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Audit Report No. 00-042

Audit of the FDIC's Payments for Claims Expenses Related to Repurchased Commercial Loans with Environmental Issues

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DATE: September 12, 2000

TO: Gail Patelunas, Deputy Director
Asset Management Branch
Division of Resolutions and Receiverships

Sharon M. Smith

FROM: Sharon M. Smith
Assistant Inspector General

SUBJECT: *Audit of the FDIC's Payments for Claims Expenses Related to Repurchased Commercial Loans with Environmental Issues* (Audit Report No. 00-042)

This report presents the results of an audit of the Federal Deposit Insurance Corporation's (FDIC) review of expenses included in claims paid for securitized commercial transactions. Specifically, the Office of Inspector General (OIG) reviewed the process that the FDIC's Division of Resolutions and Receiverships (DRR), Asset Claims Administration (ACA), used to review and approve expenses that it paid for loans repurchased out of securitized transactions. The former Resolution Trust Corporation (RTC)[1] established the securitized transactions. We limited our review to expenses related to repurchased commercial loans with environmental issues because loans with environmental claims represented almost 50 percent of the amount paid for all commercial loan claims.

BACKGROUND

Securitization is the process of pooling similar, illiquid mortgage loans and issuing marketable, liquid securities backed by those mortgage loans. The pooled loans serve as collateral for the newly formed mortgage-backed securities. Securitizations use all types of mortgage loans as collateral, including one-to-four family residential mortgages, multi-family residential mortgages, manufactured housing loans, home equity loans, and commercial loans.

Typically, each securitized transaction involved three parties—the seller, master servicer, and trustee—whose roles and responsibilities were governed by a pooling and servicing agreement (PSA) and a master servicing agreement. However, for some of the transactions included in our review, special servicers were included as specific parties and the PSAs included their roles and responsibilities. In general, master servicers were responsible for servicing securitized loans

[1] As provided in the *RTC Completion Act* of 1993, the RTC went out of existence on December 31, 1995, and the FDIC took over its functions on January 1, 1996.

(either directly or through subservicing) and maintaining documentation to adequately account for loan activity. Master servicers transferred servicing requirements for nonperforming loans to special servicers.

The RTC established representations and warranties funds by setting aside a portion of the sales proceeds for each securitized transaction. The FDIC used those set-aside funds to pay claims arising from breaches in the representations and warranties made in the PSA for each transaction. The Corporation applied representation and warranty claims that it paid for individual loans against the individual funds established for the institutions that previously owned the loans. For example, when the collateral for a securitized loan had an environmental problem, both the master servicer and special servicer could have incurred expenses related to the underlying collateral. However, in most instances, just the special servicer submitted claims, which included expenses claimed by both the special servicer and master servicer, to ACA for review and approval. In some instances, the master servicer and special servicer were the same entity.

According to DRR's *1999 Annual Performance Plan*, ACA was to monitor all contractual obligations between the sellers and purchasers of FDIC loans and loan-related assets. In addition, ACA used the Warranties and Representations Account Processing System (WRAPS) to track claims. The performance plan stated that WRAPS was to provide an automated means to (1) record asset sale agreements, (2) calculate the associated liability, (3) monitor asset claims, (4) track payments, and (5) consolidate asset claims data for management reporting.

To initiate the claims process, servicers forwarded a claim letter to ACA and later generated a repurchase schedule that included the price that the FDIC had to pay to repurchase securitized loans. The repurchase price included the current principal and interest and any expenses such as taxes, insurance, appraisals, legal fees, and environmental assessments that the servicer claimed. Based on that repurchase price, the special servicer or, in some cases, the master servicer submitted a claim to ACA for review and approval for payment.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine whether (1) expenses related to claims paid for repurchased environmental commercial loans were valid and adequately supported and (2) ACA's controls to prevent duplicate claim payments were adequate. During the audit, we expanded the scope to determine the accuracy of DRR's loan tracking systems and maintenance of original loan files for the 60 loans in our sample.

To accomplish our objectives, we interviewed officials in DRR's ACA, Asset Management Section, and Operations Branch in Washington, D.C., and DRR's Loans and Other Assets Management and the Division of Finance (DOF) in Dallas, Texas.

