement showing the previous month's balance, or the most recent 2 months' statements. Therefore, the printed page from the borrower's checking account was not sufficient to verify the borrower's assets. OIG determined that the borrower's assets were \$5,728 as shown on the verification of deposit in the loan file that was dated March 5, 2009. As a result, the lender did not verify that the borrower had the required funds available for closing (the automated underwriting system report stated \$5,869 and the lender only properly verified \$5,728). In addition, the loan file contained another printed page from the borrower's

checking account that was dated March 23, 2009, and showed that the borrower did not have the required assets available for closing.

- 6. FHA loan number:** 023-3380559
Loan status: Claim
Requesting indemnification: Yes
Default status: Preforeclosure sale completed

We are seeking indemnification based on the revised total fixed payment-to-income ratio, which reflects the allowable qualifying liabilities as calculated by OIG in accordance with HUD-FHA requirements. After recalculation, the ratio increased from 50.53 to 85.46 percent.

Credit

The lender calculated the net rental loss on the uniform residential loan application for the borrower's rental property but did not include it in the automated underwriting system as a recurring debt. In addition, the rental agreement was not valid because it was not signed by any of the parties involved as required. HUD Handbook 4155.1, REV-5, paragraph 2-7M, requires a current signed lease or other rental agreement if the property was acquired since the last income tax filing and is not shown on Schedule E. Additionally, the check for the first month's rent and security deposit was questionable because it predated the rental agreement by almost 1 year (the check was dated May 18, 2008, and the rental agreement was for April 27, 2009, to May 30, 2010). This check also predated the borrower's move to Arizona by more than 2 months.

Assets

The lender overstated the borrower's assets by \$5,362 because the lender improperly used an amount from one of the borrower's bank accounts two times. The automated underwriting system report and the borrower's bank statements showed that the lender used the previous month's balance for a savings account that was already listed on the report using the current month's balance.

- 7. FHA loan number:** 023-3485534
Loan status: Claim
Requesting indemnification: Yes
Default status: Preforeclosure sale completed

We are seeking indemnification based on the lender's not properly verifying the required assets available for closing.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 4C(2)(c).

Assets

The lender overstated the borrower's assets by \$7,743 because a retirement account that was used as a qualifying asset did not include the terms and conditions for withdrawal or borrowing and that the borrower was eligible for withdrawals as required by HUD Handbook 4155.1, paragraph 5B(3)(a). The automated underwriting system report showed that \$3,920 was required for closing; however, the lender only properly verified \$2,381. Therefore, the required assets for closing were not properly verified.

- 8. FHA loan number:** 023-3515200
Loan status: Active
Requesting indemnification: Yes
Default status: Ineligible for loss mitigation

We are seeking indemnification based on the lender not ensuring that the borrower made the required downpayment.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 4C(2)(c).

Assets

The borrower did not make the required downpayment of at least 3.5 percent of the sales price as required by HUD Handbook 4155.1, paragraph 2A(2)(c). The required downpayment was \$4,546.50; however, the borrower made a downpayment of only \$4,221.50.

In addition, the lender overstated the borrower's assets by \$7,981 because a retirement account that was used as a qualifying asset did not include the terms and conditions for withdrawal or borrowing and that the borrower was eligible for withdrawals as required by HUD Handbook 4155.1, paragraph 5B(3)(a). As a result, only \$2,029 was properly verified by the lender, and the borrower only had 1 month of reserves instead of 9.

9. FHA loan number: 023-3515994

Loan status: Active

Requesting indemnification: Yes

Default status: Reinstated by borrower without loss mitigation claim

We are seeking indemnification based on two factors: (1) the revised mortgage payment-to-income and total fixed payment-to-income ratios, which reflect the allowable qualifying income as calculated by OIG in accordance with HUD-FHA requirements, and (2) the lender's not properly documenting the transfer of gift funds that were used as the borrower's cash investment in the property. After recalculation, the mortgage payment-to-income and total fixed payment-to-income ratios increased from 42.88 and 47.88 percent to 45.72 and 51.05 percent, respectively.

