Issue Date
May 15, 2012
Audit Report Number
2012-FW-1007

TO: Charles S. Coulter
Deputy Assistant Secretary for Single-Family Housing, HU

//signed//
FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: SWBC Mortgage Corporation Did Not Follow HUD-FHA Underwriting Requirements in 1 and Had Minor Deficiencies in 3 of 10 Single-Family Loans

HIGHLIGHTS

What We Audited and Why

We audited SWBC Mortgage Corporation, a Federal Housing Administration (FHA) direct endorsement lender in San Antonio, TX. We selected the lender for audit because as of September 30, 2011, it had 25 seriously delinquent loans. Our objective was to determine whether the lender originated single-family home loans in accordance with U. S. Department of Housing and Urban Development (HUD) and FHA requirements for loans with amortization dates between October 1, 2009, and September 30, 2011.

What We Found

The lender did not follow HUD-FHA underwriting requirements for 1 and had minor deficiencies in 3 of 10 loans reviewed. These deficiencies occurred because the lender's internal controls needed improvement. As a result, the lender originated one ineligible loan totaling $176,739 that resulted in an increased risk of loss of at least $115,654 to FHA's Mutual Mortgage Insurance Fund. Additionally, while the minor deficiencies did not affect loan approval, the lender placed itself at risk of originating additional ineligible loans.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require the lender to indemnify HUD for the ineligible FHA loan with an estimated potential loss of more than $115,000[1] and implement policies and procedures to strengthen its internal controls.

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 our draft report to SWBC Mortgage Corporation on April 24, 2012, and held the exit conference on April 30, 2012. We requested and received its written response on May 8, 2012. SWBC Mortgage Corporation generally disagreed with our conclusions and provided documentation to support its position. We reviewed the documentation and made changes to the report where appropriate.

The complete text of the auditee's response, along with our evaluation of that response can be found in appendix B of this report. The additional documentation provided to support the auditee's position is available upon request.

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[1] The amount is based on the estimated percentage of loss of 66 percent that HUD would incur when the FHA property is foreclosed upon and resold as supported by the HUD Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2011.

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BACKGROUND AND OBJECTIVES

SWBC Mortgage Corporation is headquartered at 9311 San Pedro, San Antonio, TX. It has 60 approved and active branch offices. It is a nonsupervised direct endorsement lender and was approved by the U.S. Department of Housing and Urban Development (HUD) to originate Federal Housing Administration (FHA)-approved mortgage loans on March 15, 1989.

HUD's direct endorsement program simplified the process for obtaining FHA mortgage insurance by allowing lenders to underwrite and close the mortgage loan without prior HUD review or approval. Lenders are responsible for complying with all applicable HUD regulations and are required to evaluate the borrower's ability and willingness to repay the mortgage debt. Lenders are protected against default by FHA's Mutual Mortgage Insurance Fund, which is sustained by borrower premiums. FHA's mortgage insurance programs help low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers and projects that might not be able to meet conventional underwriting requirements by protecting the lender against default.[2]

According to HUD's Neighborhood Watch system,[3] SWBC Mortgage originated 3,560 loans in calendar year 2010 with original mortgage amounts totaling more than $541 million. Further, as of October 31, 2011, SWBC Mortgage had originated 2,628 loans for the calendar year with original mortgage amounts totaling more than $388 million. Its default rate was 1.3 percent compared to an average default rate for all FHA loans in the San Antonio HUD office jurisdiction of 1.23 percent.

All FHA lenders must follow all applicable statutes, regulations, and HUD's written instructions, including program handbooks and mortgagee letters. Specifically, lenders must follow HUD Handbook 4155.1, "Mortgage Credit Analysis for Mortgage Insurance on One-to-Four-Unit Mortgage Loans," when underwriting FHA loans. The lender is responsible for eliciting a complete picture of the borrower's financial situation, source of funds for the transaction, and intended use of the property. Its decision to approve the loan must be documented, supported, and verifiable.

