SECURITIZATION CREDIT ENHANCEMENT RESERVE FUND 1992-6

Audit Report No. 99-018
March 31, 1999

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20434

Office of Audits
Office of Inspector General

DATE: March 31, 1999

TO: John F. Bovenzi
Director, Division of Resolutions and Receiverships

Sharon M. Smith

FROM: Sharon M. Smith
Director, Field Audit Operations

SUBJECT: *Securitization Credit Enhancement Reserve Fund 1992-6* (Audit Report No. 99-018)

This report presents the results of an Office of Inspector General (OIG) audit of Securitization Credit Enhancement Reserve Fund 1992-6. We identified incorrect interest calculations, which resulted in overcharges to the reserve fund of $68,105.

BACKGROUND

Securitization is the process whereby loans from Resolution Trust Corporation (RTC)[1] and Federal Deposit Insurance Corporation (FDIC) institutions are used as collateral to back securities sold to investors in the capital market. Securitization 1992-6 was signed on April 29, 1992, and was comprised of mortgage loans. The collateral security agreement stated that the mortgage loans were secured by one-to-four family first-lien residential properties. Securitization 1992-6 originally included 22,681 mortgage loans with total principal balances of nearly $1.3 billion. Three reserve funds for Securitization 1992-6 were established with deposits totaling $202,501,957, or approximately 15.5 percent of the total principal loan balances.

Securitization 1992-6 has a pooling and servicing agreement (PSA) that describes the servicer's obligations. As the servicer for Securitization 1992-6, First Nationwide Mortgage (First Nationwide) was responsible for servicing loans in accordance with the PSA servicing criteria. In accordance with Article IV of the PSA, the servicer delivered to the trustee a monthly report of the aggregate draw amounts or realized losses from the reserve fund for the related payment period. This monthly report was certified by First Nationwide's servicing officer (via an officer's certificate) in accordance with section 3.11 of the PSA. The PSA (Part II, Article I) defines the realized loss as being equal to the unpaid principal balance of the loan plus interest (net of servicing fee) from the date interest was last paid through the end of the month in which the property was sold or a mortgage insurance claim was issued. The PSA also stated that the servicer was required to advance each delinquent loan's monthly principal and interest until the loan was liquidated.

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[1] RTC ceased operation on December 31, 1995, and all assets were transferred to the Federal Deposit Insurance Corporation effective January 1, 1996.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective and scope of the audit was to determine whether the realized losses charged to the reserve funds were allowable, adequately supported, and correctly calculated for the period of April 1, 1995 through March 31, 1998.[2] To accomplish the objective, we initially addressed three areas of servicer responsibility: (1) calculating the correct payment of principal and interest charged to the reserve fund, (2) remitting mortgage insurance proceeds into the fund for any collections received subsequent to charging the reserve fund, and (3) selling foreclosed properties in accordance with the PSA and accurately reflecting the proceeds in the reserve fund.

To accomplish the audit objective, the OIG interviewed mortgage-back securities administration specialists from the FDIC Division of Resolutions and Receiverships (DRR) to understand their relationship with the servicer and with the oversight contractor, MGIC Investor Services Corporation (MGIC). The OIG interviewed First Nationwide personnel assigned to perform the various functions related to the servicing of delinquent and foreclosed loans charged to the reserve fund. The OIG also reviewed the PSA and Collateral Agreement to become familiar with provisions in the agreements that relate to losses charged to the reserve fund.

Based on survey work the OIG performed, we determined that First Nationwide remitted mortgage insurance collections into the fund for any collections received subsequent to charging the reserve fund. We also determined that First Nationwide sold foreclosed properties in accordance with the PSA and accurately reflected the proceeds in the reserve fund. However, based on errors found in interest calculations for realized losses, we conducted additional audit work to address principal and interest withdrawals from the reserve fund.

