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Audit Report Number 2011-CH-1016
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TO: Deborah C. Holston, Acting Deputy Assistant Secretary for Single Family, HU  
Dane M. Narode, Associate General Counsel for Program Enforcement,  
CACC

FROM:   
Kelly Anderson, Regional Inspector General for Audit, Region V, 5AGA

SUBJECT: Countrywide Bank, FSB, Calabasas, CA, Did Not Comply With HUD  
Requirements for Underwriting FHA Loans and Fully Implement Its Quality  
Control Program In Accordance With HUD's Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited Countrywide Bank, FSB (Countrywide),<sup>1</sup> a Federal Housing Administration (FHA) supervised lender<sup>2</sup> approved to originate, underwrite, and submit mortgages for insurance under the U.S. Department of Housing and Urban Development's (HUD) direct endorsement program. We selected Countrywide based on its average default-to-claim rate of 6.76 percent for the FHA-insured loans originated in our region (Illinois, Indiana, Ohio, Michigan, Minnesota, and Wisconsin) during the period July 1, 2008, through June 30, 2010. The audit was part of the activities in our fiscal year 2010 annual audit plan. Our audit objectives were to determine whether (1) Countrywide complied with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured

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<sup>1</sup> Countrywide was acquired by Bank of America in July 2008; therefore, the recommendations will be addressed to Bank of America. The audit report represents the activities of Countrywide.

<sup>2</sup> A supervised lender or mortgagee is a financial institution which 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. A supervised lender may submit applications for mortgage insurance.

loans and (2) Countrywide's quality control plan, as implemented, met HUD's requirements.

## What We Found

Countrywide did not comply with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans. Specifically, the loan files for 7 of the 14 loans reviewed contained material underwriting deficiencies.<sup>3</sup> For these seven loans, Countrywide did not properly verify, analyze, or support borrowers' employment and income, source of funds to close, liabilities and credit information. Additionally, it allowed borrowers to skip mortgage payments for refinance transactions. This noncompliance occurred because Countrywide's underwriters did not exercise due diligence in underwriting the loans. As a result of the improperly underwritten loans, HUD paid more than \$1 million in claims and incurred losses totaling more than \$720,000 on the sales of the associated properties for the seven loans.

Additionally, Countrywide did not fully implement its quality control program in accordance with HUD's requirements. Specifically, it did not conduct quality control reviews in accordance with HUD's requirements, and its written quality control plan did not contain all of the necessary provisions. The problems occurred because Countrywide disregarded and misinterpreted HUD's requirements. As a result, Countrywide increased the risk to FHA's Mutual Mortgage Insurance Fund due to the lack of assurance of the accuracy, validity, and completeness of its loan underwriting activities.

## What We Recommend

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family require Bank of America to (1) reimburse HUD \$720,300 for the actual losses incurred on seven loans since the properties associated with these loans were sold, (2) reimburse HUD or provide sufficient documentation to support that the \$3,211 in fees charged to the four borrowers at settlement were reasonable and customary, (3) implement an adequate quality control plan that complies with HUD requirements, and (4) perform a 100 percent review of its early payment defaulted loans. Further, we recommend that HUD perform a review of Bank of America's quality control program within 9 months to determine whether the required provisions have been included in its written plan and quality control reviews are conducted in compliance with HUD's requirements.

We also recommend the HUD's Associate General Counsel for Program Enforcement pursue remedies under the Program Fraud Civil Remedies Act, where legally sufficient, against Countrywide and/or its principals for incorrectly

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<sup>3</sup> A deficiency is considered material when it affects the loan approval decision.

certifying to the integrity of the data or that due diligence was exercised during the underwriting of seven loans.

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

### **Auditee's Response**

We provided the results of our underwriting and quality control reviews to Bank of America's management during the audit. We also provided our discussion draft audit report to Bank of America's management and HUD's staff on June 24, 2011 and June 27, 2011, respectively. We discussed the draft report with Bank of America's management at the exit conference held on July 6, 2011.

We asked Bank of America's management to provide written comments to the discussion draft audit report by July 22, 2011. Bank of America provided written comments to the draft report dated June 27, 2011 that generally disagreed with our findings and recommendations. The complete text of the auditee's response, except for 146 pages of exhibits that were not necessary to understand the comments, along with our evaluation of that response, can be found in appendix B of this report.

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## BACKGROUND AND OBJECTIVES

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The National Housing Act, as amended, established the Federal Housing Administration (FHA), an organizational unit within the U.S. Department of Housing and Urban Development (HUD). FHA provides insurance to private lenders against loss on buyers financing homes. The basic home mortgage insurance program is authorized under Title II, Section 203(b), of the National Housing Act and governed by regulations in 24 CFR (Code of Federal Regulations) Part 203.

In 1983, HUD implemented the direct endorsement program, which authorizes approved lenders to underwrite loans without HUD's prior review and approval. On January 1, 2006, FHA implemented the Lender Insurance program, which enables high-performing FHA-approved direct endorsement lenders with acceptable default and claim rates<sup>4</sup> to endorse FHA loans without having a preendorsement review conducted by FHA.

Countrywide Bank, FSB (Countrywide), an FHA-approved supervised lender,<sup>5</sup> was established on August 30, 1990. Countrywide Financial Corporation acquired Countrywide through its wholly owned subsidiary, Effinity Financial Corporation, on May 18, 2001, and converted Countrywide to a national banking association regulated by the Office of the Comptroller of the Currency.<sup>6</sup> Countrywide converted its charter to a Federal savings bank regulated by the Office of Thrift Supervision on May 12, 2007.

Countrywide was approved as an FHA lender on November 29, 1993. It became an unconditional direct endorsement lender on September 21, 2007, and was approved to participate in HUD's Lender Insurance program on January 8, 2008. Countrywide originated and sponsored loans under the Lender Insurance program.

Countrywide was bought by Bank of America, N.A., Charlotte<sup>7</sup> in July 2008, and the merger of Countrywide into Bank of America, N.A., was effective on April 27, 2009. Due to the merger, Bank of America, N.A., inherited the rights, obligations, and liabilities of Countrywide as they relate to HUD and FHA. By February 26, 2010, all mortgage loan origination and servicing activities formerly performed by Countrywide had been fully integrated, and Bank of America voluntarily surrendered the HUD approval of the former Countrywide, effective March 1, 2010.

As of August 5, 2010, Countrywide had a compare ratio<sup>8</sup> of 162 percent for a 2-year FHA performance period ending June 30, 2010. Based on data in HUD's Single Family

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<sup>4</sup> Acceptable default and claim rate is at or below 150 percent of national average.

<sup>5</sup> Countrywide's lender identification number was 76514.

<sup>6</sup> The Office of the Comptroller of the Currency charters, regulates, and supervises all national banks. It also supervises the Federal branches and agencies of foreign banks. Its goal is to ensure that the banks operate in a safe and sound manner and comply with laws.

<sup>7</sup> The lender identification number for Bank of America, N.A., Charlotte is 13065.

<sup>8</sup> Compare ratio is the value that reveals the largest discrepancies between the subject's default percentage and the default percentage to which it is being compared. The percentages being compared are the percentages of originations that first defaulted during a selected period.

Neighborhood Watch Early Warning System (Neighborhood Watch),<sup>9</sup> as of September 2, 2010, Countrywide had originated 15,801 loans, of which 1,059 were seriously delinquent or had a claim insurance status. The table below shows all insured single-family loans originated by Countrywide with beginning amortization dates between July 1, 2008, and June 30, 2010, for the six States in Region V's jurisdiction.

State	Total compare ratio	Total originations	Total seriously delinquent and claims	Seriously delinquent and claims <sup>10</sup> percentage	State total originations	State total seriously delinquent and claims	State percentage seriously delinquent and claims
Illinois	176	3951	332	8.4	135306	6447	4.76
Michigan	185	2212	171	7.73	101973	4250	4.17
Minnesota	304	1165	89	7.64	70831	1776	2.51
Ohio	179	3495	209	5.98	139684	4659	3.34
Wisconsin	165	1278	75	5.87	57185	2038	3.56
Indiana	155	3700	183	4.95	96537	3090	3.2
Totals		15,801	<b>1,059</b>				
Averages				<b>6.76</b>			<b>3.59</b>

We initiated the audit of Countrywide based on its average seriously delinquent (default)-to-claim rate of 6.76 percent for the FHA-insured loans originated in our region (Illinois, Indiana, Ohio, Michigan, Minnesota, and Wisconsin) during the period July 1, 2008, through June 30, 2010. The average seriously delinquent-to-claim rate for the States in our jurisdiction was 3.59 percent.

Our objectives were to determine whether (1) Countrywide complied with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans and (2) Countrywide's quality control plan, as implemented, met HUD's requirements.

<sup>9</sup> Neighborhood Watch enables HUD staff and lenders to monitor the default and claim rates of FHA-insured loans for FHA-approved lenders and FHA programs. It highlights exceptions by lenders, programs, loan characteristics, and geographic areas with unusual originations or high defaults and claims on FHA-insured loans.

<sup>10</sup> Percentage of originations which were currently seriously delinquent or were claim terminated. Seriously delinquent loans were reported by the servicing lender as 90 days or more delinquent as of the last reporting cycle updated in Neighborhood Watch.

## RESULTS OF AUDIT

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### Finding 1: Countrywide Did Not Comply With HUD's Underwriting Requirements

Countrywide did not comply with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans. Specifically, for 7 of the 14 loans reviewed (50 percent), it did not properly verify, analyze, or support borrowers' employment and income, source of funds to close, liabilities and credit information. It also allowed borrowers to skip mortgage payments for refinance transactions. Further, Countrywide improperly charged borrowers unreasonable settlement costs, and did not comply with HUD's requirements regarding inducement to purchase and identity of interest transactions. The noncompliance with FHA's underwriting requirements occurred because Countrywide's underwriters failed to exercise due diligence in underwriting the loans. As a result of Countrywide's approving loans that did not qualify for FHA mortgage insurance, HUD paid more than \$1 million in claims and incurred losses on the sales of the properties for the seven loans totaling more than \$720,000.

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#### **Countrywide Did Not Properly Verify, Calculate, or Support Borrowers' Income**

Countrywide did not properly verify, analyze, or document borrowers' employment and income for three loans. For example, for FHA case number 263-4251461, the loan file did not contain sufficient documentation to support the borrower's monthly income of \$6,192. Using the borrower's most recent pay stub in the loan file, we calculated the borrower's monthly income as \$4,377, a difference of \$1,815. Additionally, the borrower's yearly wages significantly decreased. In 2007, the borrower earned \$91,831; however, the borrower's year-to-date earnings statement as of October 19, 2008, totaled \$42,061. Although the year-to-date earnings statement did not represent a full year, the borrower had to receive more than \$49,000 from October 20 to December 31, 2008, to make the wages earned in 2007.

According to Countrywide's Government Technical Manual, base income calculations must be compared with year-to-date figures using the verification of employment or the pay stub. If there is evidence of declining income, an average of the previous year's wages may not be used unless it can be fully explained and support is provided.<sup>11</sup>

Further, HUD requires a lender to establish a borrower's income and the likelihood of its continuance to determine a borrower's capacity to repay the

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<sup>11</sup> Countrywide's Government Technical Manual, FHA: 2.3.2, effective September 30, 2008

mortgage debt. Additionally, income may not be used in calculating a borrower's income ratios if it is unverifiable, unstable, or will not continue.<sup>12</sup>

### **Countrywide Did Not Verify and Document Sources of Funds**

Countrywide did not always verify and document borrowers' sources of funds to close, including gift funds and financial institution accounts, for four loans. HUD requires a lender to verify and document all funds for a borrower's investment in a property.<sup>13</sup> For example, for FHA case number 263-4387704, the borrower was expected to receive gift funds totaling \$2,500 from his future father-in-law. However, a copy of the cancelled check, withdrawal document, bank activity statement, or deposit slip was not in the loan file to support the transfer of the gift funds to the borrower. Additionally, the gift funds were not included on the HUD-1 settlement statement. The borrower needed a cash investment of \$2,624 to close the loan; however, the borrower's bank statement, dated November 12, 2008, did not show that the borrower had sufficient funds.

Additionally, for FHA case number 261-9606137, Countrywide did not obtain a credible explanation for two large deposits into the borrower's bank account as required by HUD.<sup>14</sup>

### **Countrywide Did Not Properly Analyze or Assess Borrowers' Credit Histories or Liabilities**

Countrywide did not properly analyze a borrower's credit history for one loan. For FHA case number 271-9566133, Countrywide, via Landsafe Credit, verified the borrower's rental history using cellular telephone numbers for landlords of the borrower's previous residences.

HUD requires a lender to verify a borrower's nontraditional credit with credit providers using a published address or telephone number. Additionally, a lender is required to include the monthly housing expense and all other recurring charges extending 10 months or more. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing.<sup>15</sup> However, Countrywide did not appropriately assess borrowers' liabilities or financial obligations for two loans. For example, for FHA case number 581-3129633,

<sup>12</sup> HUD Handbook 4155.1, REV-5, Chapter 2, Section 2: Effective Income

<sup>13</sup> HUD Handbook 4155.1, REV-5, paragraph 2-10

<sup>14</sup> HUD Handbook 4155.1, REV-5, paragraph 2-10(B)

<sup>15</sup> HUD Handbook 4155.1, REV-5, paragraphs 2-3 and 2-11(A)

Countrywide did not include the borrower's monthly liabilities totaling \$484 to a utility company and credit card company that were shown on the borrower's credit report.

The loan was processed and approved through an automated underwriting system;<sup>16</sup> however, the two liabilities were not included in the underwriting analysis. HUD requires the lender to determine the borrower's housing payment obligations.<sup>17</sup>

### **Countrywide Underwrote A Loan With Debt-to-Income Ratios Exceeding Benchmark Ratios, Without Acceptable Compensating Factors**

Countrywide underwrote one loan with debt-to-income ratios exceeding HUD's benchmarks without acceptable or significant compensating factors. HUD requires the lender to provide compensating factors to justify the mortgage approval when the mortgage payment-to-income ratio exceeds 31 percent and the total fixed payment-to-income ratio exceeds 43 percent for manually underwritten loans.<sup>18</sup> For FHA case number 261-9606137, the mortgage credit analysis worksheet showed that the borrower's mortgage payment-to-income ratio was 35.9 percent and total fixed payment-to-income ratio was 47.3 percent. The underwriter used cash reserves from the borrower's retirement plan as a compensating factor. However, the funds from the borrower's retirement plan were not eligible to be used as cash reserves because the borrower was unable to withdraw from the retirement account until he was 55 years old and no longer employed.

### **Countrywide Allowed Borrowers To Skip Mortgage Payment in Refinance Transactions**

Countrywide allowed borrowers to skip mortgage payments in four refinance loan transactions. HUD prohibits lenders from allowing borrowers to skip payments. A borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement.<sup>19</sup> For FHA case number 263-4334310,

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<sup>16</sup> For a manually underwritten loan, the underwriter analyzes a borrower's loan application and related documentation to approve the loan. Automated underwriting is the use of a computer program to analyze a loan application to arrive at a logic-based loan underwriting decision. The automated underwriting system used by a lender should communicate with the FHA TOTAL Scorecard.

<sup>17</sup> HUD Handbook, 4155.1, REV-5, paragraph 2-3(A)

<sup>18</sup> Mortgagee Letter 2005-16, dated April 13, 2005

<sup>19</sup> HUD Handbook 4155.1, REV-5, paragraph 1-10(E)

Countrywide was unable to provide documentation supporting that the borrower's mortgage payments due on October 1 and November 1, 2008, were paid before closing or that the borrower made the payments at closing. The borrower's settlement statement revealed that the refinance loan closed on November 26, 2008.<sup>20</sup>

### **Countrywide Charged Borrowers Unreasonable Costs**

Countrywide charged four borrowers unreasonable costs to close their mortgages. According to HUD's requirements, a lender may charge and collect from borrowers customary and reasonable costs deemed necessary to close the mortgage.<sup>21</sup> For example, for FHA case number 261-9576571, Countrywide erroneously charged the borrower a loan processing fee of \$500 for a streamline refinance without appraisal transaction in addition to a loan origination fee in the amount of \$826. The borrower's loan file did not contain documentation to determine whether the processing fee was customary and reasonable; therefore, we requested documentation/explanations from Bank of America. Bank of America was unable to justify the charges and acknowledged that these fees should not have been charged to borrowers.

### **Countrywide Did Not Comply With HUD's Underwriting Requirements Regarding Inducements and Identity of Interest, Resulting In Overinsured Mortgages**

Countrywide overestimated the financing costs for two loans, thereby exceeding HUD's maximum insurable mortgage limits for those loans. HUD deems the payment of consumer debt by third parties to be an inducement to purchase, which must result in a dollar-for-dollar reduction to the sales price in calculating the maximum insurable mortgage.<sup>22</sup> For FHA case number 132-2111442, the gift funds of \$3,297 from a nonprofit organization were used, in part, to pay off the borrowers' \$969.53 collection account. This was an inducement to purchase. The borrowers provided an earnest money deposit of \$500 and received cash of \$251.72 at closing. The sales price should have been reduced by \$721.25 of the collection amount paid off (\$969.53 minus \$500 earnest money plus \$251.72 cash back to borrower). Based on the recalculated sales price of \$109,178.75, the

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<sup>20</sup> The settlement date denoted on the HUD-1 settlement statement was November 26, 2008. However, the loan closing date in Neighborhood Watch was December 2, 2008, which is the same as the disbursement date on the HUD-1 settlement statement.

<sup>21</sup> Mortgagee Letter 2006-04

<sup>22</sup> HUD Handbook 4155.1, REV-5, paragraph 2-10(C)

upper limit mortgage amount would have been \$105,903.39, instead of \$106,603. Therefore, the loan was overinsured by \$700.

HUD requires an identity-of-interest transaction on a principal residence to be restricted to a maximum loan-to-value ratio of 85 percent, except when the borrower has been a tenant in the subject property for at least six months immediately predating the sales contract.<sup>23</sup> For FHA case number 263-4242692, Countrywide allowed a maximum financing above 85 percent loan-to-value ratio in an identity-of-interest transaction. The seller of the subject property was the borrower's mother. There was no evidence in the loan file that the borrower lived at the property for at least six months before the date of executed purchase agreement executed. The loan documentation supports the borrower lived at another property address before the loan closing. Countrywide improperly used a 97 percent loan-to-value ratio instead of the allowable loan-to-value ratio of 85 percent. The sales price and appraised value of the property was \$49,000. Therefore, the loan was overinsured by \$5,880.

### **Incorrect Underwriters' Certifications Were Submitted to HUD**

We reviewed the certifications for the seven loans with material underwriting deficiencies for accuracy. Countrywide's direct endorsement underwriters incorrectly certified that due diligence was used or to the integrity of the data in underwriting the seven loans. Under HUD's direct endorsement program, direct endorsement underwriters certify to the integrity of the data for automated or manually underwritten loans; the underwriter certifies that due diligence was used in underwriting the loans.

The Program Fraud Civil Remedies Act of 1986 (231 U.S.C. (United States Code) 3801) provides Federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy to (1) recompense such agencies for losses resulting from such claims and statements; (2) permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and (3) deter the making, presenting, and submitting of such claims and statements in the future.

### **Conclusion**

According to FHA requirements, a lender is required to establish that a borrower has the ability and the willingness to repay the mortgage debt, which should be based on sound underwriting principles consistent with the guidelines, rules, and

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<sup>23</sup> HUD Handbook 4155.1, REV-5, paragraph 1-8(A)

regulations denoted in HUD Handbook 4155.1, REV-5.<sup>24</sup> Additionally, the lender must support its decision to approve the mortgage with sufficient documentation. Regulations at 24 CFR (Code of Federal Regulations) 203.5(c) require a direct endorsement lender to exercise the same level of care it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment.

Countrywide failed to follow FHA requirements in underwriting 7 of the 14 loans reviewed (50 percent). This noncompliance occurred because Countrywide's underwriters did not exercise due diligence in underwriting the loans. As a result, the FHA insurance fund incurred losses totaling more than \$720,000 for the seven loans.<sup>25</sup>

Appendix C of this report provides a summary of the material underwriting deficiencies by Countrywide. Appendix D of this report provides details of the identified material underwriting deficiencies.

## Recommendations

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family require Bank of America to

- 1A. Reimburse the FHA insurance fund \$720,300 for the actual losses incurred on seven loans since the properties associated with these loans were sold.<sup>26</sup>
- 1B. Reimburse HUD or provide sufficient documentation to support that the \$3,211 in fees charged to the four borrowers at settlement was reasonable and customary.<sup>27</sup>
- 1C. Remit to HUD the amount totaling \$6,580 for the two overinsured loans (FHA case numbers 132-2111442 and 263-4242692), since a claim has already been paid on both loans.
- 1D. Implement adequate policies and procedures to ensure that it complies with HUD's underwriting requirements.

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

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<sup>24</sup> HUD Handbook 4155.1, REV-5, Forward

<sup>25</sup> Appendix A-1 provides details on the actual losses to HUD for the material underwriting deficiencies.