Lenders may use an automated underwriting system such as Desktop Underwriter to underwrite FHA loans. Desktop Underwriter works in conjunction with FHA's TOTAL (Technology Open to Approved Lenders) Mortgage Scorecard. HUD published a user guide to assist lenders using an automated underwriting system in conjunction with TOTAL Mortgage Scorecard. FHA's TOTAL Mortgage Scorecard evaluates the overall creditworthiness of the applicants based on a number of credit variables and, when combined with the functionalities of the automated underwriting system, indicates a recommended level of underwriting and documentation to determine a loan's eligibility for insurance by FHA. Taken together, TOTAL Mortgage Scorecard and the automated

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[2] HUD defines a default as the inability to make timely mortgage payments or otherwise comply with mortgage terms. A loan is considered in default when no payment has been made 30 days after the due date. Once a loan is in default, the lender can exercise legal rights defined in the contract to begin foreclosure proceedings.

[3] Neighborhood Watch is Web-based software that displays loan performance data for FHA-insured single-family loan information. The system is designed to highlight exceptions so that potential problems are readily identifiable.

underwriting system either conclude that the borrower's credit and capacity for repayment of the mortgage are acceptable or refer the loan application to a direct endorsement underwriter for further consideration and review. Each automated underwriting system using FHA's TOTAL Mortgage Scorecard produces a document that provides feedback to the insurance lender. Desktop Underwriter's feedback document is called the "Desktop Underwriter Findings". Desktop Underwriter Findings summarize an overall underwriting recommendation and eligibility of a loan and list certain steps necessary for the lender to complete the processing of the loan case file. The Desktop Underwriter Findings alert the lender to potential problems with occupancy, property valuation, or social security number data that may warrant further investigation. SWBC Mortgage used Desktop Underwriter to underwrite the 10 loans reviewed.

Our objective was to determine whether the lender originated single-family home loans in accordance with HUD and FHA requirements for loans with beginning amortization dates between October 1, 2009, and September 30, 2011.

RESULTS OF AUDIT

Finding: SWBC Mortgage Corporation Did Not Follow HUD-FHA Underwriting Requirements in 1 and Had Minor Deficiencies in 3 of 10 Loans Reviewed

The lender did not follow HUD-FHA underwriting requirements in 1 of 10 loans reviewed. Specifically, it did not include all of the borrower's debt when it qualified him for the FHA-insured loan. Further, three loans contained minor deficiencies that did not affect loan approval. These deficiencies occurred because the lender's internal controls needed improvement. As a result, the lender originated one ineligible loan totaling $176,739 that resulted in an increased risk of loss of an estimated $115,654 to the insurance fund. In addition, while the minor deficiencies did not affect loan approval, the lender placed itself at risk of originating additional ineligible loans.

SWBC Mortgage Did Not Include All Debt When Qualifying One Borrower

For one loan,[4] the lender did not include all of the borrower's debt when it qualified him for the FHA loan. The borrower's divorce decree, dated 6 months before closing, identified six accounts with balances totaling $21,800 that were not on the credit report or the Desktop Underwriter Findings and were not considered by the automated underwriting system. HUD's TOTAL Mortgage Scorecard User Guide states that

> when a debt or obligation is revealed during the application process that was not listed on the loan application and/or credit report and was *not* considered by the automated underwriting system, the lender must a) verify the actual monthly payment amount; b) include the monthly payment amount and re-submit the loan if the liability is greater than $100 per month; and c) determine that any funds borrowed were not/will not be used for the homebuyer's cash investment into the transaction.

The loan file did not contain evidence that the lender resubmitted the loan. The lender agreed that it did not include all of the borrower's debt when it qualified him for the FHA loan. As a result, the loan was ineligible for FHA insurance.

[4] FHA case number 495-8477110

4 of 10 Loans Had Minor Documentation Deficiencies

Four[5] of the ten loans reviewed contained minor documentation deficiencies. Specifically, the Desktop Underwriter Findings instructed the lender to obtain the most recent pay stubs and bank statements and verify the borrower's assets. However, the lender did not obtain the most recent pay stubs for three loans, and three loans did not contain the most recent bank statements. None of these deficiencies affected loan approval because (1) the income used to qualify the borrower was supported by documents in the loan file, (2) assets were supported by older bank statements, or (3) HUD's TOTAL Mortgage Scorecard emulator approved the loan without any reserves. Table 1 identifies the loans and their documentation deficiencies.