To determine whether the principal and interest withdrawals from the reserve fund were allowable, adequately supported, and correctly calculated, we selected a sample of 46 realized loss certificates that First Nationwide submitted to the trustee. The sample consisted of 32 randomly selected realized loss certificates totaling $1,296,183 from a population of 325 certificates totaling $14,728,872. The sample also included 14 realized loss certificates totaling $483,428 that MGIC had identified with possible incorrect interest calculations. As MBS's oversight contractor, MGIC reviewed a sample of First Nationwide's realized loss certificates. The MGIC sample of 270 realized losses consisted of all realized losses exceeding $10,000 and a random selection of losses under $10,000.

For the 46 OIG sample certificates, we obtained available documentation from First Nationwide to support the realized loss calculations. We reviewed each realized loss to determine whether First Nationwide correctly reported principal and interest based on its receipt dates of sales and mortgage insurance proceeds. We verified the dates for the following actions: (1) sale of the property, (2) receipt of sales proceeds, (3) issuance of the mortgage insurance check, (4) receipt

[2] First Nationwide began servicing Securitization 1992-6 on April 1, 1995. Previously, Standard Federal Savings Bank had serviced the loans. We limited our audit scope to the time period that First Nationwide serviced the securitization.

of mortgage insurance payments, and (5) issuance of the certificate. We also recalculated the principal and interest for each of the 46 sampled officer's certificates.

In addition to our testing of the 46 officer's certificates, based on a request from the FDIC's Mortgage-Backed Securities (MBS) unit, the OIG evaluated a methodology developed by MBS to determine whether interest charges were correctly calculated for this, and other, securitizations. Our approach to evaluating MBS's methodology was to compare the components (principal balance, interest rate, and time period) used by MBS to determine the proper servicer interest advance with our own calculations.

The OIG reviewed First Nationwide's policies and procedures pertaining to the servicing of loans for commercial customers. However, we did not review First Nationwide's internal controls. Instead, we relied on substantive testing to meet our audit objective. The OIG performed work at First Nationwide's office in Frederick, Maryland, and the FDIC's offices in Washington, D.C. The audit was conducted from August 1998 through November 1998 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

First Nationwide incorrectly calculated interest reimbursements on its realized loss certificates. Specifically, for the 46 certificates we reviewed, there were 28 certificates with incorrect interest calculations, which resulted in $68,105 of overcharges to the reserve fund. In addition, based upon OIG's limited analysis of MBS's methodology for calculating the proper servicer interest advances, even though it had some limitations, we found that MBS's methodology was a viable analytical tool for estimating total interest charges.

SERVICER OVERCHARGED RESERVE FUND $68,105

Our audit disclosed that First Nationwide incorrectly calculated interest advances, which resulted in overcharges to the reserve fund of $68,105. The interest overcharges generally occurred because First Nationwide erred in determining the ending date for calculating the interest reimbursements on the realized loss certificates.

The PSA defines a realized loss as being equal to the unpaid principal balance of the loan plus interest (net of servicing fee) from the date interest was last paid through the end of the month in which the servicer received final repayment of the loan. Loan repayments could be obtained by: (1) payment of the loan in full by borrower; (2) sale by deed-in-lieu of foreclosure; (3) sale of the foreclosed property; (4) a judgment, writ of attachment, or order of levy against the borrower or his assets; (5) insurance proceeds; or (6) sale of the loan by the trustee or servicer. According to the PSA, interest is calculated through the month in which the property was sold or mortgage insurance claim was issued.

We developed a schedule for our sample of 46 realized loss certificates to calculate the interest charges. For each sample item, we calculated the correct cutoff date per the PSA. Using the correct cutoff date, we determined the number of periods charged and calculated the associated interest charges. In calculating the interest charges, we used First Nationwide's amortized loan principal balances for each period charged and applied the correct interest rate. For the 46 sample certificates, we found 28 certificates where First Nationwide inappropriately calculated additional months of delinquent interest. The additional number of months of interest First Nationwide requested from the reserve fund for the sample ranged from 1 to 17 months. The following example shows the problem we identified. For one loan, we found that First Nationwide calculated delinquent interest for 29 months. The OIG calculated the interest through the month of the property sale date, as prescribed in the PSA. Our calculation found that 13 months was the correct period for delinquent interest charges. The additional 16 months used by First Nationwide resulted in $30,855 in overcharges to the reserve fund.