As of January 11, 1999, the FDIC had paid 325 claims totaling approximately $374 million related to the repurchase of environmentally impaired commercial assets, which included all claims paid for that type of asset since the inception of RTC. We selected 60 claims totaling approximately $201 million to review that included the 30 largest claims paid, as of January 11, 1999, and 30 randomly selected claims. The FDIC paid the claims included in our sample between 1992 and 1999. However, ACA officials could not locate the file for one claim with principal, interest, and expenses totaling $3 million. Therefore, we reviewed 59 claims totaling about $198 million in payments, of which $195 million represented principal and interest and $3 million represented expenses such as taxes, insurance, appraisals, legal fees, and environmental assessments. We reviewed the sample claims to determine the (1) servicers who submitted the claims to the FDIC, (2) dates the claims were filed, (3) types of expenses claimed, and (4) documentation available to support the claimed expenses.

We interviewed representatives from the eight loan servicers included in our sample to determine the (1) servicers' policies and procedures for submitting claims to the FDIC and (2) type of documentation available to support paid expenses. To obtain documentation to support the claims expenses included in our sample, we visited four of the eight loan servicers—AMRESCO in Atlanta, Georgia; AMRESCO in Dallas, Texas; Banc One in Dallas, Texas; and General Electric in Houston, Texas. The remaining four loan servicers—Bank of America in Los Angeles, California; GMAC in Philadelphia, Pennsylvania; JE Robert in Dallas, Texas; and Midland in Kansas City, Missouri—mailed their available documentation for the sampled expenses to the OIG in response to our request.

The RTC contracted with MGIC Investor Services Corporation[2] (MISC) to process claims for single-family and manufactured housing transactions. ACA processed claims for commercial and multi-family transactions. When MISC's contract expired in April 1998, ACA began processing all claims. We reviewed policies and procedures for reviewing and approving claims to determine specific requirements for submittal of documentation to support expenses. Although ACA did not process claims for residential loans prior to April 1998, we reviewed policies and procedures used by MISC to obtain a general understanding of supporting documentation required for claims for residential loans. In addition, we discussed the process with ACA officials.

We also reviewed correspondence between ACA and the master and special servicers regarding the status of claims and the need for documentation to support environmental assessments. In addition, we reviewed the PSAs between the master and special servicers and Mortgage-Backed Securities Administration to determine specific accounting requirements and record retention policies.

To determine the validity of claimed expenses, we reviewed the documentation—specifically, copies of invoices and canceled checks—that the eight master and special servicers in our sample provided. In addition, to determine whether ACA's controls were adequate to identify duplicate claims, we analyzed ACA's process for reviewing, approving, and tracking claims. We also interviewed ACA and DOF officials to determine their respective responsibilities in the claims approval and payment processes.

[2]Although the RTC referred to MGIC as its contractor for claims processing, the Corporation's contract is actually with MISC, a subsidiary of MGIC.

Further, we interviewed DRR officials and reviewed procedures to account for original loan files for internally and externally serviced loans. We reviewed procedures to account for the final disposition of repurchased loans through sale, compromise, write-off, or payment in full. We also reviewed loan tracking and disposition data in the Corporation's loan tracking systems—Asset Inventory Management System (AIMS), National Processing System (NPS), and National Asset Inventory System (NAIS).[3] To determine whether the FDIC properly accounted for repurchased loans, we reviewed DOF's journal entries to determine whether DOF properly documented the repurchase and final disposition of the loans. Although we did not review 1 of the 60 claim files because it could not be located, we did review loan tracking and DOF accounting data for all 60 loans in our sample.

We did not evaluate ACA's system of internal controls over claims because the OIG concluded that the audit objectives could be met more efficiently by conducting substantive tests rather than by placing reliance on the internal control system. However, we did identify controls ACA used to prevent duplicate claim payments although we did not test those controls. The OIG conducted the audit from February 1999 through December 1999 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

We could not determine the validity of $1,925,434 of the $3,110,600 in expenses that the FDIC paid for the 59 commercial loan claims reviewed related to environmental repurchases because the servicers did not provide supporting documentation. Although DRR's policies and procedures did not require the servicers to submit supporting documentation for expenses before paying the claims, the PSAs required the servicers to maintain such documentation. Although the FDIC's controls appeared adequate to prevent the payment of duplicate claims, we identified inaccuracies in the FDIC's loan tracking systems for repurchased loans and inconsistencies in the maintenance of original loan files. However, we believe that DRR's response to recommendations made in the OIG report entitled *Audit of Data Integrity Controls for Selected Division of Resolutions and Receiverships (DRR) Automated Systems* (audit report number 99-047, dated December 21, 1999) addresses those problems. In that report, the DRR agreed with the OIG's recommendation to strengthen data integrity controls and established a task force to establish a data quality program. Finally, we concluded that DOF's records provided adequate documentation of the Corporation's accounting for the 60 repurchased loans in our sample.