Table 1: Summary of minor loan deficiencies

Count	FHA case number	Pay stubs were not the most recent	Bank statements were not the most recent
1	495-8477110	X	X
2	495-8537867	X	
3	495-8612321		X
4	495-8711651	X	X
	Totals	**3**	**3**

SWBC Mortgage Did Not Manually Underwrite One Loan as Required

HUD's TOTAL Mortgage Scorecard User Guide requires lenders to manually underwrite loans when the borrower's credit report reveals disputed credit accounts. One loan[6] contained five disputed collection accounts, which required a manual underwrite. The lender did not reply to our inquiries regarding its failure to manually underwrite the loan. For manually underwritten loans, FHA requires the lender to compute two ratios: (1) mortgage payment expense to effective income and (2) total fixed payment to effective income.[7] The first ratio considers the total mortgage payment to the borrower's income, while the second ratio considers all of the borrower's debts, including the mortgage payment, to the borrower's income. When a loan is manually underwritten, the qualifying ratios generally should not exceed 31 and 43 percent, respectively, without acceptable compensating factors. When a borrower's qualifying ratios exceed the FHA-

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5 One of the four loans (FHA case number 495-8477110) was discussed earlier in the finding and was ineligible.

6 FHA case number 495-8537867

7 HUD Handbook 4155, paragraph 4.F.2

established limits, FHA requires the underwriter to support loan approval with compensating factors and support the factors with documentation.[8] Desktop Underwriter approved the loan with qualifying ratios of 42 and 55 percent, which exceeded the FHA benchmarks. The borrower's loan file contained documentation evidencing substantial cash reserves, which are acceptable as a compensating factor.[9] Therefore, the loan was eligible, making the lender's failure to manually underwrite the loan a minor deficiency.

SWBC Mortgage's Internal Controls Needed Improvement

All of the deficiencies identified during our review occurred because the lender's internal controls needed improvement. The lender did not always follow HUD's TOTAL Mortgage Scorecard User Guide and the Desktop Underwriter Findings instructions. In addition, its quality control process needed strengthening because (1) its quality control contractor reviewed but did not detect the ineligible loan[10] and (2) a quality control recommendation on another loan[11] was not followed. Lenders must design quality control programs that meet the following overriding goals of quality control: "assure compliance with FHA's and the mortgagee's own origination or servicing requirements throughout its operations, protect the mortgagee and FHA from unacceptable risk, guard against errors, omissions and fraud, and assure swift and appropriate corrective action."[12] Since the lender did not always follow HUD's TOTAL Mortgage Scorecard User Guide, the Desktop Underwriter Findings instructions, and its quality controls, its internal controls were weakened, which allowed deficiencies to occur.

Conclusion

The lender did not follow HUD-FHA underwriting requirements in 1 of 10 loans reviewed. Three loans contained minor documentation deficiencies that did not affect loan approval. Additionally, the lender did not provide documentation to show that it followed a recommendation from its quality control contractor. These deficiencies occurred because the lender's internal controls needed improvement. As a result, the lender originated one ineligible loan totaling $176,739 that resulted in an increased risk of loss of an estimated $115,654 to the insurance fund. Further, while the minor deficiencies did not affect loan approval, the lender placed itself at risk of originating additional ineligible loans.

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8 HUD Handbook 4155.1, paragraph 4.F.2.a through 4.F.3.b

9 HUD Handbook 4155.1, paragraph 4.F.3.b, lists acceptable compensating factors.

10 FHA case number 495-8477110

11 FHA case number 495-8746037

12 HUD Handbook 4060.1, REV-2, "Mortgagee Approval Handbook," paragraph 7-2

Recommendations

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

1A. Indemnify HUD for one insured loan[13] with an unpaid principal balance of $175,233, thereby putting an estimated $115,654 to better use based on the FHA insurance fund average loss rate of 66 percent of the unpaid principal balance.

1B. Implement policies and procedures to ensure that it will follow HUD's TOTAL Mortgage Scorecard User Guide and that all Desktop Underwriter Findings instructions are followed.

1C. Implement policies and procedures to ensure that all quality control contractor recommendations are implemented.