<sup>26</sup> Loss on the sale of the property identified in HUD's Single Family Acquired Asset Management System

<sup>27</sup> See Appendix A-2 for the details on the four loans with unreasonable costs.

- 1E. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against Countrywide and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of the seven loans.

## RESULTS OF AUDIT

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### Finding 2: Countrywide Did Not Fully Implement Its Quality Control Program in Accordance With HUD Requirements

Countrywide generally complied with HUD requirements, in terms of timeliness and frequency, when performing routine quality control reviews for FHA-insured loans. However, it did not fully implement its quality control program in accordance with HUD requirements. Specifically, it did not conduct quality control reviews in accordance with HUD requirements, and its written quality control plan did not contain all of the necessary provisions. The problems occurred because Countrywide disregarded and misinterpreted HUD's requirements. As a result, Countrywide increased the risk to FHA's Mutual Mortgage Insurance Fund due to the lack of assurance of the accuracy, validity, and completeness of its loan underwriting activities.

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#### **Routine Quality Control Reviews Were Generally Performed Frequently and in a Timely Manner**

Countrywide generally performed routine quality control reviews of FHA-insured loans frequently and in a timely manner as required by HUD. For loans that closed from July 2008 through April 2009, Countrywide performed 5,058 routine quality control reviews. Of the 5,058 reviews, only 23 reviews were completed more than 30 days after the required timeframe.<sup>28</sup> Additionally, it conducted routine quality control reviews monthly as required.<sup>29</sup>

#### **All Early Payment Defaults Were Not Reviewed**

Countrywide did not review all early payment defaults as required by HUD. HUD requires lenders to review all loans going into default within the first six payments, in addition to the loans selected for routine quality control reviews. Early payment defaults are defined as loans that become 60 days past due.<sup>30</sup>

Using HUD's Single Family Data Warehouse system, we identified 4,050 loans originated or sponsored by Countrywide that were 60 days past due within the first six payments, which are early payment defaults. These 4,050 loans closed from July 1, 2008, through May 26, 2009. However, Countrywide did not review

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<sup>28</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(A)

<sup>29</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(B)

<sup>30</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(D)

1,911 early payment defaults as required by HUD. Bank of America’s risk management manager agreed that 371 of the 1,911 loans were early payment defaults for which reviews were not performed. Contrary to HUD requirements, she indicated that 544 of the 1,911 loans were not early payment defaults because early payment defaulted loans are loans that are 60 days delinquent within the first 6 months and these loans reached 60 days delinquent in the seventh month. Additionally, Bank of America’s personnel explained that quality control reviews were not performed for the remaining 996 loans because they were no longer serviced by Countrywide or Bank of America and there was no longer a risk with a servicing transfer.

According to HUD’s Deputy Director of Quality Assurance Division, HUD requires that all early payment defaulted loans be reviewed and does not provide an exception to the requirement that the lender is no longer responsible for early payment defaulted loans for which the servicing has been sold.

Ten of the fourteen loans reviewed for compliance with underwriting requirements<sup>31</sup> were early payment defaulted loans (see finding 1). Countrywide did not perform quality control reviews for 5 of those 10 loans. The table below shows the five loans for which Countrywide did not perform quality control reviews.

FHA case number	Mortgage amount	Amount of claim paid	Material deficiencies cited in finding 1
132-2111442	\$108,202	\$121,306	
263-4242692	\$48,242	\$52,371	
263-4251461	\$95,333	\$101,281	X
271-9566133	\$262,823	\$278,840	X
581-3129633	\$293,371	\$313,871	X
Totals	\$807,971	\$867,669	

Of the five early payment defaulted loans not reviewed, we identified material deficiencies for three of the loans.

**Early Payment Defaults Were Not Reviewed in a Timely Manner**

Countrywide did not always review early payment defaults in a timely manner. Although HUD does not specify a timeframe within which the quality control reviews for early payment defaults are to be performed, one of the basic goals for a lender’s quality control program is to ensure swift and appropriate corrective action. Therefore, prudent practice would warrant that early payment defaulted loans be reviewed shortly after being identified as early payment defaults.

<sup>31</sup> See appendix C for the 14 FHA-insured loans reviewed for the audit.

From July 2008 through April 2009, Countrywide performed quality control reviews of 999 early payment defaulted loans that it originated or sponsored. These loans closed from October 1, 2007, through December 31, 2008. Of the 999 loans reviewed, Countrywide reviewed 455 loans 90 to 183 days after the loans' 60-day delinquency was reported to HUD.

**Documentation Review and Verification Were Not Consistently Performed for Loans Selected for Review**

Countrywide performed 7,599<sup>32</sup> quality control reviews during our audit period. Of the 7,599 reviews, we statistically selected 75 to continue our review of Countrywide's implementation of its quality control plan. Countrywide's quality control program did not always provide for the review and confirmation of information on all loans selected for review. Specifically, Countrywide did not consistently perform documentation review and verification for selected loans as required.

**Credit Reports Not Obtained**

Countrywide did not obtain required new credit reports on the borrowers for 5 of 10 quality control reviews. According to HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(1), a new credit report must be obtained for each borrower whose loan is included in a quality control review, unless the loan was a streamline refinance or was processed using an approved automated underwriting system exempted from this requirement. Of the 75 quality control reviews selected for review, 62 loans were streamline refinances or processed using an FHA-approved automated underwriting system, including the Countrywide Loan Underwriting Expert System, and three loans were originated under the Home Equity Conversion Mortgage program. Therefore, quality control reviews for the remaining 10 loans required the reordering of a new credit report. However, Countrywide did not reorder new credit reports for 5 of the 10 loans.<sup>33</sup>

**Documents Not Checked for Sufficiency or Subjected to Written Reverification**

Countrywide did not always check the documentation contained in the loan files for sufficiency or subject the documentation to written reverification. Specifically, for 41 loans, Countrywide did not reverify the borrowers' employment or other income, deposits, gift letters, alternate credit sources, or mortgage or rent payments as required. HUD requires a lender to check documents contained in the loan file for sufficiency and subject the loan

<sup>32</sup> See the Scope and Methodology section for specific details regarding the universe for the quality control reviews.

<sup>33</sup> FHA case numbers 022-1984561, 045-6689763, 095-0796374, 137-4180665, and 372-3872904

documents to written reverification, including employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds. Other items that may be reverified include mortgage or rent payments.<sup>34</sup> For example, Countrywide did not reverify the employment, income, or source of funds for at least 25 loans because certain entities charged fees for reverifications. Additionally, HUD requires a lender to make a documented attempt to conduct a telephone reverification, if the written reverification is not returned. Countrywide did not have supporting documentation that this requirement was met for at least six quality control reviews performed.

### **Field Reviews of Appraisals Not Performed**

Countrywide did not perform the required number of field reviews of appraisals for its routine quality control reviews in compliance with HUD requirements and its quality control plan. Specifically, Countrywide did not ensure that field reviews were performed on 10 percent of the loans selected for routine quality control reviews. Of the 5,081 routine quality control reviews for loans originated or sponsored by Countrywide with closing dates from July 2008 through April 2009, Countrywide only performed 344 field reviews of appraisals. HUD requires lenders to perform field reviews of 10 percent of the loans selected during the sampling process.<sup>35</sup>

### **Occupancy Reverification Not Performed or Supported**

Generally, no evidence was provided to show that Countrywide performed an occupancy reverification for the properties. HUD requires in cases where the occupancy of the subject property is suspect, a lender must attempt to determine whether the borrower is occupying the property.<sup>36</sup> For one loan (FHA case number 372-3786983), Countrywide's Quality Control department questioned the occupancy of the subject property because it was about 9 blocks from the borrower's current residence. However, there was no documentation showing that Countrywide's quality control reviewer attempted to reverify the occupancy of the subject property questioned.

According to Countrywide's quality control plan, occupancy reviews or inspections will be performed for three- to four-unit properties. However, for one of the two three-unit properties in the selected quality control reviews,<sup>37</sup> there was no evidence supporting Countrywide's performance of an occupancy review or inspection as denoted in its quality control plan.

### **Conditions Concerning Loan Clearance and Closing Were Not Verified**

<sup>34</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(2)

<sup>35</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(3)

<sup>36</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(4)

<sup>37</sup> For FHA case number 352-5776368

Countrywide did not verify conditions concerning loan clearance and closing as required. HUD requires a lender to review each loan selected for a quality control review to determine whether (1) conditions which were required to be satisfied before closing were met before closing, (2) the seller was the owner of record or was exempt from the owner-of-record requirement in accordance with HUD regulations, (3) the loan was closed and funds were disbursed in accordance with the lender's underwriting and subsequent closing instructions, and (4) the closing and legal document are accurate and complete.<sup>38</sup> There was no support that these HUD requirements were followed.

### **Countrywide's Quality Control Plan Did Not Meet HUD's Requirements**

Countrywide's quality control plan, as implemented, did not meet HUD's requirements. Specifically, it did not include the requirement that Countrywide perform a 100 percent review of the loans in which borrowers defaulted on their mortgages within the first six payments. However, the plan provided that a statistically valid sample of early payment defaulted loans with a 95 percent confidence level and 2 percent sample error rate be used.

Additionally, in accordance with HUD Handbook 4060.1, REV-2, Countrywide's plan did not include the provisions that<sup>39</sup>

- Its employee list should be checked concerning debarment or suspension or for those subject to a limited denial of participation at least semiannually (7-3G1).
- It must report findings within 60 days of initial discovery. Further, the findings should be reported via the Lender Reporting feature in Neighborhood Watch (7-3J).
- The loans involving appraisers, loan officers, processors, underwriters, etc., who have been associated with problems must be included in the review sample (7-5C).
- Telephone reverification will be attempted when a written reverification is not returned (7-6E2).
- It will perform field reviews on ten percent of the loans selected during the sampling process outlined in paragraphs 7-6 (C) and (D) (7-6E3).
- Closing conditions are to be reviewed, and the review must determine that the seller was the owner of record or that funds were disbursed in accordance with closing instructions (7-6G).

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<sup>38</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(G)

<sup>39</sup> The provisions missing from Countrywide's quality control plan are not all listed in this report.

- It will verify that the lender ensures that none of the participants in a mortgage transaction (excluding the seller of a principal residence) is debarred or suspended or is under limited denial of participation for the program and jurisdiction. Procedures must exist that determine whether the mortgage applicant is ineligible due to a delinquent Federal debt (7-8C).
- If manual overrides or downgrades are applied, no patterns of illegal discrimination are revealed (7-9A5).

### **Bank of America's Quality Control Plan Also Did Not Include Key Provisions**

As previously mentioned, Countrywide was bought by Bank of America, N.A., Charlotte, and the merger of Countrywide into Bank of America, N.A., was effective on April 27, 2009. Therefore, we also reviewed Bank of America's quality control plan for compliance with HUD's requirements.

Bank of America's quality control plan as of March 8, 2011, also did not address key provisions. For instance, its plan did not require a 100 percent review of early payment defaulted loans as defined by HUD. HUD requires a lender to review all loans going into default within the first six payments, and defines early payment defaults as those loans that become 60 days past due.<sup>40</sup> However, its quality control plan states all loans with no payment in the first 60 days, and a percentage of randomly selected loans that were ever 90 days delinquent within 12 months after closing will be reviewed.

Further, its quality control plan did not require the re-verification of credit reports generated by LandSafe, because it is a subsidiary of Bank of America and has an inherent incentive to mitigate any risk to Bank of America. HUD requires that a new credit report be obtained for each borrower whose loan is included in a quality control review unless the loan was a streamline refinance or was processed using a FHA approved automated underwriting system exempted from the requirement.<sup>41</sup>

### **Conclusion**

Countrywide did not implement its quality control program in accordance with HUD's requirements. The problems occurred because Countrywide disregarded HUD requirements. Additionally, Countrywide misinterpreted HUD's requirements for determining early payment defaults. Contrary to HUD's definition, Bank of America's personnel defined early payment defaulted loans as

<sup>40</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(D)

<sup>41</sup> HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(2)

loans that are 60 days delinquent within the first six months. HUD defines early payment defaulted loans as the loans that are 60 days past due (in default) within the first six payments, not months. Countrywide disregarded HUD requirements by not reviewing 996 early payment defaulted loans for which the servicing had been sold because it was no longer a risk to it or Bank of America.

From 2007 through 2009, Countrywide selected early payment defaulted loans for quality control reviews using statistical sampling with a 95 percent confidence level and a 2 percent error rate and a rate based on the actual severely unsatisfactory (bad) rate from the prior year. For 2008 and 2009, Countrywide applied this sampling methodology to the past 12-month population of early payment defaults, which affects the timeliness of its review of the early payment defaulted loans.

Countrywide should have performed 508 field reviews of appraisals for the loans selected for routine quality control reviews. Bank of America's business control manager for the Credit Quality Control department stated that a field review was only required if the appraisal in the origination file was a non-LandSafe appraisal.<sup>42</sup> Additionally, before 2009, the field review samples excluded FHA loans with LandSafe appraisals because LandSafe is a subsidiary of Bank of America.

Countrywide erroneously applied a HUD waiver for Countrywide Home Loans, Inc., an affiliate entity, to its early payment default sampling for quality control reviews. HUD intended the approved waiver to apply to only Countrywide Home Loans, Inc. (lender identification number 64141) and did not extend the waiver to Countrywide (lender identification number 76514). Bank of America's Credit Quality Control Division believed the HUD waiver was valid until August 2009, when Countrywide Financial Corporation's Quality Control Division and Bank of America Corporation's Quality Control Division merged.

As a result of Countrywide's disregard and misinterpretation of HUD's requirements, HUD lacked assurance of the accuracy, validity, and completeness of Countrywide's loan files. Additionally, Countrywide contributed to an increased risk of loss to HUD's FHA insurance fund.

## Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family require Bank of America to

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<sup>42</sup> Countrywide's quality control plan, dated December 10, 2007, required the performance of field reviews for a 10 percent sampling of non-LandSafe appraisals.

2A. Implement an adequate quality control plan that complies with HUD requirements, which includes but is not limited to the performance of routine and early payment default quality control reviews.

2B. Review 100 percent of its early payment defaulted loans to ensure compliance with HUD's requirements.

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

2C. Perform a review of Bank of America's quality control program within 9 months to determine whether the required provisions have been included in its written plan and quality control reviews are conducted in compliance with HUD's requirements.

## SCOPE AND METHODOLOGY

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We performed our audit work between August 2010 and April 2011. We conducted our audit at Bank of America's office in Calabasas, CA, and HUD's Chicago regional office. Initially, the audit covered the period July 1, 2008, through June 30, 2010. However, we adjusted this period as necessary due to the merger of Countrywide and Bank of America, N.A., on April 27, 2009.

To accomplish our audit, we reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to FHA mortgage insurance programs. Further, we reviewed Countrywide's quality control plan, underwriting policy manuals, and electronic loan files and quality control documentation. We interviewed Bank of America's employees and HUD's program staff.<sup>43</sup> We also contacted borrowers' employers to confirm employment and income data in the loan files.

### Underwriting

Using HUD's data maintained in its Single Family Data Warehouse system, we determined that Countrywide had 294 loans that went to claim in 30 months or less during the period July 1, 2008, to June 30, 2010. Of the 294 loans, 28 were sponsored by Countrywide and were for properties located in Region V. We randomly selected and reviewed 14 of the 28 loans to determine whether they were underwritten in compliance with HUD's requirements. The 14 loans with mortgage amounts totaling more than \$1.5 million were comprised of two streamline refinances, six conventional FHA refinances, and six home purchase loans. The results of our underwriting review apply only to the loans reviewed and cannot be projected to the entire universe of loans.

### Quality Control

For our review of Countrywide's implementation of its quality control plan, using RAT-STATS 2007 statistical software,<sup>44</sup> with a 90 percent confidence level, 20 percent precision level, and an estimated error rate of 50 percent, we selected a sample of 75 of the 7,599 quality control reviews performed by Countrywide during our audit period, with the exclusion of targeted reviews.<sup>45</sup> The sample of 75 quality control reviews was comprised of 54 routine reviews, 13 early payment default reviews, and 8 other<sup>46</sup> reviews. The results of the sample testing of quality control reviews are not projected to the population of quality control reviews performed by Countrywide.

We relied on information maintained in HUD's Neighborhood Watch for informational purposes only. We also relied on data maintained in HUD's Single Family Data Warehouse and Bank of

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<sup>43</sup> Some Bank of America's employees were formerly employed with Countrywide Bank, FSB.

<sup>44</sup> RAT-STATS is a statistical software designed for selecting a random sample and evaluating audit results.

<sup>45</sup> Target quality control reviews are those performed at the request of the origination channels that set the scope of the reviews. These reviews are not (1) part of the quality control audit plan or (2) a statistically valid sample.

<sup>46</sup> The "other" quality control reviews include FHA loans relative to the Consumer Market Division, Correspondent Lending Division, and a joint venture between Countrywide and KB Homes.

America's systems. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes. The audit results were based on our review of electronic and hardcopy documentation maintained by Bank of America, N.A.

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

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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:

- Countrywide did not follow HUD's requirements when underwriting 7 FHA-insured loans (see finding 1).

- Countrywide's quality control plan did not meet HUD's requirements (see finding 2).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	\$720,300	
1B		<u>\$3,211</u>
1C	<u>\$6,580</u>	
Total	<u>\$726,880</u>	<u>\$3,211</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

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.

## Appendix A-1

### ACTUAL LOSSES TO HUD FOR MATERIAL UNDERWRITING DEFICIENCIES

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The table below represents the actual losses to HUD for the FHA loans with material deficiencies (Recommendations 1A).

Count	FHA case number	Mortgage amount	Unpaid principal balance <sup>47</sup>	Claim paid	Actual loss to HUD <sup>48</sup>
1	261-9606137	\$126,327	\$124,548	\$142,531	\$66,441
2	263-4251461	95,333	93,963	101,281	51,197
3	263-4334310	77,140	76,029	83,549	79,439
4	263-4387704	50,239	49,374	56,359	24,436
5	271-9566133	262,823	257,818	278,840	247,529
6	581-3129633	293,371	288,079	313,871	171,463
7	581-3168637	93,301	91,524	102,251	79,795
	<b>Totals</b>	<b>\$998,534</b>	<b>\$981,335</b>	<b>\$1,078,682</b>	<b>\$720,300</b>

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<sup>47</sup> The unpaid principal balance amounts were pulled from HUD's Single Family Data Warehouse system.

<sup>48</sup> Loss on the sale of the property identified in HUD's Single Family Acquired Asset Management System.

## Appendix A-2

### **LOAN DETAILS FOR UNREASONABLE COSTS CHARGED**

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The table below represents the amounts for the unreasonable costs charged, as cited in finding 1 (Recommendation 1B).

<b>Count</b>	<b>FHA case number</b>	<b>Processing fee</b>	<b>Lender fee</b>	<b>Application fee</b>	<b>Underwriting fee</b>	<b>Total fees</b>
1	<b>261-9576571</b>	\$500				\$500
2	<b>263-4270999</b>	407				407
3	<b>411-4176620</b>		\$805	\$314		1,119
4	<b>581-3129633</b>	685			\$500	1,185
	<b>Totals</b>	<b>\$1,592</b>	<b>\$805</b>	<b>\$314</b>	<b>\$500</b>	<b>\$3,211</b>

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

**Bank of America** 

4500 Park Granada, Calabasas, CA 91302

July 19, 2011

**VIA FEDERAL EXPRESS**

Ms. Kelly Anderson  
Regional Inspector General for Audit – Region V  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
Ralph H. Metcalfe Federal Building  
77 West Jackson Blvd., Suite 2646  
Chicago, Illinois 60604

**RE: Countrywide Bank, FSB  
HUD OIG Draft Audit Report**

Dear Ms. Anderson:

Countrywide Bank, FSB ("Countrywide" or "Company") is in receipt of the Draft Audit Report ("Report"), dated June 27, 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 Countrywide that the OIG conducted during an extensive eight-month period beginning in August 2010 and concluding in April 2011. The OIG reviewed Federal Housing Administration ("FHA") loans that Countrywide originated or sponsored, and the review period covered the time between July 1, 2008 and June 30, 2010, which the reviewers adjusted as necessary due to the merger of Countrywide and Bank of America, N.A. ("Bank of America" or "Bank") effective April 27, 2009.

The Report states that the OIG's objective was to determine whether Countrywide complied with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans and whether its Quality Control Plan, as implemented, met HUD's requirements. The Report contains two findings, alleging material underwriting deficiencies in nine cases, as well as over-insurance or improper fees in an additional three cases, and a failure to fully implement a quality control program in accordance with HUD's requirements. Based on these findings, the Report recommends that HUD, among other things, require Bank of America to: (1) indemnify and/or reimburse the Department in connection with the 10 Countrywide loans that allegedly contain material underwriting deficiencies and/or are over-insured; (2) reimburse HUD for certain of Countrywide's fees charged to four borrowers; (3) implement a compliant Quality Control Plan; and (4) perform a 100% review of

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Countrywide's early payment defaulted loans. The Report further recommends that HUD perform a review of Bank of America's quality control program within nine months to determine whether its written plan includes all required provisions and whether it conducts reviews in accordance with HUD's requirements, as well as pursue remedies under the Program Fraud Civil Remedies Act ("PFCRA"), 31 U.S.C. §§ 3801 et seq., and/or civil money penalties under HUD regulations.