VALIDITY OF CLAIMED EXPENSES COULD NOT BE DETERMINED

We could not determine the validity of $1,925,434—about 62 percent of the $3,110,600 in expenses that we reviewed because the servicers did not provide supporting documentation. Although the FDIC did not require loan servicers to provide documentation for expenses paid for

[3] AIMS was the RTC's system for tracking externally serviced loans. NPS is the FDIC's system of record for internally serviced loans. NAIS is the FDIC's central inventory system for tracking all assets including loans.

environmentally impaired commercial assets before reimbursing the servicers, the PSAs required the servicers to maintain such documentation. In response to our requests, the servicers did not provide documentation (i.e., copies of invoices and canceled checks) to support $1,925,434 of the expenses that we reviewed. Table 1 shows the expenses reviewed and the amounts questioned by servicer.

Table 1: Analysis of Reimbursed Expenses and Questioned Costs by Servicer

Servicer	Expenses Reimbursed	Questioned Costs
Bank of America	$797,799	$136,034
AMRESCO (Atlanta)*	602,044	602,044
General Electric	590,435	547,440
Banc One	555,879	355,779
JE Robert	237,376	24,753
AMRESCO (Dallas)*	209,756	142,073
Midland	102,975	102,975
GMAC	14,336	14,336
Totals	**$3,110,600**	**$1,925,434**

*AMRESCO's Atlanta and Dallas offices billed separately for claimed expenses. Accordingly, the table presents servicer information by location.

Source: OIG analysis of ACA's claims files, WRAPS data, and servicer documentation to support claimed expenses.

According to ACA officials, they reviewed each claim to determine whether information forwarded by servicers adequately supported environmental assessments and those assessments supported an environmental classification for the asset. However, although ACA officials stated that they reviewed each claim for reasonableness, they did not require servicers to submit support for expenses associated with the claims.

ACA officials stated that they did not have specific criteria that required loan servicers for commercial loans to submit documentation to support expenses. In contrast, the manual that MISC used to process claims for residential loans provided specific requirements for residential expense claims. Specifically, the manual states that reimbursement claims must include " . . . copies of invoices and receipts or other evidence of the losses incurred . . . and any other documentation necessary to support the Claim, e.g., a copy of the defective loan document or delinquent tax invoice." The manual further states that a valid repurchase claim must contain ". . . documentation necessary to support the Claim, as applicable."

In addition, the PSAs for the securitized commercial loans in our sample required the servicers to maintain loan-related documentation. Specifically, the PSAs required the servicers to maintain adequate accounting records on a loan-by-loan basis, which included maintaining accurate records for each property's taxes, insurance, assessments, and other similar items or liens.

Moreover, the PSAs did not establish limits on the amount of time that servicers were to maintain loan-related documentation.

Because ACA did not require loan servicers to submit documentation to support claimed expenses, we requested the servicers to provide supporting documentation for our review. However, the servicers only provided documentation to support about 38 percent of the expenses paid. Further, officials of one loan servicer stated that the servicer had destroyed some records that might have supported claimed expenses. Officials of other servicers stated that supporting documentation had been included in the original loan files that they returned to the FDIC. However, our review of available original loan files identified only limited documentation to support the expenses claimed. Moreover, the limited documentation found duplicated what the servicers had already provided.

On September 22, 1999 and February 23, 2000, we discussed our findings with ACA officials. During those discussions, ACA officials agreed to request copies of invoices and canceled checks from servicers for future claims. However, to ensure that claims against receiverships are adequately supported and DRR complies with its performance plan to determine the validity of claims against receiverships, we believe that documentation to support claimed expenses should be expressly required before the Corporation reimburses loan servicers for expenses.