[13] FHA case number 495-8477110

SCOPE AND METHODOLOGY

We conducted the audit between November 2011 and April 2012 at the lender's headquarters office in San Antonio, TX, and the HUD OIG San Antonio, TX, and Fort Worth, TX, field offices. We selected the lender for audit because, according to HUD's Neighborhood Watch system, between October 1, 2009, and September 30, 2011, it had 25 seriously delinquent loans out of 1,930 originated in the San Antonio, TX, office jurisdiction. Our objective was to determine whether the lender originated single-family home loans in accordance with HUD and FHA requirements for loans with beginning amortization dates between October 1, 2009, and September 30, 2011.

To accomplish our objective, we

- Reviewed applicable HUD regulations, requirements, and mortgagee letters;
- Reviewed reports and information on HUD's Neighborhood Watch system;
- Reviewed the lender's quality control contract and written quality control plan;
- Selected all 25 seriously delinquent loans for review;
- Obtained all 25 seriously delinquent electronic loan files and reviewed 10 files beginning with the lowest number of payments before first default;
- Reviewed quality control reports for five loans that defaulted in six payments or fewer;[14]
- Reviewed the lender's policies and procedures; and
- Conducted interviews with applicable HUD staff, lender staff, and borrowers that were available.

After we completed 10 file reviews, our results indicated that only 1 loan was ineligible. As a result, we discontinued testing. We did not evaluate the reliability of HUD's Neighborhood Watch system because we were not auditing the system and used it only to select an auditee and identify which loans to review. During the file review, we compared instructions in the Desktop Underwriter Findings to the documents in the file to test whether the Desktop Underwriter Findings instructions were followed. We also compared our file review results to the quality control reviews that were completed on loans that defaulted in six payments or fewer.

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

[14] HUD Handbook 4060.1, REV-2, paragraph 7-6(D), requires lenders to perform a quality control review of all loans that default in six payments or fewer. Our review scope included five loans that fell into that category.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Policies and procedures intended to ensure that FHA-insured loans are properly originated and underwritten,
- Safeguarding FHA-insured mortgages from high-risk exposure, and
- Policies and procedures intended to ensure that the quality control program is an effective tool in reducing underwriting errors and noncompliance.

We assessed the relevant controls identified above.

A deficiency in internal controls 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 Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The lender's internal controls needed improvement because it did not always follow HUD's TOTAL Mortgage Scorecard User Guide, Desktop Underwriter Findings instructions, or quality control recommendations (finding).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$115,654

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if HUD implements our recommendation to indemnify the loan that was not originated in accordance with FHA requirements, it will reduce FHA's risk of loss to the insurance fund. The amount above reflects HUD's calculation that FHA loses an average of about 66 percent of the claim amount when it sells a foreclosed-upon property.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

SWBC Mortgage
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May 8, 2012

VIA UPS MAIL AND EMAIL, gkirkland@hudoig.gov

Mr. Gerald Kirkland
Regional Inspector General for Audit
Office of Inspector General, Region VI
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

Re: SWBC Mortgage Corporation Did Not Follow HUD-FHA Underwriting Requirements in 1 and Had Minor Deficiencies in 7 of 10 Single-Family Loans

Dear Mr. Kirkland:

Thank you for the opportunity to respond to the findings in the above-referenced draft audit report. SWBC Mortgage Corporation ("SWBC Mortgage") is a full-service mortgage banking firm, which has provided mortgage banking services for more than 22 years. SWBC Mortgage credits our superior performance and growth to our highly experienced management and support team members, many of which have been with SWBC Mortgage for more than 15 years.

SWBC Mortgage welcomes this opportunity to work with the Office of Inspector General and remains committed to making high quality loans to serve our customers and strengthen our partnership with FHA and investors. SWBC Mortgage has diligently focused on quality control measures to ensure compliance with guarantor, insurer, and investor requirements. SWBC Mortgage takes great pride in the fact that HUD's Neighborhood Watch system shows that SWBC Mortgage's default rate in the San Antonio jurisdiction was 1.33% on September 30, 2011, which fell to 1.02% by December 31, 2011, and was .71% on March 31, 2012. Additionally, the Compare Ratio during this time went from 108% on September 30, 2011, to 77% on December 31, 2011, and was 65% as of March 31, 2012. Consequently, SWBC Mortgage has improved since the audit period of this review (October 1, 2009 to September 30, 2011), which is reflective of the additional oversight and controls that were put in place prior to this audit.