The OIG provided Bank of America with an opportunity to submit written comments for inclusion in the final report. This response briefly summarizes the history and merger of Countrywide and Bank of America, as well as addresses the individual findings and recommendations in the Report. We appreciate this opportunity to comment on the OIG's findings and recommendations. We understand, however, that final audit reports routinely include auditors' comments about the audited lender's written response, but that the lender is not provided an opportunity to respond to these additional comments. Often, these comments include substantive allegations or statements that were not contained in the draft audit report provided to the lender. To the extent 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**

Countrywide no longer exists. It was established on August 30, 1990, was acquired by Countrywide Financial Corporation on May 18, 2001, and converted its charter to a Federal savings bank on May 12, 2007. Countrywide received FHA approval in November 1993, its Direct Endorsement underwriting authority in September 2007, and its Lender Insurance approval in January 2008. The Company ultimately became one of the largest FHA lenders in the nation. In July 2008, however, Bank of America acquired Countrywide, with the entities' merger effective as of April 27, 2009. Effective March 1, 2010, the Bank surrendered Countrywide's HUD/FHA approval.

Bank of America is a national bank with approximately 6,000 banking centers and dates back to 1784, when its predecessor first opened for business. Headquartered in Charlotte, North Carolina, Bank of America now is one of the largest nationwide lenders and servicers in the United States. Its participation in HUD's FHA mortgage insurance programs dates back to 1935, long before the creation of HUD in 1965, and it is one of the largest FHA lenders with hundreds of registered FHA locations. Bank of America employs experienced staff with a working knowledge of FHA requirements and who take quality control and compliance matters seriously. It continuously strives to ensure full adherence to FHA rules and regulations and remains a dedicated participant in FHA programs. Bank of America is committed to its

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relationship with the Department and endeavors at all times to ensure its employees' compliance with FHA requirements and successful implementation of FHA programs.

Since its acquisition of Countrywide, Bank of America has expended substantial time, effort, and resources consolidating the entities' mortgage operations, providing training, and reorganizing Countrywide's business. Bank of America did not merely purchase Countrywide and continue to operate its business as the Company previously had done. To the contrary, Bank of America restructured Countrywide's mortgage lending and compliance divisions to integrate them appropriately into the Bank, terminated many existing Countrywide employees and re-assigned others to new duties, hired new personnel, and augmented and strengthened quality control and compliance functions. The policies, procedures and loans that the OIG reviewed and at issue in the Report were born of an entity that no longer exists or operates. Nevertheless, although Bank of America did not subsume Countrywide until well after Countrywide had originated and closed the loans cited in the Report and performed the quality control reviews at issue, Bank of America responds to the OIG's findings in turn.

**II. RESPONSE TO THE FINDINGS**

The Report contains two findings, including several sub-findings, alleging that Countrywide did not underwrite a handful of loans or implement a quality control program in compliance with HUD/FHA requirements and guidelines. Upon receipt of the draft Report, Bank of America performed a stringent review of both the loan files cited in the findings and Countrywide's quality control policies and procedures, as well as thoroughly examined applicable HUD/FHA requirements and guidelines, in an effort to provide pertinent information and documentation with this response. Based on its diligent examination and analysis of the matters raised in the Report, Bank of America disagrees with a number of the OIG's assertions and takes strong exception to most of the recommendations to HUD, including the OIG's suggestion that HUD consider pursuing remedies under PFCRA.

Bank of America's review indicated that several of the findings in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, and/or do not affect the underlying loans' insurability. Contrary to the allegations in the Report, Countrywide generally exercised due diligence in underwriting the cited files, and it maintained a robust quality control program under which it generally performed quality control reviews in compliance with FHA requirements as actually acknowledged in the Report. While Bank of America recognizes that oversights may have occurred in some instances, such oversights by no means suggest that Countrywide intentionally disregarded FHA guidelines, sought to qualify ineligible borrowers for FHA financing, or failed to take quality control and compliance matters seriously. Instead, they reflect isolated occurrences in a handful of cases among thousands of FHA loans originated or sponsored by Countrywide during the relevant time period. What's more, in those

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cases where deficiencies may be present, Bank of America acknowledges the potential deficiency and notes again that the findings in the Report are based on the operations of an entity that no longer exists. Below we reply to the individual matters raised in the Report.

**A. FINDING 1 – UNDERWRITING**

Finding 1 of the Report asserts in several sub-findings that Countrywide did not underwrite a handful of loans in compliance with HUD requirements. Between August 2010 and April 2011, the OIG reviewed 14 randomly selected files. In nine of these cases, the Report suggests that Countrywide: did not properly verify, analyze or support the borrower's employment and income, source of funds to close, liabilities, credit history, or debt-to-income ratio; allowed borrowers to skip prior mortgage payments in refinance transaction cases; did not adjust the financing for an identity-of-interest transaction; and/or charged unreasonable settlement costs. The Report further alleges that a tenth loan was over-insured and that improper fees were charged in another two cases, for a total of 12 loans cited in the underwriting findings on which the OIG bases its recommendations to HUD/FHA.

While the Report contains specific allegations in each of the 12 cases, it states that noncompliance with FHA underwriting requirements in these files occurred because Countrywide's underwriters failed to exercise due diligence in underwriting the loans. Bank of America respectfully disagrees with this broad and unsupported statement. As explained below in our loan-level responses to the OIG's underwriting findings, many of the assertions in the Report are inaccurate, do not constitute violations of HUD/FHA requirements, or state beliefs and opinions about which reasonable persons may differ. As the Department has acknowledged, "[u]nderwriting is more of an art than a science and requires the careful weighing of circumstances that affect the borrower's ability and willingness to make timely mortgage payments." Mortgagee Letter 00-24; see also Mortgagee Letter 95-07. Underwriting requires the subjective evaluation of information based on experience in determining whether a potential borrower is creditworthy. An underwriter must carefully weigh all aspects of an individual's case, consider all relevant circumstances, and exercise discretion in deciding whether to approve or reject a loan. See HUD Handbook 4155.1 REV-5, ¶ 2-3.<sup>1</sup> So long as the required documentation is in the file, it is up to the underwriter to determine whether financing is appropriate. In any given case, were two underwriters to review the same file, one might approve a loan

<sup>1</sup> While the Department has issued a new online version of Mortgage Credit Analysis Handbook 4155.1, the new Handbook became effective for loans originated on or after May 11, 2009, after the loans cited in the Report were originated and closed. We therefore rely on the prior Handbook, 4155.1 REV-5, and accompanying Mortgagee Letters throughout this response.

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where the other would deny a loan, yet both decisions would comply with FHA requirements assuming required documentation was obtained. The fact that HUD, the OIG, or anyone else may disagree with an underwriter's determination does not render the determination noncompliant.

That said, the files cited in the Report are well documented and the underwriting decisions are supported. The Countrywide underwriters do not appear to have disregarded FHA requirements or guidelines, and the file documents reveal their care in making loan decisions. The OIG's suggestion that, based on its disagreement with underwriting determinations in a handful of cases reviewed long after the files were closed, Countrywide underwriters failed to exercise due diligence in underwriting the loans is inflammatory and gratuitous. Moreover, to the extent oversights may have occurred in some instances, they did not have a material adverse impact on the borrower's eligibility for FHA financing. We address the allegations in each case separately below.

1. **[REDACTED] - FHA Case No. 261-9606137, CHL # 195441889**

In the [REDACTED] case, the Report alleges that Countrywide did not properly verify, document, and/or analyze the borrower's source of funds or liabilities, as well as miscalculated the borrower's debt-to-income ratio and failed to consider valid compensating factors. As explained below, however, Countrywide in fact verified and documented the source of funds in this case and, while it appears to have undercalculated the borrower's liabilities and debt-to-income ratio, it also underestimated the borrower's income; therefore, the borrower's debt-to-income ratio actually was significantly lower than the ratio approved by the automated underwriting system ("AUS"), and any deficiency in this file constituted at worst harmless error and had no material adverse impact on the loan.

First, the Report alleges that Countrywide did not obtain a credible explanation of the source of funds for large deposits made to the borrower's bank account. The Report notes that these deposits were direct deposits from the borrower's current employer, but were substantially higher than the borrower's regular earnings. Bank of America understands and appreciates that a lender must obtain a credible explanation of the source of funds for a large increase in a borrower's bank account, and we understand that it was Countrywide's policy and practice to obtain such explanations. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B). Here, although the referenced deposits were for greater amounts than the borrower's regular earnings, they were directly from the employer and were not inconsistent with the borrower's income. A written Verification of Employment ("VOE") from the employer indicated substantial overtime, holiday, and double time earnings (**Exhibit A-1**), all of which were reflected on the borrower's pay stubs, which also reflected reimbursement for travel expenses (**Exhibit**

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**Comment 4**

**A-2).** The direct deposits on the borrower's bank statement appear to have included not only regular earnings, but this additional income as well. The file verified the source of the additional income deposited into the borrower's account through the VOE and pay stubs, the pay stubs did not indicate any loans against the borrower, and there is no reason to question the source of funds.

Second, the Report alleges that Countrywide understated the borrower's city property tax by \$26.24 per month and excluded the county property tax of \$141.05 per month when calculating the borrower's future monthly payments reflected on the Mortgage Credit Analysis Worksheet ("MCAW"). Bank of America agrees that the total property taxes were \$396.94 per month, as stated in the Report, and that they were underestimated on the MCAW. Countrywide's error in this case, however, did not materially affect the loan. Recalculation of the borrower's qualifying ratios using \$396.94 in property taxes yields a debt-to-income ratio of 44.1%, as explained below (**Exhibit A-3**). Notably, this loan received an AUS accept with a debt-to-income ratio of 47.27% (**Exhibit A-4**). The calculation error therefore did not impact the borrower's eligibility for financing.

**Comment 4**

Lastly, the Report alleges that inclusion of the correct property taxes increases the borrower's debt-to-income ratio from 47.3% to 52.144%, and that the cash reserves noted in the Remarks section of the MCAW were not a sufficient compensating factor to offset the higher ratios because they did not total at least three months of mortgage payments. Significantly, use of the correct property tax amount yields a back-end ratio of 44.1%, not 52.144%. Although the MCAW reflects a back-end ratio of 47.3% using the lower property tax amount, the underwriter understated the borrower's income. The MCAW reflects income of \$3,161 (**Exhibit A-3**). The borrower's VOE (**Exhibit A-1**) and pay stubs (**Exhibit A-2**), however, reflect base earnings of \$3,740 (i.e., \$21.58 per hour x 40 hours per week x 52 weeks per year / 12 months). Using income of \$3,740 per month and property taxes totaling \$396.94 per month, the back-end ratio is 44.1%. While Bank of America has been unable to locate any additional information or documentation to clarify why the Countrywide underwriter considered cash reserves as a compensating factor, the Report agrees that the borrower had at least 2.2 months of reserves and we note again that this loan was approved by an AUS with the lower income amount and a higher ratio of 47.3%. Any deficiency in this case therefore constituted at worst harmless error and did not negatively affect the borrower's eligibility for FHA financing.

The foregoing discussion and enclosed documentation demonstrate that Countrywide substantially adhered to HUD's underwriting requirements in connection with the [REDACTED] file and that the borrower qualified for FHA financing. For these reasons, administrative action is not warranted and the allegations in this case should be removed from the final report.

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**2. [REDACTED] – FHA Case No. 263-4242692, CHL # 192062472**

In the [REDACTED] case, the Report alleges that Countrywide allowed maximum financing above an 85% loan-to-value (“LTV”) ratio in an identity-of-interest transaction. It states that, according to the FHA identity of interest certification form completed and signed by the borrower, the borrower had an identity of interest with the seller of the property he was purchasing – namely, the seller was the borrower’s mother. The Report alleges that there was no evidence in the file that the borrower lived at the property for at least six months before the purchase agreement was executed, and that Countrywide’s use of a 97% LTV instead of the 85% maximum resulted in the loan being over-insured by \$5,880.

Bank of America understands and appreciates that, when a family member purchases another family member’s home as a principal residence, the transaction is restricted to a maximum LTV ratio of 85%, unless, among other exceptions, the purchaser has been a tenant in the property for at least six months immediately predating the sales contract, as evidenced by a lease or other written evidence to verify occupancy. See HUD Handbook 4155.1 REV-5, ¶ 1-8(A). While we understand that it was Countrywide’s policy and practice to ensure such prior residency before allowing maximum financing in an identity of interest transaction, it appears that this matter went unnoticed in the [REDACTED] case, perhaps in part due to the borrower’s certification of intent to occupy the subject property as a primary residence (**Exhibit B**). The Bank therefore agrees that the underwriter’s oversight resulted in the loan being over-insured and that reimbursement to HUD in the amount of the over-insurance (i.e., \$5,880) is appropriate. The borrower, however, did qualify for FHA financing, which is not disputed in the Report. Thus, indemnification of the loan is unwarranted and this recommendation should be removed from the final Report.

**Comment 5**

**3. [REDACTED] – FHA Case No. 263-4251461, CHL # 200161210**

In the [REDACTED] case, the Report alleges that Countrywide did not properly verify, calculate and support the borrower’s monthly income, did not obtain an explanation for a large deposit to the borrower’s checking account, and did not comply with HUD’s refinancing requirements concerning skipped mortgage payments. Bank of America addresses each allegation in turn below.

**a. Income**

First, with regard to the borrower’s income, the Report alleges that the Countrywide Loan Underwriting Expert System (“CLUES”) loan report revealed monthly income of \$6,191.55, but it is unclear how the underwriter arrived at this amount as an income worksheet was not completed and the underwriter did not explain the method of calculation on the MCAW. Specifically, the Report states that the underwriter may have

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**Comment 6**

averaged the borrower's 2007 and 2008 year-to-date earnings, but that it should have used the most recent pay stub, which yields a much lower figure, because the borrower's yearly wages significantly decreased from 2007 to 2008 and Countrywide did not verify or receive an explanation for the declining income. The Report further asserts that Countrywide did not perform a direct verification of the borrower's employment history, although it included overtime and performance bonus pay in the borrower's qualifying income without verifying the likelihood of its continuance.

Initially, we note that the Report cites to Countrywide's Government Technical Manual for the proposition that the underwriter should have included an income calculation analysis in the file and used only the borrower's most recent pay stub to calculate wages rather than averaging current and prior earnings due to the borrower's declining income. Countrywide's Government Technical Manual, however, was an internal guidance document for Company employees. It referenced FHA requirements among others, but it was not issued by HUD and it contained requirements specific to Countrywide that were not imposed by HUD/FHA. Thus, an underwriter's deviation from the Government Technical Manual constituted a violation of Countrywide's internal policies and procedures, but could not be deemed a violation of FHA requirements unless it also deviated from HUD-issued requirements and guidance. Significantly, we are unaware of (and the Report does not cite) any FHA requirement that a lender use an income worksheet or otherwise document on the MCAW or elsewhere in the file how income was calculated or dictating how a lender is to calculate income in any given case (e.g., using the pay stubs versus the W-2 forms), whether or not there is declining income. The underwriter's failure to complete an income worksheet or otherwise provide detailed information on how income was calculated in this case does not constitute a violation of FHA requirements. Likewise, the underwriter's use of average 2007 and 2008 income, rather than only year-to-date earnings on the pay stub, does not constitute a violation of FHA requirements. We therefore take exception to the Report's suggestion that the underwriter's deviation from Countrywide's internal company policy in this case somehow violated FHA requirements.

That being said, Bank of America understands and appreciates that a mortgagee must determine the likelihood that income will continue through at least the first three years of the mortgage loan. See HUD Handbook 4155.1 REV-5, ¶ 2-7. To this end, FHA guidelines instruct lenders to obtain either a written VOE and the most recent pay stub, or pay stubs covering the most recent 30-day period, W-2 forms for the previous two years, and a telephone or automated verification of employment. See *id.* ¶ 3-1(E) and Mortgagee Letter 97-26. In this case, the file contains a VOE from The Work Number verifying the borrower's employment at General Motors Corporation for over 12 years (**Exhibit C-1**), as well as pay stubs covering over 30 days (**Exhibit C-2**) and the prior two years' W-2 forms (**Exhibit C-3**). This documentation satisfied the foregoing FHA documentation requirements, as well as the CLUES requirement to obtain the

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most recent pay stub documenting one full month's earnings and a written, verbal, or electronic VOE (**Exhibit C-4**).

In addition, respecting the calculation of income, the Loan Underwriting and Transmittal Summary ("LT") reflects monthly income of \$6,191.55 (**Exhibit C-5**). Contrary to the suggestion in the Report that the underwriter did not indicate in the file how this income was calculated, a handwritten note on the bottom of the pay stub dated October 19, 2008 indicates that the underwriter averaged the borrower's year-to-date earnings and the prior year's earnings (**Exhibit C-2**). Additionally, while these figures included overtime earnings, such inclusion was permitted. FHA guidelines provide that overtime income may be used to qualify the borrower if the lender uses an average and the employment verification does not state it is unlikely to continue. See HUD Handbook 4155.1 REV-5, ¶ 2-7(A). Here, the overtime income appeared on all of the borrower's pay stubs, the VOE was silent with respect to overtime (i.e., it did not state it was unlikely to continue), and the prior years' W-2 forms confirmed that the borrower continuously had been receiving overtime pay given that the total income exceeded the borrower's base earnings on the pay stubs. As the underwriter averaged the borrower's income over a nearly two-year period to determine qualifying wages, the underwriter's consideration of overtime income was allowed. Nevertheless, we note that, even excluding the overtime income, the borrower still would have qualified for FHA financing. The borrower's pay stubs reflect earnings of 28.710 per hour and over 40 hours of work per week (**Exhibit C-2**). Considering only the base income and a 40-hour work week, the borrower earned \$4,976.40 per month. Using income of \$4,976.40 per month, the borrower's debt-to-income ratio is only 43% (**Exhibit C-5**), which is in line with FHA guidelines. See HUD Handbook 4155.1 REV-5, ¶¶ 2-12, 2-13 and Mortgagee Letter 2005-16.

In accordance with FHA requirements, Countrywide properly analyzed the borrower's income to ensure its stability and continuance and obtained all required documentation. Thus, no administrative action is warranted on this basis and the income allegation should be removed from the final Report.

**b. Assets**

Second, the Report alleges that there was an unexplained large deposit of \$7,100 to the borrower's checking account on September 9, 2008. Bank of America understands and appreciates that a lender must obtain a credible explanation of the source of funds for a large increase in a borrower's bank account, and we understand that it was Countrywide's policy and practice to obtain such explanations. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B). While Bank of America has been unable to locate a copy of the explanation in the [REDACTED] case, given the age of the file, it is possible that an explanation was obtained prior to loan closing and subsequently was misplaced. The fact that Bank of America cannot locate an explanation at this time does not mean

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that Countrywide did not obtain one prior to closing. What's more, there is no reason to believe that the deposit at issue was derived from an impermissible source of funds.

**c. Mortgage Payments**

Finally, the Report alleges that Countrywide closed the refinance loan despite the fact that the borrower had skipped payments on the prior mortgage. It states that the LandSafe credit report dated October 28, 2008 reflected a \$91,182 mortgage with Chase Manhattan, but that the HUD-1 Settlement Statement ("HUD-1") reflected a payoff of \$92,500 to Bayview Lending on November 21, 2008, and there was no payoff demand in the file. It further asserts that there was no documentation supporting the borrower's payment of the mortgage amounts due on October 1 and November 1, 2008.

**Comment 8**

Bank of America understands and appreciates that a borrower may not skip payments on a prior mortgage or roll payments on a prior loan into the new FHA loan amount when refinancing. See HUD Handbook 4155.1 REV-5, ¶ 1-10(E). Countrywide did not permit the borrower to do so in the [REDACTED] case. A more recent credit report evidences that the borrower made the October 2008 mortgage payment to Chase and closed the account in November 2008 with no late payments reflected (**Exhibit C-6**). Thus, the borrower did not skip any payments on the prior mortgage in this case. No administrative action is warranted on this basis and this allegation should be removed from the final report.

**4. [REDACTED] – FHA Case No. 263-4334310, CHL # 200266826**

In the [REDACTED] case, the Report alleges that Countrywide closed the refinance loan despite the fact that the borrower had skipped payments on the prior mortgage. It states that the Countrywide Home Loans amended payoff demand statements for a jumbo conventional mortgage and a second conventional mortgage, dated November 25, 2008, showed principal balances, interest, late charges, prepayment penalties, and fees due for September through December 2008, and that there was no documentation in the file to support the borrower's payment of amounts due on October 1 and November 1, 2008, prior to loan closing on November 26, 2008.