The interest overcharges occurred because First Nationwide used either the month of the receipt of the sale or insurance proceeds or the realized loss certificate completion dates as cut-off dates rather than the month of the sale for calculating the interest reimbursements. In total, OIG calculated $68,105 in total interest overcharges to the reserve fund for the 28 incorrectly realized loss certificates from the 46 sampled.

MBS and First Nationwide agreed with the OIG's finding. MBS also agreed to include the $68,105 overcharges to the reserve fund in its negotiations to collect overcharges to the total loan population of Securitization 1992-6.

Recommendation

The OIG recommends that the Assistant Director, Asset Marketing Section, DRR,

(1) Disallow $68,105 of interest that the servicer improperly charged to the reserve fund (questioned cost).

MBS CALCULATION OF INTEREST OVERCHARGES

During our audit, MBS was in the process of terminating Securitization 1992-6. As part of the termination process, MBS wanted to verify whether the loan servicer correctly calculated mortgage interest charges for all realized losses in Securitization 1992-6. Accordingly, using servicer data, MBS developed a methodology to calculate the total interest charges. MBS provided OIG the methodology and data used and requested that the OIG review this information for reliability. If the information proved to be reliable for this securitization, MBS would apply the methodology to its universe of securitizations to calculate correct interest charges for realized loss certificates. Based on our limited review of the MBS information for Securitization 1992-6, we believe that the methodology is a viable analytical tool for estimating the total interest overcharges for securitizations.

To evaluate MBS's interest calculations for Securitization 1992-6, we compared our sample of 46 loss certificates to the certificates that MBS included for this securitization. In doing so, we identified 31 loss certificates that matched.[3] For these 31 losses, we then compared our interest calculations to MBS's calculations. Both the OIG and MBS found errors in the servicer's interest charges. Specifically, the OIG calculated $48,889 in net interest overcharges and MBS calculated $51,790 in interest overcharges on the 31 losses for a difference of $2,901.

We determined that the $2,901 difference between MBS's and OIG's interest calculations resulted from MBS and OIG using different outstanding principal balances in their respective calculations. MBS calculated more in interest overcharges because it used a constant beginning principal balance in its calculations whereas the OIG used an amortized declining principal balance for the overcharged period.

MBS personnel stated they recognized that the methodology they used to calculate interest charges to the reserve fund for Securitization 1992-6 slightly overstated the total interest charges. MBS personnel said they used the constant principal balance because the data was readily available. Further, because securitizations are beginning to terminate at a rapid rate, MBS believed it needed an expedient method of quantifying a perceived problem, one of interest overcharges, for all securitizations. MBS stated that the time required to input principal amortization amounts into the calculation would not be cost-effective and could not be accomplished in time to be effectively used in the termination process.

Accordingly, although we did not perform a complete audit of MBS's methodology for calculating interest overcharges, we believe MBS's methodology is a viable analytical tool for estimating total interest overcharges to the reserve funds.

CORPORATION COMMENTS AND OIG EVALUATION

On March 12, 1999, the Deputy Director, Asset Marketing Branch, DRR, provided a written response to a draft of this report. The response is presented as appendix I to this report. A summary of the Deputy Director's response to the draft report and our analysis follows.

Disallow $68,105 of interest that the servicer improperly charged to the reserve fund (questioned cost)(recommendation 1): The Deputy Director agreed with the OIG's finding, which included the recommendation to disallow $68,105 in interest improperly charged to the reserve fund. Further, as we previously mentioned, during our audit MBS developed a methodology to calculate correct interest charges for realized loss certificates for its universe of securitizations. In his response to this draft report, the Deputy Director included a letter from First Nationwide, which indicated that First Nationwide agreed to reimburse the FDIC a total of $304,558. According to a

[3] MBS's oversight contractor, MGIC, reviewed a sample of realized loss certificates. For the sample, MGIC included all realized losses exceeding $10,000 and randomly selected losses under $10,000. MGIC's sample consisted of 270 realized loss certificates. MBS used MGIC's sample in MBS's methodology for calculating interest for realized losses charged to the reserve fund. OIG selected its sample of realized loss certificates from a population of 325 certificates. Since OIG used a larger population, it included certificates that MGIC did not select. Therefore, the other 17 losses not included are those OIG selected from the 325 population.