The audit report (the "Report") indicates SWBC Mortgage was selected for audit because it had 25 seriously delinquent loans. According to the HUD Neighborhood Watch system, the number of seriously delinquent loans in the San Antonio jurisdiction is 12 as of March 31, 2012. SWBC Mortgage has always endeavored to originate mortgage loans in accordance with FHA policies and procedures. As industry data became available, SWBC Mortgage increased usage of tools and resources that indicated default risk and continued to assess the internal control processes and implement risk mitigation measures through proper controls.

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FINDING

SWBC MORTGAGE DID NOT INCLUDE ALL DEBT WHEN QUALIFYING ONE BORROWER

For one loan, the lender did not include all of the borrower's debt when it qualified him for the FHA loan. The borrower's divorce decree, dated six months before closing, identified six accounts with balances totaling $21,800 that were not on the credit report or the Desktop Underwriter Findings and were not considered by the automated underwriting system. HUD's TOTAL Mortgage Scorecard User Guide states that when a debt or obligation is revealed during the application process that was not listed on the loan application and/or credit report and was *not* considered by the automated underwriting system, the lender must a) verify the actual monthly payment amount; b) include the monthly payment amount and re-submit the loan if the liability is greater than $100 per month; and c) determine that any funds borrowed were not/will not be used for the homebuyer's cash investment into the transaction. The loan file did not contain evidence that the lender resubmitted the loan. The lender agreed that it did not include all of the borrower's debt when it qualified him for the FHA loan. As a result, the loan was ineligible for FHA insurance.

Comment 1

Response to the Finding: SWBC Mortgage takes its underwriting responsibilities very seriously and would never knowingly approve a loan to an unqualified borrower. In this case, the borrower's divorce decree was dated six months before closing; however, a current credit report did not include the accounts listed in the divorce decree. The divorce decree included the payment of debts for which he was not legally obligated by the creditors. Also, the accounts listed in the divorce decree did not identify account numbers so it was not possible to compare the accounts in the divorce decree with the accounts listed on the credit report. SWBC Mortgage agrees that the underwriter should have inquired further; however, since the borrower was not legally obligated to pay, the typical practice of reviewing the debt did not cover this type of issue. Further, it would have been difficult to obtain current payment balances on debts from creditors when the borrower was not on the accounts. This is a highly unusual situation and SWBC Mortgage has improved processes to give specific instructions to follow total findings. Since early 2011, a pre-close review process has been in place to detect underwriting and processing deficiencies prior to the loan closing. The deficiencies should improve with the controls now in place. As noted by the OIG representative, this is not indicative of SWBC Mortgage's underwriting practices as evidenced by the fact that no other major findings were noted and the representative felt it was not necessary to review the remaining 15 of the 25 loans selected for the audit.

FINDING

8 OF 10 LOANS HAD MINOR DOCUMENTATION DEFICIENCIES

Eight of the ten loans reviewed contained minor documentation deficiencies. Specifically, the Desktop Underwriter Findings instructed the lender to obtain the most recent pay stubs and bank statements and verify the borrower's assets. However, the lender did not obtain the most recent pay stubs for seven loans, and five loans did not contain the most recent bank statements. None of these deficiencies affected loan approval because (I) the income used to qualify the borrower was supported by documents in the loan file, (2) assets were supported by older bank statements, or (3) HUD's TOTAL Mortgage Scorecard emulator approved the loan without any reserves.

Table 1 identifies the loans and their documentation deficiencies.

Table 1: Summary of Minor Loan Deficiencies

Count	FHA case number	Pay stubs were not the most recent	Bank statements were not the most recent
1	495-8477110	X	X
2	495-8840058	X	
3	495-8746037	X	X
4	495-7519279	X	X
5	495-8537867	X	
6	495-8612321		X
7	495-8666806	X	
8	495-8711651	X	X
	Totals	**7**	**5**

Response to the Finding: SWBC Mortgage respectfully disagrees with the finding on four of the eight loans cited with minor deficiencies. Per HUD Handbook 4155.1 1.B.2.a - General Mortgage Credit Analysis Documents, "Lenders must obtain the most recent documents required to perform the mortgage credit analysis. "Most Recent" refers to the most recent documents available at the time the loan application is made." The below chart indicates SWBC Mortgage's response to each loan.