**Comment 9**

Again, Bank of America understands and appreciates that a borrower may not skip payments on a prior mortgage or roll payments on a prior loan into the new FHA loan amount when refinancing. See HUD Handbook 4155.1 REV-5, ¶ 1-10(E). In the [REDACTED] case, however, after reviewing the payment histories, Bank of America agrees that the new loan was closed inadvertently despite the fact that the borrower had not made the October and November payments. We note, however, that the borrower subsequently made payments in December 2008 (**Exhibit D**). Any deficiency in connection with this matter therefore constituted at worst harmless error and indemnification is inappropriate.

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5. [REDACTED] – FHA Case No. 263-438-7704, CHL # 200751426

In the [REDACTED] case, the Report alleges that Countrywide did not document the transfer of gift funds from the donor to the borrower and that there were inconsistencies concerning the gift funds. Specifically, it asserts that, while the CLUES report reflected \$2,500 in gift funds and a gift letter indicated such a gift from the borrower's future father-in-law, the loan application reflected gift funds of only \$2,400. The Report also alleges that the file did not contain a copy of the donor's canceled check or withdrawal document or the borrower's bank statement or deposit slip to support the actual transfer of funds, and that the amount of the gift was not included on the HUD-1.

Comment 10

Bank of America understands and appreciates a lender's obligation to document the transfer of gift funds from an individual donor to the homebuyer by obtaining a copy of the donor's canceled check or other withdrawal document, as well as copy of the borrower's deposit slip or bank statement showing the deposit. See HUD Handbook 4155.1 REV-5, ¶ 2-10(C). It is Bank of America's policy and practice, as it was Countrywide's, to obtain such transfer documentation in every case where gift funds are used. In the [REDACTED] case, the file contains a gift letter wherein the donor certified that the funds were drawn on a JP Morgan Chase Bank account and were not provided by any person or entity with an interest in the sale of the property, including the seller, real estate agent or broker, builder, loan officer, or any entity associated with them (**Exhibit E-1**). The verification form contains a stamp from JP Morgan Chase Bank along with what appears to be the signature of a bank representative certifying the transfer of funds to the borrower's account and noting the donor's account balance. The file also contains a copy of the donor's gift check (**Exhibit E-2**). Thus, while we have been unable to locate the donor's withdrawal document and the borrower's deposit slip or bank statement, file documentation in fact evidences that the donor provided the funds and the donor certified that the funds came from his own account and were not supplied by an impermissible source. There is no reason to question the donor's veracity or the source of the gift funds in this case and any documentation deficiency constituted at worst harmless error and had no material adverse impact on the borrower's eligibility for financing. Lastly, we note that the final application reflects \$2,500, not \$2,400, in gift funds and therefore is consistent with other file documentation (**Exhibit E-3**).

In sum, file documentation evidences that the donor furnished \$2,500 in gift funds to the borrower and the donor certified that the gift was derived from his own funds and was not contributed by an impermissible source. Administrative action therefore is unwarranted and we respectfully submit that this finding should be removed from the final Report.

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**6. [REDACTED] – FHA Case No. 271-9566133, CHL # 194143907**

In the [REDACTED] case, the Report alleges that Countrywide did not comply with HUD/FHA requirements in verifying, documenting, and analyzing the borrower's employment and income, source of funds, and credit history. We address each of these matters in turn below.

**a. Employment and Income**

First, the Report notes that file documentation indicates the 21 year old borrower had been employed since he was 18 years old at Cristy's Bride & Tailoring and that his pay stubs and W-2 forms reflect income of over \$69,000 in 2006 and over \$78,000 in 2007. The Report suggests that Countrywide should have questioned these earnings because they appeared high related to the borrower's age and there was no documentation to support the borrower's qualifications or training for the job. The Report also states that a Google Map search reflects the business to be small and not located in a busy commercial area.

File documentation evidences Countrywide's compliance with FHA employment and income requirements in this case, and the Report fails to identify any requirement or guideline that was violated. As acknowledged in the Report, to verify a borrower's employment and income, a mortgagee must obtain a VOE and most recent pay stub, or a verbal or automated VOE, pay stubs covering the most recent 30-day period, and W-2 forms from the previous two years. See HUD Handbook 4155.1 REV-5, ¶ 3-1 and Mortgagee Letter 97-26. In compliance with these requirements, the [REDACTED] file contains a verbal VOE confirming employment for the prior two and a half years (**Exhibit F-1**), pay stubs covering the most recent 30-day period (**Exhibit F-2**), and W-2 forms for the prior two years (**Exhibit F-3**). As all of the file documentation was consistent, the underwriter made a reasonable and permissible determination that the borrower's youth and the small size of the business were not sufficient reason to question the borrower's employment or the veracity of the documents received.

The [REDACTED] file contains the employment and income documentation required by HUD/FHA, the documentation is consistent, and the underwriter exercised due care and made a permissible underwriting decision in this case. Administrative action on this basis therefore is unwarranted and this finding should be removed from the final Report.

**b. Source of Funds**

Second, the Report alleges that Countrywide failed to verify the source of a large deposit to the borrower's account or that the \$500 earnest money deposit ("EMD") was actually provided by the borrower.

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**Comment 12**

With regard to the large deposit to the borrower's bank account, the Report states that the loan application dated August 26, 2008 showed assets of \$5,025 in a savings account with Guaranty Bank and that a prior account activity statement revealed an ending and average balance of \$25 on June 17, 2008, a checking history inquiry printout showed a teller deposit of \$6,000 on July 15, 2008, and a letter from the borrower also dated July 15, 2008 indicated that the borrower did not make any deposits to the account because he sent all of his money to his family in Puerto Rico. The Report alleges, however, that the file did not contain sufficient documentation to show how the borrower was able to accumulate the funds at home,

Contrary to the suggestion in the Report, and in compliance with HUD/FHA guidelines, the file contains a credible explanation of the source of the \$6,000 deposit to the borrower's account, as well as evidences the borrower's reasonable ability to accumulate these funds based on his income, expenses, and history of using financial institutions. See HUD Handbook 4155.1 REV-5, ¶¶ 2-10(B), (M). First, the borrower provided a written explanation indicating that he generally did not make deposits to his Guaranty Bank account because he usually sent all of his money to his family in Puerto Rico, but that he did in fact make the \$6,000 deposit on July 15<sup>th</sup> using money he had been keeping at home (**Exhibit F-4**). As stated in the Report and evidenced by the borrower's pay stubs and W-2 forms (**Exhibits F-2 – F-3**), the borrower earned \$5,700 per month. Given that the borrower had no monthly liabilities other than a \$1,000 rental payment (**Exhibit F-5**), he would have been able to accumulate one month's salary in savings at home over a very short period of time and there is no reason to question the borrower's certification that he made the deposit using funds kept at home.

With regard to the EMD, the Report alleges that the purchase agreement indicated the borrower had provided earnest money of \$500 using a check on March 22, 2008, but that there was no supporting documentation such as a canceled check for the deposit and the borrower's bank account activity did not begin until April 2008. As noted in the Report, a lender must verify an EMD when it exceeds two percent of the sales price or appears excessive based on the borrower's history of accumulating savings. See HUD Handbook 4155.1 REV-5, ¶ 2-10(A). Here, the sales price was \$264,900 (**Exhibit F-6**), two percent of which would be \$5,298. As the borrower's EMD was only \$500 – a mere 0.18% of the sales price – and it did not appear excessive based on the borrower's ability to accumulate savings at home, Countrywide was not required to document the source of the \$500 deposit.

Countrywide complied with HUD/FHA requirements regarding the borrower's source of funds in this case. Administrative action on this basis therefore is unwarranted and this finding should be removed from the final Report.

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**c. Credit history**

Finally, the Report notes that the LandSafe merge credit report indicated the borrower did not have credit and that a nontraditional credit report reflected utility accounts with Qwest and Xcel Energy, an insurance account with Farmers Insurance Group, and current and previous rental histories. It alleges, however, that the nontraditional credit report did not disclose the borrower's previous rental address and that it was unclear how LandSafe obtained the landlords' contact information as the borrower's rental history was verified using the landlords' cell phone numbers. The Report further alleges that there were inconsistencies regarding the borrower's letter of credit and information on the nontraditional credit report. Specifically, it notes that the letter from Xcel Energy reflects both the landlord's and the borrower's name and indicates a start date over 16 months prior to the borrower's rental start date, and that the letter from Qwest confirmed good credit for both the landlord and the borrower but reflects a start date over 29 months before the borrower's rental start date. The Report concludes that it is unclear how Countrywide verified the authenticity of the letters of credit to ensure the credit history was for the borrower and not the landlord.

FHA guidelines state that a lack of credit history may not be used as a basis for rejecting a loan application and that, for those borrowers who do not use traditional credit, a lender must develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider. See HUD Handbook 4155.1 REV-5, ¶ 2-3. To do so, a lender may either (1) document that the providers of nontraditional credit in fact exist using some means of objective confirmation, including a published address or telephone number for the creditor, or (2) use a nontraditional mortgage credit report developed by a credit-reporting agency provided the agency has verified the existence of the credit providers and the lender verifies that the nontraditional credit was extended to the applicant using a published address or telephone number to do so. See *id.* Here, in compliance with these requirements, and as acknowledged in the Report, the file contains a nontraditional mortgage credit report developed by a credit-reporting agency. The fact that LandSafe may have used the landlords' cell phone numbers to contact them and verify contact information in no way suggests any impropriety or that contact was not adequately established. Moreover, the letters from the utility companies address the history of the utilities for the locations, noting acceptable payments by both the landlord and the borrower. The fact that the letters date back prior to the borrowers' occupancy of the premises is irrelevant given that the letters address payments at the locations rather than payments by each resident. The letters, however, cover the borrower's payments and clearly indicate good standing by the borrower. The file documentation complies strictly with FHA requirements in this case and there is no reason to question the veracity of the items received. Administrative action on this basis therefore is unwarranted and this finding should be removed from the final Report.

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7. [REDACTED] – **FHA Case No. 411-4176620, CHL # 192895320**

In the [REDACTED] case, the Report asserts that Countrywide did not comply with HUD/FHA requirements in verifying the borrower's employment and income, as well as charged improper fees to the borrower.

With regard to employment and income verification, the Report states that the loan application indicated a telephone interview was conducted with the borrower on May 9, 2008, but that The Work Number verification, dated June 9, 2008, indicated the borrower started working at her current employment on May 12, 2008, which was only three weeks at the time of the automated employment verification and there was no documentation to show that Countrywide verified the probability of continued employment. The Report further notes that, according to the CLUES loan report dated July 2, 2008, Countrywide was required to obtain the most recent year-to-date pay stub for one full month's earnings, but the loan file contained only two pay stubs covering two weeks showing an average of 36 hours per week. The Report also asserts that, although the borrower had been receiving part-time income from another employer for over seven years, there was no evidence she had worked at the job uninterrupted for the past two years or that she would continue to do so.

FHA guidelines provide that, to verify employment and income, a lender must obtain (1) a VOE and the borrower's most recent pay stub, or (2) a telephone or automated VOE, pay stubs covering the most recent 30-day period, and IRS W-2 Forms from the previous two years. See HUD Handbook 4155.1 REV-5, ¶ 3-1 and Mortgagee Letter 97-26. In the [REDACTED] case, the file contains a VOE from The Work Number verifying the borrower's current primary employment (**Exhibit G-1**), pay stubs covering the most recent 30-day period – two from the primary employment (**Exhibit G-2**) and two from the second job (**Exhibit G-3**), and the prior year's W-2 form (**Exhibit G-4**). As reflected on the borrower's pay stubs, the borrower earned \$572.40 per week, or \$2,480.40 per month, from her primary employment (**Exhibit G-2**), and \$843.75 per month from her part-time cleaning job (**Exhibit G-3**), totaling \$3,324.15 per month as reflected in the CLUES loan report (**Exhibit G-5**). Thus, the file clearly documents the borrower's employment and the underwriter verified the income used to qualify the borrower. There is no reason to question the borrower's employment or income in this case.

What's more, although the borrower recently had begun her new position with the primary employer, Countrywide adhered to HUD guidelines in verifying the likelihood of her continued employment. FHA requirements state that:

To analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the

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employer's confirmation of continued employment. A borrower who changes jobs frequently within the same line of work, but continues to advance in income or benefits, should be considered favorably. In this analysis, *income* stability takes precedence over *job* stability.

HUD Handbook 4155.1 REV-5, ¶ 2-6 (emphasis in original). Countrywide adhered to these requirements in analyzing the borrower's likelihood of continued employment in this case. The borrower had been working in the same manufacturing line of business for many years (**Exhibit G-6**) and held previous jobs in this profession. As discussed above, the file contains ample documentation and there is no evidence to suggest that the borrower's employment was unlikely to continue after closing.

**Comment 15**

Lastly, in Appendix A-2, the Report questions the \$805 lender fee and \$314 application fee that Countrywide charged at settlement, citing Mortgagee Letter 2006-04 for the basis of its allegation that the fees are impermissible. Mortgagee Letter 2006-04, however, merely eliminated HUD's prior restrictions on fees that a lender could collect from a borrower, instead providing that a lender may collect customary and reasonable fees necessary to close the mortgage (other than a tax service fee) as long as the fees comply with HUD's tiered pricing and seller contribution rules and other applicable state and federal laws, and so long as a lender does not mark-up third-party costs. Neither Mortgagee Letter 2006-04 nor any other FHA rule or guideline prohibits lender and application fees to cover costs incurred in making the mortgage loan. In fact, Mortgagee Letter 2006-04 expressly states that FHA no longer prescribes borrower paid closing costs and the OIG admits in Appendix A of the Report that the OIG cannot determine whether the fees in the [REDACTED] case were acceptable and that a decision by HUD program officials is required as to this matter. Based on our industry experience, we believe that the referenced fees are customary and reasonable in the industry. What's more, they did not violate HUD's tiered pricing or seller contribution restrictions, and they did not involve third-party fees and so did not constitute mark-ups. There was no prohibition against them and Countrywide did not violate any FHA requirement or guideline in charging them.

In sum, Countrywide verified and documented the borrower's employment and income in this case, and its lender and application fees were allowable under FHA guidelines. Administrative action therefore is unwarranted in this case and these findings should be removed from the final Report.

**8. [REDACTED] – FHA Case No. 581-3129633, CHL # 185174100**

In the [REDACTED] case, the Report alleges that Countrywide did not comply with HUD/FHA requirements for verifying employment and income, analyzing liabilities, or prohibiting skipped mortgage payments, and that the Bank charged impermissible processing and underwriting fees. We address each issue in turn below.

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**a. Employment and Income**

First, the Report alleges that Countrywide did not properly verify the co-borrower's employment and income. Specifically, it alleges that the co-borrower's employment start date was the same as the date the VOE was obtained, the underwriter recommended approval of financing pending automated underwriting approval at higher ratios, and the file contained verification of only six days' income despite the CLUES requirement for verification of one full month's earnings. The Report further alleges that the probability of continued employment could not be properly determined given that the co-borrower had worked at the current job for only one day when the VOE was completed, and that a two-year employment history was not properly documented as only verbal VOEs were obtained for prior employment. Additionally, while the co-borrower's employer indicated that the co-borrower was employed as a delivery driver on a full-time basis and was expected to work there indefinitely, the Report states it does not appear reasonable that the co-borrower was employed permanently as a delivery driver for an entity that provides temporary employment services.

**Comment 16**

The fact that the co-borrower had just started a new job did not negate the acceptability of his income for qualifying purposes and there is no reason to question the employer's verification that the co-borrower was permanently employed. HUD has stated expressly that it does "not impose a minimum length of time a borrower must have held a position of employment to be eligible" and that, "[t]o analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment." HUD Handbook 4155.1 REV-5, ¶ 2-6. Thus, the co-borrower's recent retention of the current employment did not render his income ineligible for inclusion in qualifying income.

What's more, the underwriter in this case carefully examined the co-borrower's employment record and situation, as well as obtained confirmation of continued employment as required by HUD. To this end, the underwriter prepared detailed written comments explaining that the co-borrower had a prior work history and discussing the reasoning behind loan approval in this case (**Exhibit H-1**). In addition, the employer provided a letter explaining that the co-borrower had been hired full-time as a delivery driver and that his employment was expected to continue indefinitely (**Exhibit H-2**). Although the employer is a temporary staffing agency that matches individuals with employers, it verified the co-borrower's full-time status and likelihood of indefinite employment. Regardless of whether the OIG believes such employment status was likely or reasonable, the fact is that the employer verified as much in writing and there is no basis on which to conclude the employer made a false statement to Countrywide. The required documentation was obtained.

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Nevertheless, we note that the borrower would have qualified for financing even without the co-borrower's income. Exclusion of the co-borrower's income would yield qualifying ratios of 51% and 54% (**Exhibit H-3**). Although these ratios would have exceeded HUD's benchmark guidelines of 31% and 43%, significant compensating factors would have justified loan approval. Specifically, the borrowers had been making timely mortgage payments at a higher amount than the proposed mortgage for 12 months, and they would have been receiving additional income not included in effective income but directly affecting their ability to make the mortgage payments (i.e., the co-borrower's excluded income) (**Exhibits H-1 and H-4**). HUD expressly recognizes these items as significant compensating factors that justify loan approval when the qualifying ratios exceed the benchmark guidelines. See HUD Handbook 4155.1 REV-5, ¶ 2-13(A) (stating that "the borrower has successfully demonstrated the ability to pay housing expenses equal to or greater than the proposed monthly housing expense for the new mortgage over the past 12-24 months") and ¶ 2-13(E) (stating that "the borrower receives documented compensation or income not reflected in effective income, but directly affecting the ability to pay the mortgage"). Thus, to the extent the OIG disagrees with the underwriting determination respecting the co-borrower's income eligibility, we note that the borrowers still would have qualified for the loan.

Countrywide complied with HUD/FHA requirements in verifying and documenting the co-borrower's employment and income, and it retained the maximum information and documentation available given the length of time the borrower had been employed on the current job. Given these facts, and given that the borrower would have qualified for FHA financing even without the co-borrower's income, administrative action on this basis is unwarranted and this finding should be removed from the final Report.

**b. Liabilities**

Second, the Report alleges that Countrywide excluded a \$342 utility payment and a \$142 credit card payment when calculating the borrower's liability and that inclusion of these amounts would increase the borrowers' qualifying ratios above HUD's benchmark guidelines. Bank of America is uncertain why the underwriter did not consider these amounts when computing the borrowers' liabilities. As explained above, however, even if the qualifying ratios exceeded the benchmark guidelines, the borrowers still would have qualified for FHA financing given that significant compensating factors expressly permitted by HUD were documented in the file. Any deficiency in connection with this matter therefore constituted at worst harmless error and did not have a material adverse impact on the loan. Indemnification therefore is inappropriate.

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**Comment 18**

**c. Skipped Mortgage Payments**

Third, the Report alleges that there is no evidence the borrowers made the August and September 2008 payments on their prior mortgage. The Report acknowledges, however, that a payoff statement valid through September 1, 2008 indicated a payoff of \$259,300.40 and the HUD-1 reflected an actual payoff of \$259,004.99 on September 13, 2008. While Bank of America has been unable to locate an updated payoff statement from the creditor, we note that there is no evidence the borrowers missed payments on the prior mortgage. In fact, a post-closing credit report reflects that the borrowers' previous mortgage with CitiMortgage was paid as agreed with no late payments and was current in September 2008 (**Exhibit H-5**). Administrative action on this basis therefore is unwarranted and this finding should be removed from the final Report.

**Comment 19**

**d. Fees**

Lastly, in Appendix A-2, the Report questions the \$685 processing fee and \$500 underwriting fee that Countrywide charged at settlement, citing Mortgagee Letter 2006-04 for the basis of its allegation that the fees are impermissible. Mortgagee Letter 2006-04, however, merely eliminated HUD's prior restrictions on fees that a lender could collect from a borrower, instead providing that a lender may collect customary and reasonable fees necessary to close the mortgage (other than a tax service fee) as long as the fees comply with HUD's tiered pricing and seller contribution rules and other applicable state and federal laws, and so long as a lender does not mark-up third-party costs. Neither Mortgagee Letter 2006-04 nor any other FHA rule or guideline prohibits processing and underwriting fees. In fact, Mortgagee Letter 2006-04 expressly states that FHA no longer prescribes borrower paid closing costs and the OIG admits in Appendix A of the Report that the OIG cannot determine whether the fees in the [REDACTED] case were acceptable and that a decision by HUD program officials is required as to this matter. Based on our industry experience, we believe that the referenced fees are customary and reasonable in the industry. What's more, they did not violate HUD's tiered pricing or seller contribution restrictions, and they did not involve third-party fees and so did not constitute mark-ups. There was no prohibition against them and Countrywide did not violate any FHA requirement or guideline in charging them. Administrative action on this basis therefore is unwarranted and this finding should be removed from the final Report.

**9. [REDACTED] – FHA Case No. 581-3168637, CHL # 195487691**

In the [REDACTED] case, the Report alleges that there was no documentation in the file to support that the borrowers paid amounts due for principal, interest, and recording fees between September 1 and October 14, 2008 on the prior mortgage by the time the new loan closed on October 7, 2008. According to Bank of America's servicing system,

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**Comment 20**

however, the borrowers made all payments on the prior loan timely, with the last payment made on September 16, 2008 (**Exhibit I**). Countrywide complied with FHA requirements in this case. Administrative action therefore is unwarranted and this finding should be removed from the final Report.