RISK OF DUPLICATE CLAIM PAYMENTS MINIMAL

Although ACA did not have specific written procedures to test for duplicate payments for claims filed for environmentally impaired commercial assets, it did have compensating controls that minimized the risk of duplicate payments. ACA required claimants to send the original loan documents to DOF and relied on claims technicians and WRAPS to prevent duplicate claim payments. After receiving notification from DOF that it had received the original loan files from the servicer, ACA approved the claim for payment. In addition, when ACA received claims, its specialists and technicians manually searched WRAPS to determine whether ACA had reimbursed servicers for similar breaches of FDIC warranties and representations for a particular loan. The specialists and technicians searched for duplicate claims by scrolling through the system and reviewing groups of claims filed by securitized transaction, receivership number, and claim number. Because WRAPS assigns a unique control number to each receivership, securitized transaction, and claim and allows specialists and technicians to include written comments regarding the reason for each claim, it reduces the probability that duplicate claims will be paid.

In addition, in September 1999 the FDIC replaced AIMS, a system to track externally serviced loans, with NAIS, a system to track all FDIC assets including loans. NAIS is part of WRAPS and assigns a different control number for each loan in the system. In essence, each claim is associated with a specific loan. Therefore, because the FDIC can readily identify multiple claims filed for the same loan, it reduces the risk of duplicate payments. Accordingly, we believe that the controls in ACA's claims review process, WRAPS, and NAIS reduce the risk of the FDIC paying duplicate claims to a low level.

The former RTC's loan tracking system for externally serviced loans—AIMS—did not always provide accurate information on the status and disposition of repurchased loans. In addition, FDIC officials could not account for the original loan files for 10 of the 60 loans reviewed. Those loans had a repurchase value of $46.2 million, of which $45.8 million represented principal and interest and $415,000 represented expenses. Specifically:

- FDIC officials did not ensure that its loan tracking system for externally serviced loans was adequately maintained because data included in AIMS did not always reflect actual loan status and disposition. The FDIC repurchased all of the 60 loans in our sample between 1992 and 1999. Of those 60 loans, it had recorded 28 in AIMS. AIMS data indicated that 9 of the 28 loans recorded in that system were still in their original securitized transactions.

- Analysis of the remaining 32 loans indicated that 31 had been recorded in NPS. DOF data showed that 23 of the 31 loans recorded in NPS had been disposed of through bulk sales, write-offs, or payoffs. The remaining eight loans recorded in NPS were still active loans. Finally, neither AIMS nor NPS contained 1 of the 32 loans. However, the loan had been compromised (i.e., the loan terms were revised). Because most of those loans were repurchased during the time that accounting functions transferred from the RTC field accounting offices to the FDIC's DOF, we believe that the repurchased loans were appropriately recorded in NPS rather than AIMS.

- The 10 loan files that FDIC officials could not properly account for included (1) the 9 loans that AIMS showed were still in the original securitization transaction although the loans had been repurchased and (2) the 1 loan that was not recorded in either AIMS or NPS. Based on DOF's journal entries, six of the loans had been compromised, three had been written off, and one had been paid in full.

On February 23, 2000, we discussed the loan tracking and original file issues with DRR's Deputy Director, Field Operations Branch. In addition, we discussed the OIG's report entitled *Audit of Data Integrity Controls for Selected Division of Resolutions and Receiverships (DRR) Automated Systems* (audit report number 99-047 dated December 21, 1999). The report discussed data integrity problems associated with the NPS, Credit Notation System, Owned Real Estate System, and the Subsidiaries Information Management Network. The report did not specifically discuss AIMS, which is no longer an on-going system, or NAIS, which is the FDIC's current system for tracking all FDIC assets including internally and externally serviced loans. Nonetheless, DRR management agreed with the OIG's findings related to improving the reliability and accuracy of data maintained on its systems. In addition, we could not determine whether the 10 original loan files that the FDIC could not account for were either (1) not returned to the FDIC or (2) misplaced after the FDIC received them. Accordingly, we are not making a recommendation related to that issue.