Count	FHA case number	Pay stubs were not the most recent	Bank statements were not the most recent
1	495-8477110	Agree	Agree
2	495-8840058	Disagree	
3	495-8746037	Disagree	Disagree
4	495-7519279	Disagree	Disagree
5	495-8537867	Agree	
6	495-8612321		Agree
7	495-8666806	Disagree	
8	495-8711651	Agree	Agree

Comment 2

495-8840058 ([redacted]) - The application date for this loan was 07/05/2010 and the most recent pay stub in the file was dated 06/25/10. Based on the frequency the borrower is paid, the 06/25/10 pay stub was the most recent at the time of application.

495-8746037 ([redacted]) - The application date for this loan was 04/05/10 and the most recent pay stub was dated 04/01/10. Based on the frequency the borrower is paid, this was the most recent pay stub available at the time of application. The bank statement provided covered a period of 02/16/10 to 031/5/10. Again, based on the application date of 04/05/10, this would be the most recent statement available.

495-8519279 ([redacted]) - The application date for this loan was 09/17/10 and the most recent pay stub in the file was dated 10/15/10. This is within HUD's documentation requirements. The bank statement provided was dated 09/02/09 and a statement from the borrower's retirement account was dated 09/16/09. Based on the application date of 09/17/10, these would be the most recent statements available at the time of application.

495-8666806 ([redacted]) - The application date was 02/11/10, the pay stub provided by the borrower was dated 02/24/10 and the pay stub provided by the co-borrower was dated 02/10/10. The file contains an earlier paystub provided by the borrower, but based on the application date it would not have satisfied HUD's documentation requirements. This is why we have a more recent pay stub in the file for the borrower compared to the documentation provided by the co-borrower.

On the four remaining files, SWBC Mortgage concurs with the findings concerning the age of the documents. We agree with the OIG representative's statement that none of the deficiencies affected the loan approval. The income and assets were supported by other documentation in the loans files such as tax returns, tax transcripts, W-2s and verbal verifications of employment. SWBC Mortgage strictly enforces our underwriting process and as previously mentioned the pre-closing process closely monitors dates as an additional control that may not have been in place during the audit period.

FINDING

SWBC MORTGAGE DID NOT MANUALLY UNDERWRITE ONE LOAN AS REQUIRED

HUD's TOTAL Mortgage Scorecard User Guide requires lenders to manually underwrite loans when the borrower's credit report reveals disputed credit accounts. One loan contained five disputed collection accounts, which required a manual underwrite. The lender did not reply to our inquiries regarding its failure to manually underwrite the loan. For manually underwritten loans, FHA requires the lender to compute two ratios: (1) mortgage payment expense to effective income and (2) total fixed payment to effective income. The first ratio considers the total mortgage payment to the borrower's income, while the second ratio considers all of the borrower's debts, including the mortgage payment, to the borrower's income. When a loan is manually underwritten, the qualifying ratios generally should not exceed 31 and 43 percent, respectively, without acceptable compensating factors. When a borrower's qualifying ratios exceed the FHA established limits, FHA requires the underwriter to support loan approval with compensating factors and support the factors with documentation. Desktop Underwriter approved the loan with qualifying ratios of 42 and 55 percent, which exceeded the FHA benchmarks. The borrower's loan file contained documentation evidencing substantial cash reserves, which are acceptable as a compensating factor. Therefore, the loan was eligible, making the lender's failure to manually underwrite the loan a minor deficiency.

Comment 3

Response to Finding: On February 21, 2012, SWBC Mortgage received an email message from the auditor stating that "this to let you know that we are "surveying out" of SWBC Mortgage Corporation. This means that our survey work did not produce results to justify a full audit. Therefore, we are issuing an audit report based on our review of 10 files." Consequently, SWBC Mortgage is surprised by this finding and thought the requirement to provide additional information had passed. However, SWBC Mortgage would be happy to provide a response at this time. Based on a review of the file, SWBC Mortgage agrees that this should have been issued as a manual downgrade; however, this loan was processed prior to the underwriting processes and pre-closing quality control measures currently in place.