**10. [REDACTED] - FHA Case No. 132-2111442, CHL # 194147009**

In the [REDACTED] case, the Report alleges that Countrywide overestimated the financing costs. Specifically, it alleges that the gift funds of \$3,297 from a nonprofit organization were used in part to pay off the borrowers' \$969.53 collection account. The Report states that this payment was an inducement to purchase that should have resulted in a dollar-for-dollar reduction to the sales price. It concludes that, based on an adjusted sales price, the loan was over-insured by \$940.44.

**Comment 21**

Bank of America understands and appreciates that FHA deems the payment of consumer debt by third parties to be an inducement to purchase and that expenses paid on the borrower's behalf (other than allowable contributions towards the borrower's actual closing costs and financing concessions), including gift funds not meeting the requirement that the gift be for down payment assistance and payment of borrower debts other than by a family member, must result in a dollar-for-dollar reduction to the sales price in calculating the maximum insurable mortgage. See HUD Handbook 4155.1 REV-5, ¶ 2-10(C). While we understand that it was Countrywide's policy and practice to ensure nonprofit gift funds were used only for down payment assistance and not to repay borrower debt or for any other purpose, it appears that an oversight occurred in the [REDACTED] case and the Bank therefore agrees that the loan was over-insured. We note, however, that the loan was over-insured by \$700, not \$940.44.

As reflected on the HUD-1 (**Exhibit J-1**), the borrower made a \$500 EMD and received \$251.72 in cash back, leaving a balance of \$248.28 from the EMD to be applied to the \$969.53 debt payoff, which in turn left \$721.25 in remaining debt. The purchase price of the property in this case was \$109,900 (**Exhibit J-2**). A dollar-for-dollar reduction to the sales price for the \$721.25 in remaining debt yields a base loan amount of \$105,903 versus \$106,603, rendering the loan over-insured by \$700. Bank of America therefore agrees that the Countrywide underwriter's oversight resulted in the loan being over-insured and that reimbursement to HUD in the amount of the over-insurance (i.e., \$700) is appropriate. The borrower, however, did qualify for FHA financing, which is not disputed in the Report. Thus, administrative action is unwarranted and this recommendation should be removed from the final Report.

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- 11. [REDACTED] – FHA Case No. 261-9576571, CHL # 194802389
- 12. [REDACTED] – FHA Case No. 263-4270999, CHL # 193475521

**Comment 22**

In the [REDACTED] and [REDACTED] cases, Appendix A-2 of the Report questions the \$500 and \$407 processing fees that Countrywide charged to the borrowers, respectively. The Report cites Mortgagee Letter 2006-04 for the basis of its allegation that the fees are impermissible. As explained above, however, Mortgagee Letter 2006-04 merely eliminated HUD's prior restrictions on fees that a lender could collect from a borrower, instead providing that a lender may collect customary and reasonable fees necessary to close the mortgage (other than a tax service fee) as long as the fees comply with HUD's tiered pricing and seller contribution rules and other applicable state and federal laws, and so long as a lender does not mark-up third-party costs. Neither Mortgagee Letter 2006-04 nor any other FHA rule or guideline prohibits processing fees. In fact, Mortgagee Letter 2006-04 expressly states that FHA no longer prescribes borrower paid closing costs and the OIG admits in Appendix A of the Report that the OIG cannot determine whether the fees in the [REDACTED] and [REDACTED] cases were acceptable and that a decision by HUD program officials is required as to this matter. Based on our industry experience, we believe that the referenced fees are customary and reasonable in the industry. What's more, they did not violate HUD's tiered pricing or seller contribution restrictions, and they did not involve third-party fees and so did not constitute mark-ups. There was no prohibition against them and Countrywide did not violate any FHA requirement or guideline in charging them. Accordingly, administrative action on this basis is unwarranted and the finding should be removed from the final Report.

**B. FINDING 2 – QUALITY CONTROL**

In Finding 2, the Report alleges that Countrywide did not fully implement its quality control program in accordance with HUD requirements. Specifically, the Report asserts that Countrywide did not conduct quality control reviews in accordance with HUD requirements, particularly with respect to early payment defaults and loan level review and reverification, and that Countrywide's written Quality Control Plan did not contain all of the required provisions. The Report states that these alleged deficiencies "occurred because Countrywide disregarded and misinterpreted HUD's requirements" and that, as a result, Countrywide did not assure the accuracy, validity, and completeness of its loan underwriting activities. Finding 2 also asserts that Bank of America's Quality Control Plan, as of March 8, 2011, did not address key provisions required by HUD.

**Comment 23**

First and foremost, we note that there is no basis for the OIG's statement that Countrywide "disregarded" HUD's requirements. To the contrary, Countrywide had a robust quality control and compliance system in place to monitor FHA compliance, and

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it adhered to a detailed written Quality Control Plan that the Company routinely revised and updated as necessary to remain compliant with applicable internal and external requirements and guidelines. An internal Quality Control Department managed Countrywide's FHA quality control program, including a division responsible for credit quality control ("CQC") (i.e., origination matters). The CQC division was sufficiently staffed at all times, and Countrywide auditors performed timely quality control reviews on a sampling of FHA loans and rated their findings by level of risk. Countrywide also had procedures in place for reporting findings to management and taking corrective action. For example, among other things, quality control personnel met with production divisions on a monthly basis and regularly presented quality control findings and issues at corporate credit risk committee meetings. In fact, the Report itself acknowledges that "Countrywide generally complied with HUD requirements, in terms of timeliness and frequency, when performing routine quality control reviews for FHA-insured loans" and that the Company performed quality control reviews of thousands of FHA loans each year. Countrywide took its quality control obligations seriously and endeavored to comply with FHA's quality control requirements at all times. It did not disregard HUD requirements or ignore its quality control and compliance obligations.

Moreover, we note that the allegations in the Report relate to an entity that no longer exists. Bank of America acquired Countrywide in July 2008, with the entities' merger effective as of April 27, 2009. Significantly, Bank of America did not adopt Countrywide's written Quality Control Plan, or its quality control and compliance policies and procedures. At the time of acquisition, the quality control managers of both entities met to review and determine the best quality control processes to implement moving forward. Bank of America has a distinct, well developed, and formidable quality control program in place designed to comply with the multitude of laws, regulations, guidelines, and investor requirements applicable to its mortgage lending operations, including FHA requirements and guidelines. Quality control is handled in house at Bank of America by an experienced staff of more than 200. A training team within the quality control group is responsible for ensuring that quality control employees have a thorough, up-to-date understanding of quality control policies and procedures, and a quality assurance team reviews the work of quality control employees to evaluate auditor performance and identify areas that may require further training or clarification. Regular communication is built into the process. For example, a Critical Working Group meets weekly to facilitate communication between the quality control group and the production channels, and a Sampling / Audit Plan Governance meeting is held on a monthly basis to review the audit sample and audit plan for compliance with investor/insurer requirements and prudent risk management practices. Bank of America continuously strives to improve its quality control program and periodically revises its written Quality Control Plan to ensure full compliance with HUD requirements.

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Below we address the specific matters raised in Finding 2 of the Report, including: (1) Countrywide's quality control reviews of early payment defaults; (2) Countrywide's loan level reviews and reverifications; and (3) the entities' written Quality Control Plans.

**1. Early Payment Defaults**

The Report asserts that Countrywide did not review all early payment defaults as required by HUD and that it did not always review early payment defaults in a timely manner. With regard to the number of early payment defaults reviewed, the Report states that HUD requires lenders to review all loans going into default within the first six payments, and that Countrywide originated or sponsored 4,050 loans in this category that closed between July 1, 2008 and May 26, 2009, but that Countrywide did not review 1,911 of these loans.

Bank of America understands and appreciates that, in addition to loans selected for routine quality control reviews, all loans going into default (i.e., becoming 60 days past due) within the first six payments (i.e., early payment defaults) must be reviewed. See HUD Handbook 4060.1 REV-2, ¶ 7-6(D). Countrywide, however, requested a variance to this requirement from HUD given the size of its portfolio, and HUD granted the variance in January 2007 (**Exhibit K**). Specifically, the variance allowed Countrywide to perform quality control reviews of a statistically valid sample of early payment default loans rather than of all early payment default loans. According to the first paragraph of the letter from HUD, the variance applied to "Countrywide Financial Corporation and Countrywide Home Loans, Inc. (collectively CHL)." As a subsidiary of Countrywide Financial Corporation, Countrywide believed that it was covered by the variance and therefore reviewed a statistically valid sample of early payment default loans with a 95% confidence level and two percent precision on a monthly basis. Bank of America understands from the OIG that the variance applied only to Countrywide Home Loans, Inc., and not to Countrywide, and that Countrywide therefore erred in not reviewing all early payment default loans.

**Comment 24**

That being said, Countrywide did not simply ignore its obligations or disregard FHA requirements as suggested in the Report. It maintained a good faith belief that it was covered by the variance, and it acted accordingly. What's more, as recognized in the Report, Countrywide reviewed 2,139 early payment default loans that closed during the relevant 11-month period, which reflected its commitment to reviewing early payment defaults to identify and address any concerns. The OIG's claim that Countrywide disregarded HUD's requirement is unfounded and unnecessarily inflammatory.

With regard to the timing of early payment default reviews, the Report alleges that Countrywide did not always review early payment defaults in a timely manner.

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Specifically, it states that, from July 2008 through April 2009, Countrywide performed quality control reviews of 999 early payment defaulted loans and that it reviewed 455 of these loans between 90 and 183 days after the 60-day delinquency was reported to HUD. Contrary to the suggestion in the Report, the timing of these reviews complied with FHA requirements. As the OIG acknowledges, HUD does not specify a timeframe within which quality control reviews of early payment defaults must be performed. While Bank of America agrees that one of the goals underlying a lender's quality control program is to ensure swift and appropriate corrective action, Countrywide presumably performed the referenced reviews as quickly as possible given its other obligations, such as conducting routine quality control reviews of other loans on a monthly basis. As the OIG notes in the Report, for loans that closed between July 2008 through April 2009, Countrywide performed 5,058 routine quality control reviews, and only 23 of those reviews were completed more than 30 days after the required timeframe. Given the volume of loans to be reviewed, Countrywide completed its early payment default reviews in a reasonably timely manner. Countrywide did not ignore its obligation to review early payment defaults or postpone the reviews indefinitely; rather, it performed the reviews as soon as possible while simultaneously conducting a substantial number of routine quality control reviews on a timely basis. Regardless, there is no prescribed time frame for such reviews and thus there is no violation of FHA requirements in connection with this matter. Accordingly, administrative action on this basis is unwarranted and this finding should be removed from the Report.

**2. Loan Level Review and Reverification**

In Finding 2, the OIG also alleges that Countrywide did not consistently perform documentation review and verification for selected loans as required. The OIG reviewed 75 of the 7,599 quality control reviews that Countrywide performed during the audit period. The Report alleges that, in these 75 cases, Countrywide did not: order new credit reports as required in five cases; reverify employment, income, gift funds, alternate credit, and/or mortgage or rent payments in 41 cases; obtain field reviews of appraisals in 10% of the files; obtain occupancy reverifications; and/or verify that conditions concerning loan clearance and closing were met.

Initially, we note that it was Countrywide's policy to perform the functions and obtain the documentation referenced in the Report. For example, Countrywide's most recent written Quality Control Plan (**Exhibit L**) required the retention of a new credit report for each borrower whose loan is included in a quality control review unless the loan was a streamline refinance or was processed using a FHA approved AUS exempted from this requirement, as required by HUD. See HUD Handbook 4060.1 REV-2, ¶ 7-6(E)(1). Its written plan likewise required reverifications of employment, deposit, gifts, mortgage/rent, occupancy, and other items, as well as assurance that all required documents were obtained in the file, as required by HUD. See *id.* ¶¶ 7-6(E)(2),

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(4), 7-7. Thus, to the extent any such items were not found in the quality control files reviewed, these omissions did not reflect Countrywide's general policies or practices. Bank of America notes that the alleged deficiencies relate to a small number of loans taken from a sample that represents less than one percent of the quality control reviews performed by Countrywide during the applicable period. To the extent that Countrywide auditors may have overlooked certain items in these cases, such omissions were not necessarily indicative of a larger compliance problem. What's more, these files were reviewed by Countrywide several years ago and it is possible that the referenced items were obtained at the time but subsequently misplaced or lost. Additionally, Countrywide no longer exists, and any deficiencies that may have occurred in Countrywide's quality control program are not indicative of similar problems at Bank of America.

**3. Written Quality Control Plans**

Lastly, Finding 2 asserts that Countrywide's written Quality Control Plan did not meet HUD's requirements. To this end, the Report cites nine purportedly missing items. Finding 2 also asserts that Bank of America's written Quality Control Plan, dated March 8, 2011, is missing two required provisions. We address the entities' plans separately below.

**a. Countrywide's Quality Control Plan**

As explained above, Countrywide had a robust quality control and compliance system in place to monitor FHA compliance, and it adhered to a detailed written Quality Control Plan that the Company routinely revised and updated as necessary to remain compliant with applicable internal and external requirements and guidelines. As recognized in the Report, Countrywide generally performed timely quality control reviews on a monthly basis as required by HUD, rated its findings by level of risk, and had ample procedures in place for reporting findings to management and taking corrective action. Countrywide performed reviews of thousands of FHA loans each year, took its quality control obligations seriously, and endeavored to comply with FHA's quality control requirements. To that end, while Bank of America recognizes that Countrywide's most recent written plan, dated March 10, 2009, could have been more specific in certain instances, we believe that the written plan in fact substantially complied with HUD requirements. **See Exhibit L.**

**Comment 26**

First and foremost, the Report states that Countrywide's written plan did not include a requirement to review 100% of the entity's early payment defaults and instead provided for the review of a statistically valid sample. As explained above, however, Countrywide required the review of a statistically valid sample rather than a 100% review based on its understanding that it was covered by a Countrywide Financial Corporation waiver granted by HUD. While it appears that the Company may have been mistaken in its belief that the waiver extended to it, Countrywide did not ignore or

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overlook the review requirement. It maintained a good faith belief that it was acting in accordance with HUD guidance, and it in fact reviewed thousands of early payment default loans during the relevant time period.

Second, the Report states that Countrywide's written plan did not include a requirement to check the Company's employee list at least semiannually to discern whether any employees had been debarred, suspended, or subject to a limited denial of participation. Contrary to this assertion, however, Countrywide's plan provided for such reviews. Specifically, the "Employment Policy" section on page 9 of the plan states that, prior to extending an offer to a potential employee, Countrywide's Human Resource Department determines whether the applicant is debarred, suspended, or subject to a limited denial of participation. The "Production" section, also on page 9, further provides that each Countrywide production division is responsible for "ensuring that employees, correspondents and brokers underwriting/submitting/delivering FHA/VA loans are authorized to do so," which in practice included verification of whether employees were debarred, suspended, or subject to a limited denial of participation. While Bank of America recognizes that Countrywide's written plan could have been more specific in this regard, the plan was intended to cover the requirement.

Third, the Report states that Countrywide's written plan did not include a provision that it must report findings to HUD within 60 days of initial discovery via the Lender Reporting feature in Neighborhood Watch. Although Countrywide's written plan did not specifically reference Neighborhood Watch as the reporting vehicle, it in fact included a provision for reporting findings to HUD within 30 days of the completion of the audit. To this end, the plan provided for fraud investigations as necessary (which expressly included notification to HUD) on page 5, as well as reports of findings to HUD generated during quality control meetings within 30 days of audit completion on page 7. Countrywide's written plan properly included provisions respecting timely investor and insurer notification.

Fourth, the Report states that Countrywide's written plan did not include a provision that the loans involving appraisers, loan officers, processors, underwriters, etc. who have been associated with problems must be included in the review sample. Contrary to this allegation, Countrywide's plan provided for such coverage in various provisions. For example, the section titled "Plan Scope" on page 2 indicated that the audit program was designed and administered to monitor not only new originations, but specific areas of concern. The plan also provided for focus and target audits (page 3) for the purpose of identifying trends and mitigating risks. These provisions were intended to provide for the review of loans involving individuals associated with problems in the past. Thus, while Bank of America agrees that Countrywide's plan could have been more specific in this regard, the plan contained provisions intended to cover the stated requirement.

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Fifth, the Report states that Countrywide's written plan did not include a provision that telephone reverification will be attempted when written reverification is not returned. Although the plan did not reference telephone reverification, it required subsequent written requests. Specifically, if Countrywide did not receive a response to a written request for reverification within 21 days of sending the request, a second written request had to be attempted (page 4). Countrywide thereby implemented cautionary measures even more stringent than those required by HUD.

Sixth, the Report states that Countrywide's written plan did not include a provision that a desk review of the property appraisal must be performed on all loans chosen for a quality control review except streamline refinances and HUD real estate-owned sales. That is not the case. Countrywide's written Quality Control Plan clearly stated that a desk review of the property appraisal must be performed for all loans chosen for review. This requirement appeared in two places in the "Underwriting Review" section of the plan on page 4. First, in the subsection entitled "Appraisal," the plan states: "All audits are subject to a Desk Review performed by the QC Underwriter." Second, in the subsection entitled "QC Underwriter Desk Reviews," the plan includes the following language: "The QC underwriters perform desk reviews on all appraisals, whether the loan is subject to full re-verification or not." Countrywide's written plan therefore complied with the desk review requirement.

Seventh, the Report states that Countrywide's plan did not include a provision that closing conditions are to be reviewed, and that such review must determine that the seller was the owner of record and that funds were disbursed in accordance with closing instructions. The re-verification process outlined on pages 3-4 of the plan, however, stated that loans selected for audit will undergo the full re-verification process to determine the integrity of loan documentation and information, which was intended to include documentation of adherence to closing conditions. In addition, the "Insurance and Guarantee (I&G)" section of the plan stated that the I&G Department is responsible for performing complete insurance audits for FHA/VA loans, which includes a verification of the HUD-1, identification and curing of missing or incomplete documentation, and verification of current loan status prior to insurance package submission (page 9). As indicated, the description of the scope of these audits was not exclusive and would have included determination of whether closing conditions were in fact satisfied, whether the seller was the owner of record, and whether loan funds were disbursed in accordance with the closing instructions. Although the plan could have included greater detail, the plan covered these items.

Eighth, the Report states that Countrywide's written plan did not require verification that none of the participants in a mortgage transaction (excluding the seller of a principal residence) is debarred or suspended or is under a limited denial of participation for the program and jurisdiction, and that the mortgage applicant was not

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ineligible due to a delinquent Federal debt. Note, however, that the "Production" and "Insurance and Guarantee (I&G)" sections on page 9 of the plan specifically provided that each Countrywide production division was responsible for "ensuring that employees, correspondents and brokers underwriting/submitting/delivering FHA/VA loans are authorized to do so" and that the I&G Department would perform "complete insurance audits" for FHA loans. While Bank of America recognizes that Countrywide's plan could have been more detailed in this regard, the plan contained provisions intended to cover the stated items and Countrywide loan files evidence the Company's policy and practice of performing such reviews in each case.

Finally, the Report states that Countrywide's written plan did not include a provision that if manual overrides or downgrades are applied, no patterns of illegal discrimination are revealed. To the contrary, the "Compliance Reviews" and "Production" sections on page 9 of the plan covered this requirement. The "Compliance Reviews" section stated: "Loans are reviewed to ensure compliance with Truth in Lending, RESPA, ECOA, Fair Credit Reporting Act, and privacy laws and regulations. These audits are performed by the Quality Control Compliance department under the direction of Central Compliance." Similarly, the "Production" section provided that "the production divisions are responsible for monitoring activities to ensure that there is no disparate treatment in granting overages, and taking disciplinary action, if necessary." These audits and monitoring activities necessarily would have included verifying that, if manual downgrades or overrides are applied, no patterns of illegal discrimination against loan applicants are revealed. Thus, while the plan could have been more specific in this regard, it contained provisions intended to cover the stated items.

In sum, while Countrywide's written Quality Control Plan could have been more specific in connection with certain items, Countrywide sought to comply with all applicable HUD quality control requirements and its written plan generally covered the items raised in the Report. The plan was created in an effort to address various aspects of Countrywide's business, not just FHA lending, and it was drafted in a way to ensure employee understanding of the review matters to be covered. It was not intended to regurgitate Chapter 7 of the Mortgage Approval Handbook, where the FHA requirements are set forth, but instead aimed to incorporate HUD's requirements into a framework that ultimately was broader than the FHA guidelines. Thus, the mere fact that the written plan did not phrase certain covered items using the same words that appear in the HUD Handbook does not mean that the plan excluded those items or that the Company did not incorporate them into their quality control procedures. Regardless, Countrywide no longer exists and, as discussed below, Bank of America performs quality control subject to a detailed written plan that complies with FHA requirements and guidelines.