Income

The lender overstated the monthly income for the borrower's two jobs by a total of \$207. The lender overstated the monthly income for the first job by \$70 because it improperly calculated the monthly income using an average of the previous 24 months. OIG determined that this calculation was not appropriate because the average monthly income had decreased each year. OIG calculated the borrower's monthly income using the year-to-date pay from the most recent pay stub in the loan file, which covered approximately 5 months.²⁵

The lender overstated the monthly income for the second job by \$137. The borrower was considered self-employed for this job, requiring the lender to calculate the monthly income using the average from the previous 2 years by using the adjusted gross income from the tax return as stated in HUD Handbook 4155.1, paragraph 4D(5)(a). However, the lender instead used the net business profit from the tax return, which did not include the one-half of self-employment tax.

In addition, the lender should have questioned the borrower's self-employment income as OIG noted several issues. For example, the amounts from the Internal Revenue Service Form W-2 for the first job did not reconcile with the tax returns for 2007 and 2008. Also, the 2007 tax return only listed one dependent; however, the earned income credit worksheet for 2007 and the 2008 tax return both listed two dependents. Although it was not required, the lender should have performed a verification of employment because the borrower received an Internal Revenue Service Form 1099-MISC.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 4C(2)(c).

²⁵ \$6,482 divided by 4.97 months equals \$1,304.

Assets

The lender did not obtain the required documentation supporting the transfer of a \$4,500 gift from the borrower's relative. Specifically, the lender did not obtain the deposit slip and the withdrawal document from the donor. HUD Handbook 4155.1, paragraph 5B(5)(b), requires the lender to obtain a copy of the withdrawal document showing that the withdrawal is from the donor's account and the borrower's deposit slip and bank statement showing the deposit. The lender did obtain a bank statement from the donor; however, the statement covered the period May 15 to June 12, 2009, and the gift was made on July 22, 2009. Therefore, the bank statement did not show the withdrawal from the donor's account. Without the gift, the borrower did not have sufficient funds to close.

10. FHA loan number: 023-3551691

Loan status: Active

Requesting indemnification: Yes

Default status: Repayment

We are seeking indemnification based on the lender's not verifying the borrower's employment history for 2 years. Without the borrower's income included in the qualifying ratios, the total fixed payment-to-income ratio would have increased from 30.27 to 62.03 percent.

Income

The lender did not verify the employment history for the borrower for 2 full years as required by HUD Handbook 4155.1, paragraph 4D(1)(b). A verbal verification of employment, dated June 16, 2009, from the borrower's current employer showed that the borrower had been employed with the company since November 21, 2008. Also, the lender obtained the 2008 W-2s for the borrower's current and former employers. Therefore, at most, the lender only verified approximately 1.5 years of employment for the borrower.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 4C(2)(c).

Assets

The lender overstated the borrower's assets by \$4,051 because two retirement accounts that were used as a qualifying asset did not include the terms and conditions for withdrawal or borrowing and that the borrower was eligible for withdrawals as required by HUD Handbook 4155.1, paragraph 5B(3)(a).

11. FHA loan number: 023-3789597

Loan status: Active

Requesting indemnification: Yes

Default status: Reinstated by borrower without loss mitigation claim

We are seeking indemnification based on the lender's inability to determine the borrower's liabilities.

Credit

The lender did not obtain a credit report for the borrower's nonpurchasing spouse as required by HUD Handbook 4155.1, paragraph 4A(5)(b), which requires the debts of nonpurchasing spouses to be included in the borrower's qualifying ratios if the borrower resides in a community property State or the property being insured is located in a community property State such as Arizona. HUD Handbook 4155.1, paragraph 4A(5)(c), further states that the nonpurchasing spouse's credit report that complies with HUD's requirements must be provided to determine the debt-to-income ratio. Based on the documentation in the loan file, specifically the disclaimer deed, dated before the loan closed, and a copy of an instruction permit (for the spouse), it appeared that the borrower was married. In an interview with the borrower, he informed OIG that he was married when he was approved for the loan. Without obtaining the nonpurchasing spouse's credit report or establishing alternative credit, the lender was unable to determine the debts of the nonpurchasing spouse, which were required to be included in the borrower's qualifying ratios.