CONCLUSIONS AND RECOMMENDATIONS

The FDIC's controls appeared adequate to prevent the payment of duplicate claims. However, of the $3,110,600 in expenses that we reviewed, we questioned $1,925,434 as unsupported. Although ACA officials agreed to start requesting loan servicers to submit documentation supporting expenses before paying the claims, we believe that DRR should go further and establish a policy requiring servicers to submit supporting documentation for claimed expenses. The PSAs already require servicers to maintain that documentation. The OIG believes that reviewing documentation to support claimed expenses before they are paid should help ensure that the Corporation only pays claims for expenses that servicers incur and relate to FDIC assets. Requiring supporting documentation will also assist DRR in complying with its performance plan in which it accepted responsibility for determining the validity of claims against receiverships. Accordingly, we recommend that the Deputy Director, Division of Asset Management, DRR, take the following actions:

(1) Disallow $212,586 (questioned costs, all of which is unsupported) that loan servicers billed for expenses related to environmental claims.

(2) Establish a policy requiring loan servicers to submit documentation (i.e., invoices and canceled checks) for claimed expenses before the expenses are paid.

CORPORATION COMMENTS AND OIG EVALUATION

On August 15, 2000, the Deputy Director, Asset Management Branch, DRR, provided a written response to a draft of this report. The Deputy Director's response disagreed with recommendation 1 and agreed with recommendation 2. The Deputy Director's response is presented as appendix I to this report.

A summary of the Deputy Director's response to recommendation 1 and our analysis follows. We did not summarize the response to recommendation 2 because the actions planned or taken are identical to those recommended.

Disallow $1,925,434 (questioned costs, all of which is unsupported) that loan servicers billed for expenses related to environmental claims (recommendation 1): The Deputy Director disagreed with the recommendation in our draft report to disallow $1,925,434 in reimbursable expenses because the servicers did not produce adequate documentation to support these expenses. The Deputy Director stated that "According to our legal review, none of the PSAs require that the Servicer provide receipts, invoices, canceled checks, or other specific documentation supporting the expenses as a prerequisite to the FDIC's repurchase of an asset." The Deputy Director also stated that "In the normal course of evaluating a claim, ACA reviews the asset claim to determine if the amounts claimed, including expenses, are allowable and reasonable."

We recognize that the PSAs to not require the servicers to provide adequate supporting documentation with claims for reimbursement. That fact is the basis of our second recommendation with which management agrees. We also acknowledge that many of the claimed expenses may appear to be reasonable. However, because the servicers did not maintain adequate documentation supporting the reimbursable expenses, we cannot provide assurance that the servicers actually incurred the claimed expenses. Nonetheless, given the age of some of the expenses and the lack of a specific requirement in the PSA for the servicers to maintain and provide supporting documentation with their claims, we are revising our questioned cost to the $212,586 that the Deputy Director has agreed to disallow. The Deputy Director's response provided the necessary requisites for a management decision.

Appendix II presents management's proposed actions on our recommendations and shows that there is a management decision for each recommendation in this report.

Based on our audit work, the OIG will report questioned costs of $212,586 in its *Semiannual Report to the Congress*.

FDIC
Federal Deposit Insurance Corporation
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August 15, 2000

TO: Sharon M. Smith
Assistant Inspector General for Field Operations

FROM: Gail Patelunas, Deputy Director
Asset Management Branch

SUBJECT: Revised Response to Audit Number 98-110

The following is the Division of Resolutions and Receiverships (DRR) revised response to the Draft Report entitled *Audit of the FDIC's Payment for Claims Expenses Related to Repurchased Commercial Loans with Environmental Issues* prepared by the Office of the Inspector General (OIG).

As of December 30, 1999[1], the Asset Claims Administration Section (ACA) of DRR had received 80,680 asset claims totaling $4.1 billion on 463,885 assets. ACA determined $1.7 billion, or 41%, were valid, and these claims were paid. ACA denied or otherwise resolved the remaining 59% or $2.4 billion in asset claims.

Of the $1.7 billion paid asset claims, $370 million were environmental repurchase claims on assets sold in commercial or multifamily securitizations. The OIG sampled 60 commercial and multifamily securitization claims filed between 1992 and 1999. The OIG selection included the 30 largest asset claims paid and 30 chosen at random. One asset claim file, initially processed in 1994, could not be located. Although ACA reproduced most of the pertinent documents related to the claim, the OIG removed that asset claim from its sample. The remaining 59 asset claims reviewed by the OIG totaled $ 198 million of which $195 million represented the outstanding principal and interest on the loans and $3 million represented expenses. The OIG questioned $1.9 million in expenses which represents 0.52% of the $370 million paid on the reviewed claims.