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**b. Bank of America's Quality Control Plan**

Although the OIG audit was of Countrywide, the OIG indicated that it also reviewed Bank of America's written Quality Control Plan dated March 8, 2011. Based on that review, the Report alleges that Bank of America's plan (1) does not require a 100% review of early payment defaulted loans and (2) does not require the reverification of credit reports generated by LandSafe, a subsidiary of Bank of America.

With regard to early payment defaults, Bank of America understands and appreciates that, in addition to the loans selected for routine quality control reviews, mortgagees must review all loans going into default within the first six payments. See HUD Handbook 4060.1 REV-2, ¶ 7-6(D). Although the March 8<sup>th</sup> plan did not expressly state this requirement, and while certain individuals with whom the OIG auditors spoke during its review of Countrywide may have been confused as to the definition of an early payment default (i.e., 60 days past due within the first six payments versus 60 days past due within the first six months), please note that Bank of America properly reviews 100% of its early payment defaults as defined by HUD (i.e., all loans that become 60 days past due within the first six payments). Moreover, Bank of America has amended its Quality Control Plan to properly reflect the Bank's practice. A copy of the amended plan is enclosed (**Exhibit M**).

With regard to credit reports, Bank of America understands and appreciates that a new credit report must be obtained for each borrower whose loan is included in a quality control review, unless the loan was a streamline refinance or was processed using a FHA-approved AUS exempted from this requirement. See HUD Handbook 4060.1 REV-2, ¶ 7-6(E)(1). Please note that the Bank complies with this requirement. To this end, its March 8<sup>th</sup> plan expressly provided that: "A merged credit report must be obtained on all government loans unless the loan was a streamline refinance or was processed using a FHA approved AUS exempted from this requirement." The subsequent phrase respecting LandSafe was intended to clarify what entity is performing the reverification. It was not intended to exempt, and in practice never has exempted, LandSafe from the reverification process. Bank of America reverifies credit for every borrower included in a quality control review (other than in streamline refinance or exempted AUS transactions), regardless of who generated the credit during the origination process, and the Bank has revised its Quality Control Plan to properly reflect this practice and eliminate any possible ambiguity (**Exhibit M**).

**III. RESPONSE TO THE OIG'S RECOMMENDATIONS**

Based on its underwriting findings in 12 Countrywide files cited in Finding 1 of the Report, the OIG recommends that HUD require Bank of America to indemnify HUD for any losses that it has incurred or that it may incur in connection with nine files containing allegedly material underwriting deficiencies, reimburse HUD in two cases for

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the amounts by which the loans are purportedly over-insured, and reimburse allegedly improper fees to four borrowers. The OIG also recommends that HUD pursue remedies under PFCRA. Based on its quality control findings in Finding 2 of the Report, the OIG recommends that HUD require Bank of America to implement a written Quality Control Plan that complies with HUD requirements, including but not limited to the performance of routine and early payment default quality control reviews, as well as review 100% of its early payment defaulted loans to ensure compliance with HUD requirements. The OIG further recommends that HUD perform a review of Bank of America's quality control program within nine months to determine whether the Bank has included the required provisions in its written plan and whether Bank of America is conducting quality control reviews in compliance with HUD's requirements. We take exception to these recommendations.

**A. RECOMMENDATIONS FOR INDEMNIFICATION AND REIMBURSEMENT**

**Comment 28**

Bank of America opposes most of the individual allegations contained in the Report and the OIG's associated recommendations for indemnification and/or reimbursement. As discussed above in our response to the underwriting findings, many of the assertions in the Report are inaccurate, do not constitute violations of HUD/FHA requirements, or state beliefs and opinions about which reasonable minds may differ. The files generally include the required documentation, the underwriters do not appear to have disregarded FHA requirements or guidelines, and, to the extent oversights may have occurred in some instances, they did not have a material adverse impact on the borrower's eligibility for FHA financing.

**B. RECOMMENDATION THAT HUD PURSUE REMEDIES UNDER PFCRA**

The OIG recommends not only indemnification and/or reimbursement in connection with its underwriting findings, but that HUD pursue remedies under PFCRA in connection with nine loans cited in Finding 1 on the theory that Countrywide's underwriters incorrectly certified to the use of due diligence or the integrity of the data in these files. We understand that this recommendation is predicated on the OIG's determination that the nine files contain material underwriting deficiencies. The Report suggests in Finding 1 that the underwriters' alleged oversights in these cases demonstrate that they did not exercise due diligence in examining the loan files and, as a result, made inaccurate certifications. The OIG therefore recommends 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 PFCRA for the purportedly inaccurate certifications. As discussed in detail above, Bank of America takes exception to the allegations that these loans contained material underwriting

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deficiencies, as well as the inflammatory recommendation to impose PFCRA penalties made in connection with this finding.

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 nine cases, the underwriters' certifications that due diligence was used in underwriting these loans are inaccurate. As demonstrated in the above discussion, however, in the nine cases cited, Countrywide substantially complied with HUD requirements and the underwriters made reasonable decisions to approve the loans after exercising due diligence in examining the files at issue. For these reasons, Bank of America 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.

Additionally, there is no reason to believe or evidence to suggest that Countrywide or its employees intended to circumvent HUD underwriting guidelines in these cases. Rather, the underwriters executed the certifications after diligently reviewing the loan files and making every effort to comply with FHA requirements. At the time they made the certifications, the underwriters believed that the borrowers qualified for FHA financing, which in fact they did in each case. There was no attempt to mislead the Department. The Report does not allege that Countrywide or its underwriters knowingly misrepresented facts to the Department or intentionally provided false information in the cases at issue. Significantly, in determining whether penalties under PFCRA are appropriate in any given case, HUD must consider whether there was a knowing and material violation. PFCRA penalties are available only when a person making, presenting, or submitting the written statement (or causing the same), knew or had reason to know that the statement asserted a material fact that is false, fictitious, or fraudulent or that it omitted a material fact. See 24 C.F.R. § 28.15(b). HUD also weighs a number of factors, including the lender's intent. While intentional violations or blatant disregard for HUD requirements may lead to severe sanctions, such as PFCRA penalties, HUD traditionally imposes less severe consequences for deficiencies resulting from unintentional error. Additionally, Bank of America maintains that the borrowers in the cited cases qualified for FHA financing. At worst, there may be minor deficiencies in certain of the files that did not adversely affect the borrowers' eligibility for FHA financing or the ultimate insurability of the loans. As indicated above, Bank of America believes that the final report should omit recommendations of administrative action in connection with many of these cases, which renders the OIG's recommendation of PFCRA penalties all the more severe under these circumstances.

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We further note that the PFCRA recommendation appears to be an attempt to increase the number of allegations made against Countrywide and exaggerate the already unfairly negative depiction of Countrywide's underwriting practices in the Report. In the past, OIG audit reports have alleged deficiencies in companies' FHA operations and the companies received an opportunity to address the materiality and accuracy of the allegations. By piling an incorrect certification allegation on top of underwriting assertions to which the respondent has yet to reply, the OIG creates a situation where every misunderstanding of FHA requirements, unintentional oversight, or inadvertent document error in a FHA loan could give rise to false certification allegations. Considering the public nature of OIG audit findings, such actions may create a chilling effect on lenders who want to participate in FHA programs. Enforcement actions are meant to reinforce HUD's rules and regulations, not discourage broad participation in FHA lending. For these reasons, we hope the OIG will reconsider its inclusion of false certification allegations in draft audit reports and focus instead on the issue of compliance with FHA rules and regulations.

Moreover, the PFCRA allegations constitute a recommendation to HUD, not a final action by the Department. As previously noted, the Report merely recommends that HUD determine the legal sufficiency of pursuing PFCRA remedies and/or civil money penalties in the cited cases. Upon receiving the final report, the Department will have an opportunity to examine the review findings and make an independent determination of whether such penalties are appropriate in these nine cases. As discussed at length earlier in this response, Bank of America disagrees that the Report's assertions warrant administrative action, civil money penalties, or PFCRA remedies. HUD also may disagree with the Report's assertions and decide not to pursue PFCRA or civil money penalties in this instance.

**Comment 29**

In addition, while the review process is still ongoing at the time the OIG issues its "final" report, the Report and the OIG's recommendations typically are publicized on the OIG website. As a result, a lender's investors and peers are able to access the OIG's preliminary recommendations before HUD has an opportunity to make a final assessment as to their merit. These entities often misinterpret the OIG's recommendations to be final actions by the Department. Under these circumstances, publicizing the OIG's preliminary recommendations, including a recommendation that HUD pursue PFCRA remedies based on an unsupported allegation that the underlying loans involve misrepresentation, will have a material, adverse effect on the Bank's reputation and business.

If the OIG's goal is to present the reader with a full and accurate disclosure of its review and findings, the final Report should include the following disclosure on the first page in bold, capitalized lettering:

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**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 MADE BY THE REPORT'S ADDRESSEE, THE HUD ASSISTANT SECRETARY FOR HOUSING – FEDERAL HOUSING COMMISSIONER, WHO WILL ULTIMATELY DECIDE WHETHER TO ACCEPT THE REPORT'S RECOMMENDATIONS IN WHOLE OR IN PART OR REJECT THEM.**

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

**C. QUALITY CONTROL RECOMMENDATIONS**

Based on its quality control findings in Finding 2 of the Report, the OIG recommends that HUD require Bank of America to implement a written Quality Control Plan that complies with HUD requirements, as well as perform a review of Bank of America's quality control program within nine months to determine whether the Bank has included all required provisions in its written plan and whether Bank of America is conducting quality control reviews in compliance with HUD's requirements. As explained above, Bank of America has a written Quality Control Plan in place that complies with HUD/FHA requirements and the Bank performs quality control reviews as required by the Department. Nevertheless, Bank of America takes strong exception to inclusion of the quality control recommendations in the final Report.

**Comment 30**

The OIG audit was a review of Countrywide, not Bank of America. The foregoing recommendations, however, give the impression that Bank of America's quality control program is largely deficient or noncompliant with FHA requirements. As explained above, that is not the case. Bank of America in fact has a substantial quality control system in place with hundreds of employees dedicated to ensuring compliance with HUD/FHA requirements, identifying potential compliance concerns, and ensuring swift and appropriate corrective action as necessary. When Bank of America acquired Countrywide, it did not adopt Countrywide's written Quality Control Plan or procedures. To the contrary, the Bank restructured departments, reorganized job duties, and endeavored to ensure its maintenance and implementation of the most vigorous and comprehensive quality control system possible. We strongly object to the OIG's recommendations for future HUD review of or action against Bank of America based on an evaluation of a former company that no longer exists and whose policies and procedures were not continued. What's more, the Report suggests that HUD should expend significant time and resources to review Bank of America's FHA quality control procedures outside of its normal Quality Assurance process, which does not conform to standard audit procedures and, as such, is inappropriate and should be removed from the final Report.

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**IV. CONCLUSION**

Bank of America takes the matters raised in the draft Report seriously. Given the Bank's long-standing relationship with HUD and the importance of FHA lending to consumers, Bank of America is committed to ongoing education and training for its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, since its acquisition of Countrywide, Bank of America has expended substantial time, effort, and resources consolidating the entities' mortgage operations and integrating the businesses. Bank of America, however, did not assume Countrywide's methods of operation, and the policies, procedures and loans that the OIG reviewed and at issue in the Report were born of an entity that no longer exists or operates. That being said, our review of the matters and loan files referenced in the Report revealed that Countrywide generally complied with FHA underwriting requirements and made loans to qualified FHA borrowers in the cases cited. Many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. Countrywide acted with due diligence in originating and closing the loans and the underwriters neither disregarded HUD/FHA requirements nor misrepresented information submitted to the Department. With respect to quality control, Countrywide adhered to a written Quality Control Plan and had substantial controls in place to ensure the timely performance of quality control reviews and implementation of corrective actions.

We believe that this response and accompanying exhibits respond fully to the matters raised in the Report and demonstrate that the OIG's recommendations to HUD are unwarranted. We respectfully request that the OIG remove allegations from the Report in those instances where Bank of America has demonstrated Countrywide's compliance with applicable HUD/FHA requirements and revise its recommendations to suit the facts of this case.

If you have any questions, or if you need additional information, please do not hesitate to contact me at (213) 345-8603, or our Washington counsel, Phillip L. Schulman, at (202) 778-9027, or Emily J. Booth, at (202) 778-9112.

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Thank you for your kind consideration.

Sincerely,



Linda Jacopetti  
Senior Vice President  
Government Lending Business Control Executive

Enclosures

cc: Phillip L. Schulman, Esq.  
Emily J. Booth, Esq.

## OIG Evaluation of Auditee Comments

**Comment 1** We provided Bank of America the opportunity to informally respond to our tentative findings during the audit. We considered its comments and revised our conclusions where appropriate. We then prepared the discussion draft audit report and provided Bank of America an opportunity to respond to the draft report in writing. We included its written response (minus supporting documentation) in this report along with our evaluation of the response. Bank of America will have further opportunity to provide comments and supporting documentation to HUD to resolve the recommendations.

**Comment 2** Due to the merger between Bank of America and Countrywide Bank FSB (Countrywide), Bank of America inherited the rights, obligations, and liabilities of Countrywide as they relate to HUD and FHA. Thus, we have addressed the findings and recommendations to Bank of America.

**Comment 3** Bank of America asserts the referenced deposits were directly from the employer and were not inconsistent with the borrower's income. We disagree that the referenced deposits were not inconsistent with the borrower's income. The two direct deposits from the borrower's employer were 2.9 and 3.43 times higher than his regular weekly gross pay of \$863.20.

Bank of America assumed the direct deposits represented the borrower's regular earnings, overtime, holiday, double time earnings, and reimbursement for travel expenses. However, Bank of America did not provide documentation confirming this assumption about the deposits. The pay stubs dated August 7 and August 14, 2011, did not support the additional earnings deposited in the borrower's bank account as indicated by Bank of America. Additionally, the two deposits in question were not verified through the verification of employment dated July 24, 2008. HUD requires a lender to obtain a credible explanation for the source of funds, if there is a large increase in an account. Countrywide did not obtain a credible explanation of the source of funds for the two large deposits made into the borrower's bank account, as required for this loan transaction.

**Comment 4** Bank of America agreed the total property taxes were \$396.94 (\$229.65 + \$167.29) per month, and the amounts were underestimated on the mortgage credit analysis worksheet. However, it disagreed with the material effect of Countrywide's error on this loan. Instead, Bank of America indicated the underwriter understated the borrower's income by \$579 (\$3,740 - \$3,161). Therefore, with the correct property tax amount and the recalculated borrower's pay amount, the back-end ratio should have been 44.1 percent, not 52.144 percent. We disagree with Bank of America's recalculation of the borrower's monthly pay amount and back-end ratio.

Bank of America's computation of the borrower's income contradicts Countrywide's policy noted in the income worksheet used by Countrywide's

underwriters. According to Countrywide's policy for computing the borrower's base pay income, the calculations for the base pay income must be compared with the year to date figure, and if the year to date figure is lower than the current base pay, then the underwriter should use the lowest of the two figures in qualifying the borrower if there is no reasoning or documentation to justify the difference. Even Countrywide's Quality Control department arrived at a lower monthly base pay income of \$3,093, using the borrower's year to date on the pay stub dated August 14, 2011, excluding the overtime and holiday pay. Additionally, it was not adequately supported that the borrower worked an average of 40 hours per week.

Bank of America did not provide additional information to support the use of the retirement income as cash reserves. HUD requires that if cash reserves are used as a compensating factor, then the borrower should have at least three months worth documented after closing.

Similar to our conclusions, Countrywide's Quality Control auditor generally disagreed with the underwriter's decisions when evaluating and calculating the borrower's liability, debt to income ratios, cash reserves and funds to close. This loan was manually underwritten, and the CLUES accept approval did not consider the understated property tax amount. Therefore, our findings and recommendations for this loan will remain in the report.

**Comment 5** Bank of America agreed the loan was over-insured by \$5,880, and HUD should be reimbursed for the over-insured amount. However, it disagreed with the indemnification of the loan.

We agree; therefore, we will remove the recommendation concerning the reimbursement of the FHA insurance fund for the actual loss of \$44,664 on the sale of the subject property, and will only recommend that Bank of America reimburse HUD \$5,880 for the overinsured loan amount.

**Comment 6** Bank of America asserts Countrywide properly analyzed the borrower's income to ensure its stability and continuance and obtained all required documentation. We disagree.

According to HUD's requirements, underwriters must exercise due diligence when considering borrowers for mortgage approval. Specifically, a direct endorsement lender shall exercise the same level of care which it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment. Further, HUD Handbook 4155.1 REV-5, Chapter 2, Section 5, provides that underwriting requires careful analysis of the many aspects of the mortgage. Each loan is a separate and unique transaction, and there may be other factors that demonstrate the borrowers' ability and willingness to make timely mortgage payments. The lender is responsible for adequately analyzing the probability that the borrower

will be able to repay the mortgage obligation in accordance with the terms of the loan. Although HUD allows for judgment, HUD Handbook 4155.1 REV-5, Chapter 2, Section 5, states that there is a danger of "layering flexibilities" in assessing mortgage insurance risk, and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting.

Apart from Countrywide's violation of its own internal policies and procedures (or guide) for underwriting loans, it materially violated HUD's requirements for underwriting FHA-insured loans. Countrywide did not properly establish the anticipated income to determine the borrower's capacity to repay the mortgage debt. Additionally, income may not be used in calculating a borrower's income ratios if it is unverifiable, unstable, or will not continue. The borrower's year-to-date earnings statement as of October 19, 2008, totaled \$42,061. When compared to the borrower's 2007 earnings of \$91,831, the borrower would have had to earn more than \$49,000 in less than three months for 2008 earnings. The apparent decrease in the borrower's yearly wages was not addressed by Countrywide. HUD Handbook 4155.1 REV-5, paragraph 3-1, requires the loan application package to contain all supporting documentation for the lender's loan approval decision. When standard documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or to supplement the documentation submitted by the borrower. The borrower's most recent pay stub in the loan file did not support the monthly income of \$6,192. Since Bank of America did not provide any further documentation to resolve this issue, this finding item was not removed from the report.

**Comment 7** Bank of America did not provide additional documentation to support that Countrywide obtained an explanation and documentation for the large deposit of \$7,100 in the borrower's checking account, as required by HUD. Therefore, this finding item will remain in the report.

**Comment 8** Bank of America provided a LandSafe credit merge report, dated May 5, 2011, showing the last activity in the account, which was current, was in October 2008. The conventional real estate mortgage account with Chase was closed in November 2008. Our report has been revised regarding the October 2008 mortgage payment.

Bank of America did not provide any evidence that the borrower also made the mortgage payment due on November 1, 2008. The credit report in the loan file showed a mortgage balance of \$91,182 with Chase Manhattan. The settlement statement revealed that the mortgage payoff of \$92,500 was made to Bayview Lending. The difference between the credit report mortgage balance and the settlement statement payoff amount was \$1,318, the mortgage amount owed before closing but not paid by the borrower.

Countrywide allowed the borrower to skip the November 2008 mortgage payment, in violation of HUD's requirements.

**Comment 9** Bank of America agreed that the loan was closed without the borrower making the October and November 2008 mortgage payments. It provided a loan history inquiry printout as of May 4, 2011, showing the payments made on December 5, 2008, for the October and November 2008 mortgage amounts after the loan closed. Therefore, this loan should not have been closed because it did not comply with HUD's requirements regarding skipped mortgage payments.

**Comment 10** The Request for Verification of Gift/Gift Letter signed by the gift donor's depository was proof that the donor had the funds in his account to make a gift to the borrower. The verification of gift does not certify the gift funds had been transferred from the donor's account to the borrower's account. Further, the front of the gift check from the borrower's future father-in-law does not support the transfer of the gift funds to the borrower. The borrower needed a cash investment of \$2,624 to close loan; however, the borrower's bank account inquiry document dated November 12, 2008, showed the borrower had only an available balance totaling \$1,094.20. Without the gift funds, the borrower did not have sufficient funds for loan closing.

Bank of America provided a loan application dated December 19, 2008, listing funds from an individual/entity other than the gift donor on the verification of gift document dated December 2, 2008, in the amount of \$2,500. There was no indication of who the individual is, and this source of funds was not verified. HUD requires that all funds for the borrower's investment in the property must be verified and documented. Countrywide did not properly verify and document the borrower's source of funds to close, as required by HUD.

HUD Handbook 4155.1 REV-2, paragraph 1-7, requires the borrower to make a cash investment at least equal to the difference between the sales price and the resulting maximum mortgage amount. Further, HUD Handbook 4155.1 REV-2, paragraph 2-10(C)(2) states when the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

**Comment 11** We agree the borrower's loan file contained employment and income documentation required by HUD. However, the verification of a borrower's employment and income is more than collecting the required documentation to include in the loan file. According to HUD's requirements, underwriters must exercise due diligence when considering borrowers for mortgage approval. Specifically, a direct endorsement lender shall exercise the same level of care which it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment. Further, HUD Handbook 4155.1 REV-5, Chapter 2, Section 5,

provides that underwriting requires careful analysis of the many aspects of the mortgage. Each loan is a separate and unique transaction, and there may be other factors that demonstrate the borrowers' ability and willingness to make timely mortgage payments. The lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan. Although HUD allows for judgment, HUD Handbook 4155.1 REV-5, Chapter 2, Section 5, states that there is a danger of "layering flexibilities" in assessing mortgage insurance risk, and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting.