Assets

The lender overstated the borrower's assets by \$4,996 because the \$3,000 gift that the borrower received was listed as not deposited on the automated underwriting system report; however, the documentation in the loan file showed that the gift was deposited in the borrower's savings account. The lender should have subtracted the amount of the gift from the borrower's savings account. In addition, the lender incorrectly listed the borrower's checking account balance as \$6,000, but the documentation in the loan file showed that the balance was only \$4,004.

12. FHA loan number: 023-3948891

Loan status: Active

Requesting indemnification: Yes

Default status: Reinstated by borrower without loss mitigation claim

We are seeking indemnification based on two factors: (1) the lender's inability to determine the borrower's liabilities and (2) the lender's not ensuring that the borrower made the required downpayment.

Credit

The lender did not obtain a credit report for the borrower's nonpurchasing spouse as required by HUD Handbook 4155.1, paragraph 4A(5)(b), which requires the debts of nonpurchasing spouses to be included in the borrower's qualifying ratios if the borrower

resides in a community property State or the property being insured is located in a community property State such as Arizona. HUD Handbook 4155.1, paragraph 4A(5)(c), further states that the nonpurchasing spouse's credit report that complies with HUD's requirements must be provided to determine the debt-to-income ratio. Based on the documentation in the loan file, specifically the borrower's certificate of naturalization, it appeared that the borrower was married. In an interview with the borrower, she informed OIG that she was married when she was approved for the loan. Without obtaining the nonpurchasing spouse's credit report or establishing alternative credit, the lender was unable to determine the debts of the nonpurchasing spouse, which were required to be included in the borrower's qualifying ratios.

Assets

The borrower did not make the required downpayment of at least 3.5 percent of the sales price as required by HUD Handbook 4155.1, paragraph 2A(2)(c). The required downpayment was \$6,507; however, the borrower made a downpayment of only \$6,164.

13. FHA loan number: 023-4023605

Loan status: Active

Requesting indemnification: Yes

Default status: N/A

We are seeking indemnification based on the revised total fixed payment-to-income ratio, which reflects the allowable qualifying income as calculated by OIG in accordance with HUD-FHA requirements. After recalculation, the ratio increased from 45.75 to 48.94 percent.

Income

The lender overstated the monthly income for the borrower's two jobs by a total of \$146. The lender overstated the monthly income for the first job by \$101 because it improperly calculated the monthly income using an average of the previous 24 months. OIG determined that this method was not appropriate because the average monthly income was significantly different each year. OIG calculated the borrower's monthly income using the year-to-date pay from the most recent pay stub in the loan file divided by the number of months it covered.²⁶

The lender overstated the monthly income for the second job by \$45. The borrower was self-employed for this job, requiring the lender to calculate the monthly income using the average from the previous 2 years by using the adjusted gross income from the tax return as stated in HUD Handbook 4155.1, paragraph 4D(5)(a). However, the lender instead used the net business profit from the tax return, which did not include the one-half of self-employment tax.

14. FHA loan number: 023-4362539

Loan status: Active

²⁶ \$2,134 divided by 3.13 months equals \$682 per month.

Requesting indemnification: Yes

Default status: Reinstated by borrower without loss mitigation claim

We are seeking indemnification based on the lender's not properly documenting the transfer of gift funds that were used as the borrower's cash investment in the property.

Credit

The loan file did not contain an explanation for the credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 4C(2)(c).

Assets

The lender did not obtain the required documentation supporting the transfer of two gifts totaling \$13,743. HUD Handbook 4155.1, paragraph 5B(5)(b), requires the lender to obtain a copy of the withdrawal document showing that the withdrawal is from the donor's account and the borrower's deposit slip and bank statement showing the deposit. For the first gift, the donor paid \$6,425 directly to the closing agent and also provided \$1,755 to the borrower. The amount paid to the borrower was not properly documented because the lender did not obtain the deposit slip and cancelled check or other withdrawal document from the donor. The lender obtained a bank statement from the donor; however, the it did not show the withdrawal of the gift. Without this gift, the borrower did not have sufficient funds to close.

For the second gift, the donor made a payment to Toyota Financial Services to help pay off the balance for an auto loan. The lender obtained a copy of the check to Toyota Financial Services; however, it was not a cancelled check, and the lender did not obtain an updated account statement showing the new balance. Without this gift, the liability would have been used in determining the borrower's qualifying ratios and it was significant enough to negatively impact them..