FINDING

SWBC MORTGAGE'S INTERNAL CONTROLS NEEDED IMPROVEMENT

All of the deficiencies identified during our review occurred because the lender's internal controls needed improvement. The lender did not always follow HUD's TOTAL Mortgage Scorecard User Guide and the Desktop Underwriter Findings instructions. In addition, its quality control process needed strengthening because (1) its quality control contractor reviewed but did not detect the ineligible loan and (2) a quality control recommendation on another loan was not followed. Lenders must design quality control programs that meet the following overriding goals of quality control: "assure compliance with FHA's and the mortgagee's own origination or servicing requirements throughout its operations, protect the mortgagee and FHA from unacceptable risk, guard against errors, omissions and fraud, and assure swift and appropriate corrective action." Since the lender did not always follow HUD's TOTAL Mortgage Scorecard User Guide, the Desktop Underwriter Findings instructions, and its quality controls, its internal controls were weakened, which allowed deficiencies to occur.

Response to the Finding: SWBC Mortgage utilizes a nationally known vendor that has been in business for over 25 years and provides quality control services on behalf of 500 clients, 6 of which are top 10 lenders. SWBC Mortgage has been in contact with this vendor and we have been assured that preventative measures have been added to prevent this type of oversight in the future.

Comment 4

In response to a quality control recommendation not being followed, the quality control vendor noted a possible issue with the occupancy. The vendor was able to verify active service with the City of San Antonio Water System; however, the account was in a different name than the borrower. If the vendor notes a possible issue with the occupancy, SWBC Mortgage's Compliance Department (the "Compliance Department") will attempt to confirm occupancy prior to ordering a full occupancy inspection. In this case, the vendor noted a utility service account that was in a name other than the borrower's. The borrower and spouse do not share the same last name, so it is possible the account was in the name of the non-borrower spouse. During a subsequent review, the Compliance Department was able to locate a directory assistance listing for the borrower at the subject property address. The Compliance Department also rescored the loan through our fraud detection vendor and all credit bureaus showed the borrower linked to the subject property address. Consequently, while the vendor recommended that SWBC Mortgage conduct an occupancy inspection, the Compliance Department was able to verify the borrower's occupancy through other means described above.

FINDING

Conclusion

The lender did not follow HUD-FHA underwriting requirements in 1 of 10 loans reviewed. Seven loans contained minor documentation deficiencies that did not affect loan approval. Additionally, the lender did not provide documentation to show that it followed a recommendation from its quality control contractor. These deficiencies occurred because the lender's internal controls needed improvement. As a result, the lender originated one ineligible loan totaling $176,739 that resulted in an increased risk of loss of an estimated $115,654 to the insurance fund. Further, while the minor deficiencies did not affect loan approval, the lender placed itself at risk of originating additional ineligible loans.

Comment 5

Response to the Finding: SWBC Mortgage agrees with the auditor's findings that in all cases the minor deficiencies did not affect loan approval. While these may have been technical deficiencies, adequate documentation to support the decision was in the file in all cases. Regarding other loans referenced in this report, SWBC Mortgage believes that the pre-closing processes and internal control measures put into place between the October 1, 2009 to September 30, 2011 audit period and the time of this Report have greatly improved mitigation of risk of these types of issues.

SWBC Mortgage has carefully considered the findings and recommendations as set forth in the Report and is committed to taking appropriate action to address any deficiencies. The Company is further committed to serving the needs of consumers and complying with all HUD regulations. SWBC Mortgage has continued to recognize the need for stronger compliance controls and risk assessment and within the last three years has hired three key members of the executive management team: (l) Vice President, Compliance; (2) Executive Vice President, Risk and Operations; and (3) General Counsel. Additionally, SWBC Mortgage endeavors to monitor underwriting performance and provide ongoing training to employees on the issue of credit analysis.

SWBC Mortgage appreciates the guidance provided by your office as we continue to strive and improve internal control processes and looks forward to a continued dialogue with HUD. We believe SWBC Mortgage's emphasis on the importance of compliance is evident based on the OIG representatives' compliments to our staff regarding the extreme efficiency and ability to provide quality information in a timely manner. The OIG representatives were satisfied with their findings and subsequently decided to discontinue the audit after reviewing 10 of the 25 files selected for review.