Countrywide's underwriter did not exercise due diligence when verifying the borrower's employment and income. The income appeared unusual for the borrower's age, and for the geographic location of the business. There was no check number or advice number included on the pay stubs, and the pay date for the borrower's most recent pay stub for the earnings period from June 16, 2008 through June 30, 2008, was listed as June 3, 2008. Additionally, the borrower's address was not included on the pay stubs.

**Comment 12** Contrary to HUD's requirements, apart from the borrower's income, the borrower's loan file did not address the reasonableness of the accumulated funds in terms of the borrower's spending habits, and the length of time it took to save the cash at home. The borrower's letter dated July 15, 2008, revealed the borrower sent all his money to his family in Puerto Rico, who managed all his money. Countrywide should have requested and verified additional information, such as a budget or schedule, to support that the borrower was able to save the \$6,000 at home as required to HUD. According to the Countrywide's underwriter for this loan, the source of this deposit should have been an underwriting condition. Bank of America did not provide additional documentation to resolve the issue with the verification of deposit. So, this finding item will remain in the audit report.

Based on HUD's requirement, we agree that since the earnest money deposit was less than two percent of the sales price, it would have not been necessary to document the support for the deposit. However, since the borrower did not have a demonstrated history of accumulated savings, the amount of the earnest money deposit was considered excessive. Therefore, based the borrower's questionable income, the underwriter's improper verification of the borrower's credit history, and the borrower's insufficiently explained large deposit into a recently opened bank account, this loan will remain in the audit report.

**Comment 13** HUD requires a lender to verify the borrower's nontraditional credit using a published address or telephone number to make the verification. Countrywide did not comply with this requirement. Additionally, concerning the borrower's utility payments, Countrywide did not establish that these payments were made by the borrower, and not the landlord.

HUD Handbook 4155.1 REV-2, paragraph 3-1, states that when standard documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or to supplement the documentation submitted by the borrower. To the contrary, Countrywide and Bank of America did not provide additional documentation to address the inconsistencies and to support their decision regarding the borrower's credit.

There was a payment shock for this loan transaction. The borrower's monthly rent at the time of the loan application was \$1,000, and his future monthly mortgage payment after loan closing was \$2,073.16. The borrower's future monthly mortgage payment was more than twice the borrower's current monthly rental payment. According to information in HUD's Neighborhood Watch system, the borrower made only two payments on the mortgage before the first 90-day delinquency was reported.

**Comment 14** We agree and adjusted the audit report accordingly.

**Comment 15** The settlement statement, dated July 18, 2008, revealed that the borrower was charged a loan origination fee of \$891, lender fee of \$805, and application fee of \$314 as part of her settlement charges for this conventional refinance transaction. During the audit, Bank of America's senior business control specialist explained to the audit team that it would be acceptable to charge a borrower these fees on a purchase transaction; however, not on a refinance transaction. Therefore, Countrywide incorrectly charged the borrower the lender and application fees totaling \$1,119.

Regulations at 24 CFR (Code of Federal Regulations) 3500.14(c) prohibits the split of charges except for actual services performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. We understand that Mortgagee Letter 2006-04 allows lenders to charge and collect customary and reasonable costs necessary to close the mortgage. The mortgagee letter also limits the origination fee to one percent on forward mortgages, and requires all fees and charges to comply with Federal and State disclosure laws and other applicable laws and regulations. Bank of America did not provide documentation to support that the lender and application fees charged to the borrower were customary and reasonable. Therefore, the loan will remain in the report.

**Comment 16** We understand that the start of a new job does not negate the acceptability of the coborrower's income. In examining the coborrower's past employment record, we noted that his past jobs have not been in the same line of work. According to the mortgage credit analysis worksheet comments, the underwriter accepted the coborrower's new income based on his previous work history. However, Countrywide did not properly verify the coborrower's employment history for the previous two years, as required by HUD. FHA's TOTAL Mortgage Scorecard

User Guide, effective December 2004, requires a lender to verify the applicant's employment history for the previous two years. However, if the applicant has not been employed with the same employer for the previous two years, the lender is required to obtain one of the following for the most recent two years to verify the applicant's employment history: (1) W-2(s); (2) VOEs (that is, written verifications of employment); or (3) Electronic verification acceptable to FHA. Countrywide did not obtain W-2s, VOEs or electronic verification of employment for the coborrower's prior employment. Only verbal verifications of employment were found in the loan file for the coborrower's prior employment.

HUD requires a lender to analyze each borrower's income to be obligated for the mortgage debt to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. Further, HUD Handbook 4155.1 REV-5, Chapter 2, Section 5, provides that underwriting requires careful analysis of the many aspects of the mortgage. Each loan is a separate and unique transaction, and there may be other factors that demonstrate the borrowers' ability and willingness to make timely mortgage payments. The lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan. Although HUD allows for judgment, there is a danger of "layering flexibilities" in assessing mortgage insurance risk, and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting.

**Comment 17** Bank of America is not certain why the underwriter did not include the cited borrower's monthly liabilities. However, it states that the borrowers would have still qualified for the FHA financing with significant compensating factors permitted by HUD. We disagree. One automated underwriting condition for this loan was that the loan should be resubmitted through CLUES for an updated evaluation if any changes are discovered that would negatively affect the borrowers' ability to repay the mortgage. With the exclusion of the coborrower's income from the new employment and inclusion of the previously excluded monthly total liability of \$484, the underwriter would have had to resubmit the loan through CLUES for an updated evaluation.

In assessing the borrowers' ability to repay the loan, all factors should be considered including the borrowers' income and debts. Countrywide did not adequately support that the borrowers were able and willing to repay the mortgage debt. Additionally, according to information in HUD's Neighborhood Watch system, the borrowers made only one payment on the mortgage before the first 90-day delinquency was reported. Therefore, with the excluded liabilities and improperly verified past employment history, this loan will remain in the report.

**Comment 18** Bank of America provided a landsafe credit merge report dated May 9, 2011, which revealed the borrowers' previous mortgage with Citimortgage was current as of September 2008, the month the account was closed. The last activity for the

mortgage account was actually in August 2008. The credit report does not support that the borrowers made the mortgage payment due on September 1, 2008. Therefore, this loan should not have been closed because it did not comply with HUD requirements concerning skipped mortgage payments.

**Comment 19** The settlement statement, dated September 13, 2008, revealed that the borrowers were charged a loan origination fee of \$2,897.50, processing fee of \$685, and underwriting fee of \$500 as part of the settlement charges for this conventional loan transaction. Bank of America's senior business control specialist explained to the audit team that it would be acceptable to charge a borrower these fees on a purchase transaction; however, not on a refinance transaction. Therefore, Countrywide incorrectly charged the borrowers the processing fee and underwriting fee totaling \$1,185.

Regulations at 24 CFR (Code of Federal Regulations) 3500.14(c) prohibits the split of charges except for actual services performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. We understand that Mortgagee Letter 2006-04 allows lenders to charge and collect customary and reasonable costs necessary to close the mortgage. The mortgagee letter also limits the origination fee to one percent on forward mortgages, and requires all fees and charges to comply with Federal and State disclosure laws and other applicable laws and regulations. Bank of America did not demonstrate the cited fees were customary and reasonable costs necessary to close the mortgages in question.

Bank of America did not provide documentation to support that the processing and underwriting fees charged to the borrower were customary and reasonable. Therefore, this finding item will remain in the report.

**Comment 20** We disagree with Bank of America that the borrowers made all payments on the prior loan timely as of September 16, 2008. Bank of America provided a loan history inquiry printout dated May 9, 2011, revealing that the borrower's principal balance of \$72,501.92 and interest of \$582.12 was paid on October 15, 2008. Therefore, this loan should not have been closed because it did not comply with HUD requirements concerning skipped mortgage payments. The borrower did not make the mortgage payment that was due before or at closing as required by HUD. Therefore, this loan will remain in the report.

**Comment 21** Bank of America agreed that due to the Countrywide underwriter's oversight, this loan was overinsured but only by \$700, and not the \$940.44 cited in the draft report. We agree and reduced the reimbursable amount to HUD to \$700. This loan was not recommended for administrative action; however, we recommended that Bank of America reimburse HUD the amount of the overinsurance.

**Comment 22** The settlement statement, dated August 25, 2008, revealed that the borrower was charged a loan origination fee of \$826 and loan processing fee of \$500 as part of

his settlement charges. During the audit, Countrywide's Investor Audit Division<sup>49</sup> agreed that the loan processing fee was charged in error. Therefore, Countrywide incorrectly charged the borrower the loan processing fee of \$500 for the streamline refinance without appraisal transaction (FHA case number 261-9576571). Additionally, the settlement statement, dated July 14, 2008, revealed that the borrower was charged a loan origination fee of \$486.20 and loan processing fee of \$406.80 as part of her settlement charges. During the audit, Bank of America's senior business control specialist explained to the audit team that it would be acceptable to charge the borrower the loan processing fee on a purchase transaction but not on a refinance transaction. Therefore, Countrywide incorrectly charged the borrower the loan processing fee of \$ 406.80 for the conventional refinance transaction (FHA case number 263-4270999).

Regulations at 24 CFR (Code of Federal Regulations) 3500.14(c) prohibits the split of charges except for actual services performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. We understand that Mortgagee Letter 2006-04 allows lenders to charge and collect customary and reasonable costs necessary to close the mortgage. The mortgagee letter also limits the origination fee to one percent on forward mortgages, and requires all fees and charges to comply with Federal and State disclosure laws and other applicable laws and regulations. Bank of America did not demonstrate the cited fees were customary and reasonable costs necessary to close the mortgages in question.

Bank of America did not provide documentation to support that the cited fees charged to the borrowers were customary and reasonable. Therefore, these finding items will remain in the report.

**Comment 23** We disagree with Bank of America's assertion that Countrywide did not disregard HUD's quality control requirements. We acknowledge the tools, including staffing in place and reporting of quality control findings, which Bank of America asserts Countrywide had in place for its quality control system/program. HUD Handbook 4060.1 REV-2, paragraph 2-23, requires a lender to maintain a written Quality Control Plan for the origination and servicing of FHA insured mortgages. The Quality Control Plan and its implementation must meet the requirements set forth in chapter 7 of the handbook. Further, in paragraph 7-3(A) of the handbook, HUD requires all quality control programs to be in writing.

Our finding accurately describes the conditions found during the audit and the impact associated with the violations. Additionally, Bank of America did not provide adequate documentation during or after the audit report to support its asserted compliance with HUD's quality control requirements. We acknowledge

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<sup>49</sup> The Investor Audit (Claims Management) group falls within Countrywide Home Loans Inc., a surviving entity under Bank of America, after the acquisition of Countrywide by Bank of America. Investor Audit is responsible for evaluating, responding to and processing mortgage repurchase claims from investor. This group performs this function for Countrywide and works as an agent on behalf of other Bank of America entities.

Bank of America's commitment to institute and implement a quality control program that ensures its full compliance with HUD's requirements.

**Comment 24** We disagree with Bank of America's assertion that our claim of Countrywide's disregard of HUD's requirement is unfounded and inflammatory. Contrary to HUD's requirements, Countrywide did not perform quality control reviews for almost 50 percent (47.19 percent) of identified early payment defaulted loans. Further, we disagree with Bank of America's assertion that Countrywide performed its review of the early payment defaulted loans in a reasonable timeframe. We acknowledge that during our audit period, HUD did not have a requirement for the timeframe within which Countrywide should have performed the quality control reviews for the early payment defaulted loans. However, in order for a lender to meet one of the quality control goals of making swift and appropriate corrective action where applicable, it would have been prudent practice for Countrywide to have been timely with its reviews of the early payment defaulted loans, as opposed to completing a quality control review six months after a loan's 60-delinquency was reported to HUD, for instance.

To highlight the importance of timely reviews of the early payment defaults, in January 2011, HUD issued Mortgagee Letter 2011-02, which requires the quality control review of early payment defaults to be completed within 45 days from the end of the month a loan is reported as 60 days past due.

**Comment 25** As previously stated in our Scope and Methodology section of the report, the results of the sample testing of quality control reviews were not projected to the population of the quality control reviews performed by Countrywide. Our conclusions were drawn based on our review of the selected quality control reviews. We disagree with Bank of America's assertion that the files were reviewed by Countrywide several years ago; the earliest of the sample quality control reviews was completed in July 2008, and the latest one in June 2009. Further, the quality control review documentation was maintained in an electronic format.

Bank of America did not provide additional documentation to address the finding concerning the documentation review and verification not being consistently performed for selected loans reviewed. Therefore, this finding will remain in the report.

**Comment 26** Bank of America recognized that Countrywide's most recent written quality control plan, dated March 10, 2009, could have been more specific in certain instances. However, it believed the plan substantially complied with HUD's requirements. As previously noted in the report, Countrywide erroneously applied a HUD waiver intended for an affiliate entity, Countrywide Home Loans, Inc., to its early payment default sampling for quality control reviews. Additionally, we determined the following concerning Countrywide's quality control plan:

- Although it provided that before employees are hired they are checked for debarment, suspension, Limited Denial of Participation and checked against CAIVRS, the plan did not provide that Countrywide's employee list will be checked against these items semi-annually.
- Although it provided that parties involved in a fraudulent loan transaction may be referred to a HUD Ownership Center, the plan did not specify that Countrywide must report the findings within 60 days of initial discovery. Further, it did not specify that Countrywide will report the findings via the Lender Reporting feature in the Neighborhood Watch Early Warning System.
- It did not provide that loans involving appraisers, loan officers, processors, underwriter, etc., who have been associated with problems must be included in the review sample.
- We acknowledge that the existing plan required the written verification of employment, and that the second written request be attempted if the first written request is not received within 21 days. However, contrary to HUD's requirement, the plan did not provide that a telephone reverification will be attempted.
- We acknowledge that the plan included a provision on the performance of desk reviews on all appraisals. However, HUD also requires that mortgagees perform field reviews on 10 percent of the loans selected during the sampling process outlined in paragraphs 7-6 C and D of HUD Handbook 4060.1 REV-2. Contrary to this requirement, Countrywide's December 2007 quality control plan indicated only Non-Landsafe Appraisal was part of the 10% field review sampling. We have modified the report accordingly.
- It did not provide for the review of closing conditions, and that the review must determine that the seller was the owner of record, or that funds were disbursed in accordance with closing instructions. Further, based on the audit team's review of the sample of quality control review completed by Countrywide, we determined that Countrywide did not verify the selected loans for compliance with these requirements.
- It did not specifically provide that the Countrywide would verify to ensure that none of the participants in the mortgage transaction is debarred or suspended, or is under Limited Denial of Participation for the program and jurisdiction.
- It does not provide that Countrywide must address any pattern of illegal discrimination.

HUD Handbook 4060.1 REV-2, paragraph 2-23, requires a lender to maintain a written Quality Control Plan for the origination and servicing of FHA insured mortgages. The Quality Control Plan and its implementation must meet the requirements set forth in chapter 7 of the handbook. Further, in paragraph 7-3(A) of the handbook, HUD requires all quality control programs to be in writing.

**Comment 27** Bank of America provided a copy of the cover page for its draft quality control audit plan, with an approval date of July 20, 2011. However, the actual amended and approved quality control plan, reflecting Bank of America's current practice, was not provided. We are unable to confirm the revisions to the plan that Bank of America has indicated.

**Comment 28** Bank of America took exceptions to the recommendations in the discussion draft audit report. Specifically, Bank of America took an exception concerning the nine loans containing material underwriting deficiencies, and disagreed with the recommendation of any penalty in connection with these loans, and the recommended sanctions of civil money or PFCRA penalties.

HUD Handbook 4000.4, REV-1, CHG-2 chapter 2-4(C), requires an underwriter to assume the following responsibilities: (1) compliance with HUD instructions, the coordination of all phases of underwriting, and the quality of decisions made under the program, (2) the review of appraisal reports, compliance inspections and credit analyses performed by fee and staff personnel to ensure reasonable conclusions, sound reports and compliance with HUD requirements, (3) the decisions relating to the acceptability of the appraisal, the inspections, the buyers capacity to repay the mortgage and the overall acceptability of the mortgage loan for HUD insurance, (4) the monitoring and evaluation of the performance of fee and staff personnel under the Direct Endorsement program, and (5) awareness of the warnings signs that may indicate irregularities, and an ability to detect fraud, as well as the responsibility that underwriting decisions are performed with due diligence in a prudent manner.

The recommendations in the report are appropriate based on the issues cited. Violations of FHA rules are subject to civil and administrative actions. It is at OIG's discretion to include or exclude recommendations to HUD's Office of General Counsel related to violations of the Program Fraud Civil Remedies Act in the audit report. We have made modifications to the report as considered necessary.

**Comment 29** Bank of America objected to our policy of making audit reports public before HUD makes a final determination on the recommendations. We recognize Bank of America's objection; however, we disagree with Bank of America's categorization of the process and the way it suggests the process works. HUD management officials are responsible for initiating action to resolve reported findings and recommendations. Therefore, we will not include the language recommended by Bank of America in the audit report.

**Comment 30** The report did not state nor did it imply that Bank of America's quality control program is largely deficient or noncompliant with FHA requirements. We made these recommendations to ensure the required provisions have been included in Bank of America's written quality control plan and the quality control reviews are conducted in compliance with HUD requirements.

## Appendix C

### LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Count	FHA case number	Underwriting Method	Employment and income	Source of funds	Liabilities and credit history	Debt-to-income ratios	Skipped payments
1	261-9606137	Manual		X	X	X	
2	263-4251461	Automated	X	X			X
3	263-4334310	Automated					X
4	263-4387704	Automated		X			
5	271-9566133	Manual	X	X	X		
6	581-3129633	Automated	X		X		X
7	581-3168637	Automated					X
	Totals		3	4	3	1	4
<b>The remaining 7 of the 14 loans reviewed are FHA case numbers 132-2111442, 261-9576571, 263-424292, 263-4270999, 263-4351990, 411-4176620 and 413-5062810.</b>							

See appendix D for the details on the material underwriting deficiencies found for these loans.

## Appendix D

### NARRATIVES OF LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

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FHA case number: 261-9606137

Mortgage amount: \$126,327

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Purchase

Date of loan closing: September 26, 2008

Status: Claim

Payments before first 90-day delinquency reported: Four

Loss to HUD: \$66,441

Summary:

#### **Assets:**

Countrywide did not obtain a credible explanation of the source of funds for the large deposits made into the borrower's bank account. An activity printout of the borrower's bank account as of September 18, 2008, showed that the borrower's current balance was \$5,474.06. However, the borrower received two direct deposits from his current employer of \$2,506.81 and \$2,962.50 on September 11 and September 18, 2008, respectively. The two deposits were 2.9 and 3.43 times higher than his regular earnings of \$863.20 per week. There was no explanation in the loan file for these two large deposits as required by HUD.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 2-10(B), states that a 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 opened recently, the lender must obtain a credible explanation of the source of those funds.

### **Liabilities:**

The mortgage credit analysis worksheet, dated September 22, 2008, showed that the borrower's property taxes and assessment was \$229.65. However, the settlement statement, dated September 26, 2008, revealed that the borrower paid \$255.89 per month in city property taxes and \$141.05 per month in county property taxes. The audit team determined that Countrywide did not include the county property tax of \$141.05 per month and understated the city property tax by \$26.24 (\$255.89 - \$229.65) per month in the worksheet when calculating the borrower's future monthly payments. As a result, Countrywide undercalculated the borrower's liabilities by \$167.29 per month.

### **Criteria:**

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

### **Debt-to-Income Ratios and Compensating Factors:**

The mortgage credit analysis worksheet, dated September 22, 2008, indicated that the borrower's mortgage payment-to-income ratio was 35.9 percent and total fixed payment-to-income ratio was 47.3 percent. However, Countrywide did not include the county property tax of \$141.05 per month and understated the city property tax by \$26.24 per month when calculating the borrower's liability (see finding above). When the debt-to-income ratios were recalculated to include the omitted property taxes (and a higher monthly income), the mortgage payment-to-income ratio was 40.85 percent, and the total fixed payment-to-income ratio was 52.144 percent, exceeding HUD's requirement by 9.85 and 9.144 percent, respectively.