MBS official, $167,631 of this amount related to securitization 1992-06, with the remaining $136,927 related to securitization 1992-09.

MBS' initiative in developing the methodology for calculating interest charges will serve the Corporation well as securitizations are terminated in the future.

Based on our work, we will report questioned costs of $68,105 in our *Semiannual Report to the Congress* and explain that MBS' initiative produced savings beyond those identified by our audit.

Appendix II presents management's proposed action on the OIG's recommendation and shows that we have the necessary elements of a management decision for the recommendation in this report.

CORPORATION COMMENTS

FDIC
Division of Resolutions and Receiverships
1776 F Street, N.W.
Washington, D.C. 20429

DATE: March 8, 1999

TO: Sharon M. Smith
Director, Field Audit Operation

FROM: James R. Wigand
Deputy Director
Franchise and Asset Marketing Branch
Division of Resolution and Receivershipsy

RE: Draft Report Entitled Securitization Credit Enhancement Reserve Fund 1992-6

The following describes the management actions completed in response to recommendations contained in the above-mentioned report.

1) Disallow $68,105 of interest that the servicer improperly charged to the reserve fund (questioned cost)

A. Specific Corrective Action Already Taken:

MBS Administration and First Nationwide Mortgage Corporation ("FMMC") have reviewed the finding of the Office of Inspector General ("OIG") and do not dispute the finding.

B. Corrective Action to be Taken Along with Expected Completion Date:

Since the pools have been collapsed and FNMC cannot reimburse the credit reserve, FNMC will reimburse the FDIC upon final settlement of the remaining disputed variance issues related to credit losses. FNMC expects to resolve the remaining issues by May 31, 1999.

C. Documentation that will confirm the completion of the corrective action.

MBS Administration will maintain copies of all documentation related to the reimbursement of the credit reserve in their files.

cc: Director of Internal Control Management
Director, Division of Resolutions and Receiverships
Associate Director for Internal Review, DRR

1ST NATIONWIDE MORTGAGE

February 10, 1999

Mr. Ralph Malami
Federal Deposit Insurance Corporation
Division of Resolutions and Receiverships
1776 F Street, NW
Room 7044A
Washington, DC 20434

Re: Credit Reserve Reimbursement Related to 1992-06 and 1992-09

Dear Ralph,

First Nationwide Mortgage Corporation ("FNMC") has reviewed the finding of the Office of the Inspector General ("OIG") as it relates to the delays in filing the Officer's Certificates in the above referenced transactions. FNMC does not dispute the finding. Since the pools have been collapsed and we cannot reimburse the credit reserve, FNMC will reimburse the FDIC the amount $304,558.00. The reimbursement will be paid upon final settlement of the remaining disputed variance issues related to the credit losses.

It is FNMC's hope to resolve the remaining issues within the next thirty days.

Should you require any additional information, please contact me at (301) 696-4603.

Sincerely,

Ann E. Metz
First Vice President
Loan Servicing

CC: Brian Evans, Esquire
Susan Thrasher, Executive Vice President

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider 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 FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered 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 the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report and subsequent discussions with management representatives.

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	DRR agreed to disallow $68,105 of interest that the servicer improperly charged to the reserve fund. In addition, based on DRR's own analysis, it identified additional improper interest charges. Based on its work, First Nationwide agreed to reimburse FDIC a total of $304,558 covering securitizations 1992-6 and 1992-9.	Completed	Reimbursement Check	$304,558 Disallowed cost	Yes