If you have any questions or need additional information, please do not hesitate to contact the undersigned at (210) 581-1539.

Sincerely,

Karen A. Thomason
Vice President, Quality Control and Compliance

OIG Evaluation of Auditee Comments

Comment 1 The lender agreed that it should have inquired further about debt that was not considered in loan approval, but argued that since the undisclosed debt was not on the credit report, the borrower was not legally obligated by the creditors to pay the debt. We respectfully disagree with the lender. The unconsidered debt was itemized in a divorce decree issued by the 250th Judicial District in Travis County, TX, prior to loan origination and was included in the loan file. Therefore, the borrower was legally obligated to pay the debt. We did not change the report.

Comment 2 The lender provided additional documentation for four loans to show that documents in the loan files were the most recent available to support income and assets. We reviewed the documentation, and removed the citations for the four loans from the final report. For one loan removed from the report, the lender stated that the loan application date was September 17, 2010, the pay stub was dated October 15, 2010, and the bank statement and retirement account statement provided were dated September, 2009. All documentation related to this loan was dated 2009; thus, the dates in the lender's response were incorrect.

Comment 3 The lender stated that it was surprised by the OIG finding that one loan should have been manually underwritten. However, it agreed with our conclusions. We respectfully disagree that the lender was unaware as we notified it of this deficiency on January 23, 2012, but did not receive a response addressing the issue.

Comment 4 The lender stated that while it did not follow its quality control contractor's recommendation to perform an occupancy inspection, it was able to confirm occupancy through directory assistance and through a rescoring of the loan through its fraud detection vendor. The lender provided a screen print of the directory assistance search. However, there is no date to show when this search occurred. In addition, the lender was unable to provide documentation to show that it had rescored the loan through its fraud vendor at the time of the quality control contractor's recommendation. Further, a search of Lexis Nexis revealed that the borrower did not have a driver's license registered to the subject property. We did not change the report.

Comment 5 The lender stated that it has implemented pre-closing processes and additional internal control measures since the audit period which has improved mitigation of risk for the issues discussed in the audit report. We acknowledge its actions.

Appendix C

Case Narrative

Case Narrative – 495-8477110

Mortgage amount: $176,739

Date of loan closing: October 8, 2009

Status as of February 29, 2012: 20 months delinquent

Payments before first default reported: Zero

Underwriting deficiencies: The lender did not include all of the borrower's debt when it ran the borrower's data through the Desktop Underwriter automated underwriting system.

Summary:
All Debt Was Not Considered in Loan Approval
Desktop Underwriter approved the loan with $1,348 in monthly debt. However, we identified six accounts on the borrower's divorce decree with balances totaling $21,800 that were not considered by Desktop Underwriter. The divorce decree included a seventh account for a vehicle, which also wasn't considered by Desktop Underwriter. The divorce decree did not include a balance, but the borrower told us that his monthly payment was more than $600 for the vehicle. In addition, one of the loan applications in the loan file included a $100 per month child support payment that was not considered by Desktop Underwriter. The borrower confirmed that he paid $100 per month in child support for his disabled son and would pay this amount for the remainder of his life.

The Desktop Underwriter Findings stated, "When a debt or obligation is revealed during the application process that was not listed on the loan application and/or credit report that was not considered by Desktop Underwriter, verify the monthly payment amount. If the increased amount is outside of tolerances,[15] include the debt in the qualifying ratios and resubmit the loan case file." There was no documentation in the loan file to show that the lender verified the monthly payment amount for the debt listed on the borrower's divorce decree, and there was no documentation in the loan file to show that the lender included the additional debt in the ratio calculations.

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[15] The TOTAL Mortgage Scorecard User Guide states that when a debt or obligation is revealed during the application process that was not listed on the loan application and/or credit report and was not considered by the automated underwriting system, the lender must (1) verify the actual monthly payment amount, (2) include the monthly payment amount and resubmit the loan if the liability is greater than $100 per month, and (3) determine that any funds borrowed were not or will not be used for the home buyer's cash investment into the transaction.