To justify the mortgage approval, the underwriter indicated in the "remarks" section of the mortgage credit analysis worksheet that the borrower had great reserves. The worksheet showed "assets available" as \$38,214 and after closing, the borrower's "cash reserves" totaling \$35,426. However, the loan file did not contain sufficient documentation to support the cash reserves amount presented in the worksheet. A letter, dated August 27, 2008, from National Electrical Annuity Plan revealed that the borrower's current balance for the retirement plan was \$25,142.44. However, the letter also stated that the borrower was not eligible to withdraw his entire retirement account balance until he reached 55 years of age and was out of covered employment. At the time the loan was underwritten, the borrower was approximately 40 years old. Additionally, an activity printout of the borrower's bank account as of September 18, 2008, showed that the borrower's current balance was \$5,474.06. After the closing, the borrower's cash balance was \$3,686.06 (\$5,474.06 minus the \$1,788 in cash required from the borrower on the HUD-1), which equals approximately 2.22 months of cash reserves. As a result, the borrower's cash reserves did not meet HUD's requirement of 3 months' worth and, therefore, would not qualify as great reserves, as indicated for the compensating factor.

Criteria:

Mortgagee Letter 2005-16, dated April 13, 2005, increased the mortgage-to-payment and total fixed payment-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that any compensating factor used to justify mortgage approval must be supported by documentation. One compensating factor that may be used is that the borrower has substantial documented cash reserves (at least 3 months' worth) after closing. In determining whether an asset can be included as cash reserves or cash to close, the lender must judge whether the asset is liquid or readily convertible to cash and can be liquidated absent retirement or job termination.

FHA case number: 263-4251461

Mortgage amount: \$95,333

Section of Housing Act: 234C (Condominium)

Loan purpose: Conventional refinance

Date of loan closing: November 21, 2008

Status: Claim

Payments before first 90-day delinquency reported: Five

Loss to HUD: \$51,197

Summary:

**Income:**

Countrywide did not properly verify, calculate, and support the borrower's monthly income. The CLUES loan report revealed that the borrower's monthly income was \$6,191.55. However, it is not clear how the underwriter arrived at this amount. According to handwritten notes on the October 19, 2008, pay stub, the underwriter may have averaged the borrower's 2007 and 2008 year-to-date earnings to arrive at the monthly income. Using the borrower's most recent pay stub in the loan file, we calculated the borrower's monthly income as \$4,377, a difference of \$1,815. Additionally, the borrower's yearly wages significantly decreased.

The borrower's 2007 Internal Revenue Service (IRS) W-2 wage and tax statement revealed that the borrower earned \$91,831.46 in 2007. However, according to the borrower's pay stub as of October 19, 2008, the borrower had only earned \$42,060.89, with approximately 2½ months left in the year 2008. There was no evidence in the loan file that Countrywide verified the declining income or obtained an explanation from the borrower or employer regarding the borrower's 2008 declining income as required.

Countrywide's underwriter calculated the borrower's monthly income as \$6,192, which appeared to be based on the average of 2007 and 2008 earnings. However, due to the decline in the borrower's income and the lack of documentation in the loan file to determine whether Countrywide verified the borrower's decline in income, the underwriter should have used the borrower's year-to-date figure as required by Countrywide's Government Technical Manual.

Countrywide did not perform a direct verification of the borrower's employment history, although it included overtime and performance bonus pay in the borrower's monthly income used to qualify for the loan.

An income worksheet was not completed and documented for the income calculation and analysis performed to determine the borrower's income. Additionally, Countrywide did not provide detailed information in the "underwriter comments" section of the required form HUD-92900-LT on how the income used for qualifying was determined. Countrywide also did not verify the likelihood that the borrower's employment or overtime income would continue.

Criteria:

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

Countrywide's Government Technical Manual (September 30, 2008), FHA: 2.3.2, states that base pay income calculations must be compared with year-to-date figures using the verification of employment or pay stub. If there is evidence of declining income, an average of the previous year's wages may not be used unless it is able to be fully explained and support is provided. Both overtime and bonus income may be used to qualify if such income has been received for approximately the past 2 years and it is expected to continue. An average of bonus or overtime income for the past 2 years must be developed.

TOTAL Mortgage Scorecard User Guide, chapter 2, states that the lender is required to verify the applicant's employment history for the previous 2 years. However, *direct verification* is not required if certain conditions are met. One of the conditions is that only base pay (no overtime or bonuses) is used to qualify for the loan.

Countrywide's Government Technical Manual (September 30, 2008), FHA: 1.4.2, states that the loan file must contain adequate documentation to support the decision to approve the specific loan transaction. Additionally, depending on the income source,

- An income worksheet and/or a Fannie Mae Cash Flow Analysis (Form 1084) should be completed and documented for the income calculation and analysis performed by the underwriter to determine the borrower's income. The form(s) must be placed into the loan file and be part of the imaged documents and should be referred to in the "underwriter comments" section of the form HUD-92900-LT, or
- Detailed information should be provided in the "underwriter comments" section of the required form HUD-92900-LT on how the income used for qualifying was determined and what source form(s) were used (i.e., year-to-date pay stub, verification of employment, etc.).

Asset:

There was an unexplained large deposit of \$7,100 in the borrower's checking account. According to the bank statement for the period ending September 22, 2008, there was a deposit of \$7,100 into the checking account on September 9, 2008. The beginning balance for the checking account was zero, and the ending balance was \$5,746.15. There was no explanation in the loan file for the deposit.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 2-10B, states that a 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 opened recently, the lender must obtain a credible explanation of the source of those funds.

TOTAL Mortgage Scorecard User Guide, chapter 2, requires a lender to obtain an explanation and documentation for large deposits in excess of 2 percent of the property's sales price, including the earnest money deposit. Additionally, the lender is to verify that recent debts were not incurred to obtain part or all of the required cash investment on the property being purchased.

**Skipped Mortgage Payment:**

The LandSafe credit report, dated October 28, 2008, showed the mortgage payment history as of September 2008 for the borrower's mortgage of \$91,182 with Chase Manhattan. The loan closed on November 21, 2008. The settlement statement revealed that the mortgage payoff of \$92,500 was made to Bayview Lending. The payoff demand statement revealing the total payoff amount was not in the loan file. Additionally, there was no documentation supporting the borrower's payment of the mortgage amounts due on October 1 and November 1, 2008.

Bank of America's senior business control specialist was unable to locate a demand for payoff letter or updated documentation concerning the borrower's most recent mortgage payments as of November 1, 2008.

Therefore, this loan should not have been closed because it did not comply with HUD requirements concerning skipped mortgage payments.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Regulations at 24 CFR 203.330 state that a mortgage account is delinquent any time a payment is due and not paid.

FHA case number: 263-4334310

Mortgage amount: \$77,140

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Conventional refinance

Date of loan closing: December 2, 2008

Status: Claim

Payments before first 90-day delinquency reported: Three

Loss to HUD: \$79,439

Summary:

**Skipped Mortgage Payment:**

For the borrower's jumbo conventional mortgage, the Countrywide home loans amended payoff demand statement, dated November 25, 2008, showed the principal balance (\$52,143.06) as of September 1, 2008, interest (\$906.04) from September 1 through December 2, 2008, and uncollected late charges (\$36). For the borrower's second conventional mortgage, the payoff demand statement, dated November 25, 2008, revealed the principal balance (\$13,291.33) as of September 1, 2008, interest (\$292.05) from September 1 through December 10, 2008, uncollected late charges (\$13.88), prepayment penalty (\$132.91), and fees due (\$15). The loan was closed on November 26, 2008 (settlement date). However, there was no documentation in the loan file to support the borrower's payment of the mortgage amounts due on October 1 and November 1, 2008.

Bank of America's senior business control specialist agreed that the documentation in the file revealed that the interest payments for September 1 to December 1, 2008, were not made. Additionally, Bank of America personnel were unable to locate an updated demand for payoff or other supporting documentation showing that the payments were current.

Therefore, this loan should not have been closed because it did not comply with HUD requirements concerning skipped mortgage payments.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1

and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Regulations at 24 CFR 203.330 state that a mortgage account is delinquent any time a payment is due and not paid.

FHA case number: 263-4387704

Mortgage amount: \$50,239

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Purchase

Date of loan closing: December 19, 2008

Status: Claim

Payments before first 90-day delinquency reported: Five

Loss to HUD: \$24,436

Summary:

**Gift funds:**

Countrywide did not document the transfer of gift funds from the donor to the borrower, and there was inconsistency concerning the gift funds. The CLUES report, dated December 10, 2008, revealed that the borrower had \$2,500 in gift funds. The gift letter, dated December 2, 2008, indicated that the borrower would receive a gift of \$2,500 from his future father-in-law. However, a copy of the cancelled check, withdrawal documents, bank statement, or deposit slip was not in the loan file to support the transfer of the gift funds to the borrower. Additionally, the gift fund amount was not included on the HUD-1 settlement statement, dated December 19, 2008. The uniform residential loan application, dated November 6, 2008, showed that the gift amount was \$2,400.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 2-10 (C)(1), states that if the gift funds are in the home buyer's bank account, the lender must document the transfer of the funds from the donor to the home buyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The home buyer's deposit slip and bank statement that show the deposit are also required.

HUD Handbook 4155.1, REV-5, paragraph 3-1(L), states that explanatory statements or additional documentation necessary to make a sound underwriting decision is to be included in the case binder.

FHA case number: 271-9566133

Mortgage amount: \$262,823

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Purchase

Date of loan closing: August 26, 2008

Status: Claim

Payments before first 90-day delinquency reported: Two

Loss to HUD: \$247,529

Summary:

**Employment and Income Verification:**

The telephone contact certification, dated August 5, 2008, showed that the borrower had worked for his current employer, Cristy's Bride & Tailoring, for 2 years and 5 months; the borrower was employed in sales and marketing. The uniform residential loan application, signed August 26, 2008, revealed that the borrower was 21 years old at the time he applied for the loan. Thus, the borrower started working at his current employment when he was 18 years old.

The IRS W-2 wage and tax statements showed that the borrower earned \$69,063.95 and \$78,217.15 in 2006 and 2007, respectively. Additionally, two pay stubs for pay periods ending June 15 and June 30, 2008, showed that the borrower had earned regular year-to-date amounts of \$31,350 and \$34,200, respectively. The borrower's pay rate was \$2,850 for 2 weeks, and he also received a bonus of \$500 each pay period. The pay stub for the period ending June 30, 2008, showed that the pay date was June 3, 2008. Additionally, there were no check numbers included on the pay stubs.

Countrywide did not properly verify the borrower's income. The earnings presented for the borrower were questionable. The borrower's income appeared to be high related to his age, and there was no documentation to support the borrower's qualifications or training for the job. According to the audit team's Google Map search, the business appeared to be small and was not located in a busy commercial area.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 3-1(E), states that as an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 forms from the previous 2 years.

The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified.

HUD Handbook 4155.1, REV-5, paragraph 3-1(L), states that explanatory statements or additional documentation necessary to make a sound underwriting decision are to be included in the case binder.

Regulations at 24 CFR 203.5(c) state that a direct endorsement lender shall exercise the same level of care that it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment.

### **Verification of Deposit:**

The uniform residential loan application, signed August 26, 2008, showed under the “assets” section that the borrower had \$5,025 in a savings account with Guaranty Bank. An account activity statement, dated June 17, 2008, revealed that the borrower had an ending and average balance of \$25 in a “free & easy” checking account; activity began in this account on April 18, 2008. The checking history inquiry printout, dated July 15, 2008, showed that a teller deposit of \$6,000 was made on the same date into the borrower’s account, resulting in an ending balance of \$6,025. A letter, dated July 15, 2008, and signed by borrower indicated tht the borrower did not make any deposits into the bank account with Guaranty Bank because he sent all of his money to his family in Puerto Rico, who managed all of his money. However, the loan file did not contain sufficient documentation to show how the borrower was able to accumulate the funds at home.

The audit team also noted that the bank account number listed on the loan application did not agree with the account number on the account activity documentation.

### **Criteria:**

HUD Handbook 4155.1, REV-5, paragraph 2-10(B), states that a 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 opened recently, the lender must obtain a credible explanation of the source of those funds.

HUD Handbook 4155.1, REV-5, paragraph 2-10(M), states that borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. The lender must determine the reasonableness of the accumulation of the funds based on the borrower’s income stream, the period during which the funds were saved, the borrower’s spending habits, documented expenses, and the borrower’s history of using financial institutions.

### **Earnest Money Deposit:**

The purchase agreement, dated March 22, 2008, indicated that the borrower had provided earnest money of \$500 using a check. However, there was no supporting documentation such as a

cancelled check for the earnest money deposit received from the borrower. The activity in the borrower's account with Guaranty Bank only started in April 2008.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. Paragraph 2-10(A) of the handbook states that if the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation of the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower's cancelled check. A certification from the deposit holder acknowledging receipt of funds and separate evidence of the source of funds is also acceptable. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made, the average balance was sufficient to cover the amount of the earnest money deposit.

**Credit History:**

The Landsafe credit merge report, dated June 10, 2008, revealed that the borrower did not have traditional credit. A Landsafe nontraditional credit report, completed June 13, 2008, showed that the borrower had a utility account with Qwest, which was opened in April 2005. Additionally, the borrower had a utility account with Xcel Energy and an insurance account with Farmers Insurance Group, both opened in April 2006.

The nontraditional credit report indicated that Landsafe Credit verified the borrower's rental history with the current and previous landlords. Specifically, the borrower had been renting at the current address since September 15, 2007 (about 8 months), for \$1,000 per month. The report also showed that the borrower previously had a monthly rent payment of \$800 at another location for a year, ending September 1, 2007. However, the report did not disclose the previous rental address. It was also unclear how Landsafe obtained the landlords' contact information since the borrower's rental history was verified using the landlords' cell phone numbers.

There were inconsistencies regarding the borrower's letter of credits and information on the nontraditional credit report. A letter from Xcel Energy (utility company), dated March 20, 2008, included both the landlord's and the borrower's names and showed that the customer start date was April 27, 2006, more than a year and 4 months before the borrower started renting at the current property address. Similarly, the residence credit certificate, dated April 20, 2008, from Qwest (telephone company) confirmed that the landlord and borrower had established good credit with the telephone service starting April 1, 2005, which was more than 2 years and 5 months before the borrower started renting at the current property address. The credit certificate did not show the name of person verifying the credit. It is not clear how Countrywide verified the authenticity of the letters of credit to ensure that the credit history was for the borrower and not the landlord.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the lender may elect to use a nontraditional mortgage credit report developed by a credit-reporting agency, provided that the credit reporting agency had verified the existence of the credit providers and the lender verifies that the nontraditional credit was extended to the applicant. The lender must verify the credit using a published address or telephone number to make that verification.

HUD Handbook 4155.1, REV-5, paragraph 2-3(A), states that the payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity of interest with the borrower), verification of mortgage directly from the mortgage servicer, or canceled checks covering the most recent 12-month period.

FHA case number: 581-3129633

Mortgage amount: \$293,371

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Conventional refinance

Date of loan closing: September 13, 2008

Status: Claim

Payments before first 90-day delinquency reported: One

Loss to HUD: \$171,463

Summary:

**Employment and Income Verification:**

The verification of employment, dated August 26, 2008, revealed that the coborrower's date of current employment was August 26, 2008, the same date as the verification of employment. According to the underwriter findings and comments document, as of July 29, 2008, no information had been provided for the coborrower's income, and the underwriter recommended the approval of the loan "pending satisfactory AUS [automated underwriting system] with approval at higher ratios." However, the CLUES decision document, dated August 28, 2008, included the coborrower's income from his current employment, although he had only worked at the company for 2 days. One of the CLUES underwriting conditions required Countrywide to obtain the most recent year-to-date pay stub for 1 full month's earnings. However, the coborrower's pay stub in the loan file covered his year-to-date earnings for only 6 days, for the week ending August 31, 2008. Therefore, Countrywide did not properly verify the coborrower's current employment.

The verification of employment indicated that the coborrower's probability of continued employment was excellent. It was not clear how the coborrower's stability of income was determined when he had only started working at his current employment the day the verification of employment was completed. Countrywide also did not properly verify the coborrower's employment history for the previous 2 years. Only verbal verifications of employment were found in the loan file for the coborrower's prior employment.

The underwriter findings and comments document as of September 9, 2008, required Countrywide to obtain documentation showing that the coborrower was "a permanent employee of Seek, and not a temporary employee farmed out to companies, who might need his services." A letter, dated September 9, 2008, from Seek Careers and Staffing indicated that the coborrower was employed by Seek Careers as a delivery driver on a full-time basis and he was expected to work for Seek indefinitely. However, it did not appear reasonable that the coborrower was

employed permanently as a *delivery driver* for Seek Careers, a company that provides temporary employment services.

Criteria:

HUD Handbook 4155-1, REV-5, chapter 2, section 2, states that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue.

HUD Handbook 4155.1, REV-5, paragraph 2-6, states that to analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, and previous training and education and the employer's confirmation of continued employment.

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

FHA's TOTAL Mortgage Scorecard User Guide, effective December 2004, states that the lender must obtain the single most recent pay stub showing year-to-date earnings of at least 1 month and any one of the following to verify current employment: (1) written verification of employment, (2) verbal verification of employment, or (3) electronic verification acceptable to FHA. Additionally, the lender is required to verify the applicant's employment history for the previous 2 years. If the applicant has not been employed with the same employer for the previous 2 years, the lender must obtain one of the following for the most recent 2 years to verify the applicant's employment history: (1) IRS forms W-2, (2) verifications of employment, or (3) electronic verification acceptable to FHA.

Liabilities:

The Landsafe residential mortgage credit report, dated August 1, 2008, showed that the borrower had a monthly payment of \$342 to a utility company and another monthly payment of \$142 for a credit card account. However, Countrywide did not include these amounts totaling \$484 when calculating the borrower's liability. Therefore, the borrower's total liabilities were understated by \$484, which affected the borrower's computed debt-to-income ratios.

Both the CLUES decision document, dated August 28, 2008, and the mortgage credit analysis worksheet revealed the mortgage payment-to-income ratio was 39.44 percent, and the total fixed payment-to-income ratio was 42.11 percent. The borrowers' recomputed total fixed payment-to-income ratio, which included the monthly total of \$484, was 50.16 percent. This ratio exceeded HUD's allowable ratio limit by 7.16 percent.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 2-11(A), states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other additional recurring charges extending 10 months or more. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing; this is especially true if the borrower will have limited or no cash assets after loan closing.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the mortgage-to-payment and total fixed payment-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively.

### **Skipped Mortgage Payment:**

The Citimortgage payoff statement, dated July 24, 2008, showed that the payoff amount of \$259,300.40 was good through September 1, 2008. However, according to the settlement statement for the loan, which closed on September 13, 2008, the payoff amount for the first mortgage with Citimortgage was \$259,004.99, which was \$259.41 less than the amount on the payoff statement. An updated payoff demand statement, revealing the correct payoff amount, was not in the borrower's loan file. Bank of America was unable to provide documentation to support the borrowers' payment of the mortgage amounts due on August 1 and September 1, 2008.

According to Bank of America's senior business control specialist, Bank of America was unable to provide the updated payoff demand statement and could not address this item because the loan was originated through a correspondent lender. Bank of America personnel further explained that it was industry practice for the total payoff to include payments to bring the loan current because the lender for the mortgage being paid off would not accept the payoff without those payments.

Therefore, this loan should not have been closed because it did not comply with HUD requirements concerning skipped mortgage payments.

### **Criteria:**

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Regulations at 24 CFR 203.330 state that a mortgage account is delinquent any time a payment is due and not paid.

Regulations at 24 CFR 202.8(b)(7) state that each sponsor shall be responsible to the HUD Secretary for the actions of its loan correspondent lenders or mortgagees in originating loans or mortgages, unless applicable law or regulation requires specific knowledge on the part of the party to be held responsible. Additionally, Section 202.8(b)(9) states that for the mortgages processed through direct endorsement under 203.5 and 203.255(b) of this chapter or through the Lender Insurance program, underwriting shall be the responsibility of the direct endorsement or Lender Insurance program sponsor, and the mortgage shall be closed in the loan correspondent lender's own name or the name of the sponsor that will purchase the loan.

FHA case number: 581-3168637

Mortgage amount: \$93,301

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Conventional refinance

Date of loan closing: October 7, 2008

Status: Claim

Payments before first 90-day delinquency reported: Seven

Loss to HUD: \$79,795

Summary:

**Skipped Mortgage Payment:**

The Countrywide home loans amended payoff demand statement, dated October 7, 2008, showed the principal balance (\$72,501.92) as of September 1, 2008, interest (\$582.12) from September 1 through October 14, 2008, and county recording fee (\$11). The loan was closed on October 7, 2008, which was after the mortgage payment due date of October 1, 2008. However, there was no documentation in the loan file to support that the borrowers brought a check payment to the settlement to pay the mortgage amount due in October 2008 as required by HUD.

According to Bank of America's senior business control specialist, the payment was due October 1, 2008, but not delinquent until October 15, 2008. The lender would have required the interest for the 7 days past the due date at the closing. Bank of America personnel further explained that it was not necessary for the borrower to come to the closing with cash because the payment could be rolled into the loan amount. For this loan, which was a cash-out refinance loan, the borrower would not need to come to the closing with funds.

Therefore, this loan should not have been closed because it did not comply with HUD requirements concerning skipped mortgage payments.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Regulations at 24 CFR 203.330 state that a mortgage account is delinquent any time a payment is due and not paid.