The audit makes two recommendations:

(1) Disallow $1,925,434 (questioned costs, all of which is unsupported) that loan servicers billed for expenses related to environmental claims.

(2) Establish a policy requiring loan servicers to submit documentation (i.e., invoices and canceled checks) for claimed expenses before expenses are paid.

[1] Source: WRAPS RPT-014 dated 12/30/99.

Recommendation (1): Disallow $1,925,434 (questioned costs, all of which is unsupported) that loan servicers billed for expenses related to environmental claims.

According to the OIG, ACA "did not require loan servicers to submit documentation to support claimed expenses." The OIG reviewed servicers' files for documentation (i.e., invoices, and canceled checks) in support of these expenses.

At our request, FDIC legal staff reviewed the terms of a sample of the PSAs governing the commercial and multifamily securitizations included in the OIG's review. **According to our legal review, none of the PSAs require that the Servicer provide receipts, invoices, canceled checks, or other specific documentation supporting the expenses as a prerequisite to the FDIC's repurchase of an asset.**

ACA is required to evaluate asset claims based on the terms of the applicable sale agreement. For securitizations, a Pooling and Servicing Agreement (PSA) defines the terms of the sale. According to the analysis performed by our legal staff, the typical commercial and multifamily PSA does not specify the level of detailed documentation required to repurchase an asset. According to FDIC's legal analysis, in the typical commercial or multifamily PSA, the Seller (FDIC) attests that as of the date the sale closes, no Mortgaged Property has a Disqualifying Condition. Either the Master or Special Servicer, as applicable, may notify the Seller when it discovers a Disqualifying Condition. The notice is to be accompanied by certain certifications relating to the status of the Mortgage Loans.

Typically, the PSA states that within 60 days of receipt of the notice and certifications, the Seller shall "at the Sellers option either (1) cure…or (y) repurchase the affected Mortgage Loan…at the Repurchase Price". The Repurchase Price includes any un-reimbursed Property Protection Expenses, Servicing Fees, advances, and "expenses reasonably incurred …in respect of the breach…." The Master Servicer, Special Servicer, or the Seller, depending on the PSA, calculates the Repurchase Price.

The OIG draft report states that "although DRR policies and procedures did not require the servicers to submit supporting documentation for expenses before paying claims, the PSAs required servicers to maintain such documentation." According to our legal analysis, the PSAs typically do not contain an omnibus record retention provision generally or with respect to claimed expenses specifically.

The commercial and multifamily PSAs do require that Servicers maintain documentation related to the mortgages as is the "customary and usual standards of practice of prudent institutional commercial mortgage lenders and loan servicers…." The Federal National Mortgage Association (FNMA) generally sets the standards of 'prudent servicing' for residential loan servicers. There is no established standard in the commercial and multifamily mortgage servicing industry. ACA staff polled several servicers to determine the usual documentation retention practices of commercial and multifamily mortgage servicers. The retention practices of these servicers varied widely and included five years to no specified policy. Servicers stated that documentation of expenses typically is purged when a loan file is sold or repurchased.

The table below summarizes the asset claims reviewed by the OIG according to the date the servicer filed the claim. As indicated below, 48% of the number of claims reviewed and 52% of the expenses questioned were filed before 1996.

REVIEWED ASSET CLAIMS BY DATE FILED

YEAR CLAIM FILED	NUMBER OF CLAIMS REVIEWED PER YEAR[(a)]	PERCENT OF TOTAL CLAIMS REVIEWED	EXPENSES QUESTIONED ($)	PERCENT OF TOTAL EXPENSES QUESTIONED
1992	3	4.11%	99,938	5.19%
1993	3	4.11%	34,802	1.81%
1994	16	21.92%	220,028	11.43%
1995	13	17.81%	648,585	33.69%
1996	23	31.51%	327,902	17.03%
1997	9	12.33%	392,840	20.40%
1998	6	8.22%	201,339	10.46%
Total	73	100.00%	$1,925,434	100.00%

[(a)] Total is greater than 59 because some claims have been serviced by more than one servicer
Source: OIG

According to the OIG, servicers are required by IRS to retain invoices and receipts. DRR looked to IRS retention policies in lieu of an omnibus retention provision in the PSA. Generally, the IRS requires record retention for three years after the filing date. **According to the servicers polled, and as corroborated by FDIC financial advisors, IRS retention policies are not applicable in this case.** Since the servicer does not hold these loans in their portfolio, the claimed expenses are passthrough expenses. Passthrough expenses do not create income or expenses for the servicer and are not an IRS reportable event. (Even if IRS standards had applied, approximately 52% of the expenses questioned would have been outside the 3-year standard.)

The OIG recommends disallowing $1,925,434 in reimbursable expenses because servicers did not produce invoices and canceled checks to support these expenses. DRR disagrees with this recommendation. Under the terms of the PSAs, the Seller must reimburse the Servicer for all allowable and reasonable expenses incurred in connection with the repurchased Mortgage Loan. As discussed above, there is no requirement in the PSA that reimbursement of reasonable expenses is contingent on the Servicer's ability to produce invoices or canceled checks.

In the normal course of evaluating a claim, ACA reviews the asset claim to determine if the amounts claimed, including expenses, are allowable and reasonable. In the 59 asset claims reviewed by the OIG, ACA authorized payment of $3 million in expenses including the $1.9 million in appraisal, title, survey, and environmental report expenses cited by the OIG. Furthermore, ACA refused payment on $1,781,765 in costs and an additional $70,490 in appraisal, title, survey and environmental report expenses. ACA re-reviewed the 59 claims to determine if any of the paid expenses were unreasonable. We determined, based on ACA's standards of reasonableness, that only two claims with expenses totaling $212,585.69 merit further investigation and this amount will be disallowed.[2]

Within 90 days of the final OIG report, ACA will request the servicers involved submit documentation, including invoices or canceled checks, in support of the $212,585.69 disallowed expenses. ACA will direct servicers to remit the disallowed expenses if the servicers cannot provide satisfactory documentation.

Recommendation (2): Establish a policy requiring loan servicers to submit documentation (i.e., invoices and canceled checks) for claimed expenses before expenses are paid.

DRR agrees with the recommendation. On August 1, 2000, ACA requested MBS Administration to modify the language of future commercial and multifamily securitizations. The requested language will require that the servicer promptly provide invoices or canceled checks on claimed expenses.

If you have any questions or comments please contact Leslie Fogg Bowie at 202-898-3621.

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[2] On 3/11/97, ACA received claim number 50952-4 and on 4/25/97 ACA denied $49,670.02 of the claim and approved payment for $3,643,100.16. The payment represented $2,459,132.56 in unpaid principal, $814,493.21 (for 4/1/94 through 7/31/97) in accrued interest and expenses totaling $369,474.39. $194,772.22 of these expenses is identified as "escrow advances." Initially, ACA staff assumed the advance was for taxes. While this would be a reasonable tax payment on a $3 million loan, there is nothing in the documentation provided that confirms the advance was in payment of taxes. Accordingly, DRR agrees to disallow the $194,772.22 claimed expenses.

Similarly, ACA approved the repurchase of Quintree Mall, claim 25027-1, on 3/10/97 for $3,734,444.40. The payment consisted of $3,263,164.01 principal balance and $35,425.23 in accrued interest (12/1/95 through 3/1/97). ACA paid $17,452.85 for taxes, flood insurance, legal expenses and for environmental reports. Additionally, ACA paid $17,813.47 for an item identified as "operational expenses." Upon further review, ACA determined that the documentation does not explain this expense. DRR agrees to disallow the $17,813.47 in claimed expenses.

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report on the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider the FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount that the FDIC plans to disallow must be included in management's response.

If management does not agree that it should implement a recommendation, it must describe why it does not consider the recommendation valid.

Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents management's responses on recommendations in our report and the status of management decisions. The OIG based the information for management decisions on management's written response to our report and subsequent conversations with management.

Rec. Number	Corrective Action: Taken or Planned / Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Deputy Director, Asset Management Branch, DRR, will request servicers to submit documentation, including invoices and canceled checks, in support of the $212,586 in disallowed expenses.	90 days from final report	Letter to servicers requesting documentation	$212,586 disallowed cost	Yes
2	The Deputy Director, Asset Management Branch, DRR, agreed with the recommendation. On August 1, 2000, ACA requested MBS Administration to modify the language of future commercial and multifamily securitizations.	Completed	Modified language in future securitizations	N/A	Yes