

---

# AUDIT REPORT



NATIONAL CITY MORTGAGE COMPANY  
NON-SUPERVISED LENDER

MIAMISBURG, OHIO

2005-CH-1015

AUGUST 23, 2005

OFFICE OF AUDIT, REGION V  
CHICAGO, ILLINOIS

---



Issue Date August 23, 2005
-------------------------------

Audit Report Number: 2005-CH-1015
--------------------------------------

TO: Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing  
Commissioner, H  
John W. Herold, Associate General Counsel for Program Enforcement, CE

FROM:   
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: National City Mortgage Company, Non-supervised Lender; Miamisburg, Ohio;  
Improper Submission of Late Requests for Endorsement Increased the Risk to  
Insurance Fund

## **HIGHLIGHTS**

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

We audited National City Mortgage Company (National City), a nonsupervised lender approved to originate, underwrite, and submit insurance endorsement requests under the U.S. Department of Housing and Urban Development's (HUD) single family direct endorsement program. The audit was part of the activities in our fiscal year 2005 annual audit plan. We selected National City for audit because of its high late endorsement rate. Our objective was to determine whether National City complied with HUD's regulations, procedures, and instructions in the submission of insurance endorsement requests.

### **What We Found**

National City did not always comply with HUD's requirements on late requests for insurance endorsement. National City submitted 2,071 late requests for endorsement out of 68,730 loans tested. The loans were either delinquent or otherwise did not meet HUD's requirements of six monthly consecutive timely payments subsequent to delinquency, but before submission to HUD. National City also incorrectly certified that both the mortgage and escrow accounts for 133 loans,

and the escrow accounts for taxes, hazard insurance premiums, and mortgage insurance premiums for 497 loans were current when they were not. National City lacked adequate procedures and controls to ensure that it followed HUD's requirements regarding late requests for insurance endorsement. These improperly submitted loans increased the risk to the Federal Housing Administration insurance fund.

### **What We Recommend**

We recommend that HUD's assistant secretary for housing-federal housing commissioner require National City to indemnify HUD for any future losses on 529 loans with a total mortgage value of \$63,543,359 and take other appropriate administrative actions up to and including civil money penalties, and reimburse HUD \$2,305,957 for the actual losses it incurred on 57 loans since the properties associated with these loans were sold and for any future losses from \$3,194,948 in claims paid on 45 insured loans with a total mortgage value of \$4,982,334 once the associated properties are sold. We also recommend that HUD's assistant secretary for housing-federal housing commissioner take appropriate administrative action against National City for violating the requirements in effect at the time when it submitted 804 loans with a total mortgage value of \$99,643,484 without the proper six-month payment histories.

We recommend that HUD's associate general counsel for program enforcement determine legal sufficiency, and, if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against National City and/or its principals for incorrectly certifying that the mortgage and/or the escrow accounts for taxes, hazard insurance premiums, and mortgage insurance premiums were current for 630 loans submitted for Federal Housing Administration insurance endorsement when the mortgage and/or escrow accounts were not current at submission.

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

### **Auditee's Response**

We provided the results of our late endorsement testing and loan file reviews to National City during the audit. We also provided our discussion draft audit report to National City's chairman, senior vice president and vice president of post funding, and HUD's staff on June 17, 2005. We conducted an exit conference with National City's management on June 27, 2005.

National City's President provided written comments to the discussion draft audit report on July 18, 2005, that generally agreed with our findings but disagreed with the number of loans recommended for indemnification. The complete text of National City's written response including a three-paged cover letter, and our evaluation of that response, can be found in appendix B of this report.

## TABLE OF CONTENTS

---

Background and Objectives	5
Results of Audit	
Finding: National City Improperly Submitted Late Requests for Endorsement	6
Scope and Methodology	10
Internal Controls	12
Followup on Prior Audits	14
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	15
B. Auditee Comments and OIG's Evaluation	16
C. Federal Requirements	37

## **BACKGROUND AND OBJECTIVES**

---

National City Mortgage Company (National City) is a division of National City Bank of Indiana. National City's headquarters office is located in Miamisburg, Ohio. In May 1955, National City was approved to originate Federal Housing Administration-insured loans. National City also participates in the U.S. Department of Housing and Urban Development's (HUD) direct endorsement program. As a direct endorsement lender, National City determines that the proposed mortgage is eligible for insurance under the applicable program regulations and submits the required documents to HUD without its prior review of the origination and closing of the mortgage loan. National City is responsible for complying with all applicable HUD regulations and handbook instructions.

As of May 26, 2005, National City sponsored Federal Housing Administration loans that 4,129 lenders originated. As of June 3, 2005, National City had 114 loan correspondents, 99 principals, and 148 authorized agents. National City is a full service mortgage company that originates, markets, and services loans. National City originates loans in 37 states through its 300 lending offices coast to coast and the remaining continental United States through direct-to-consumer telephone and Internet preferred lending centers in Miamisburg, Ohio, and Santa Rosa, California.

We audited National City as part of the activities in our fiscal year 2005 annual audit plan. We selected National City for audit because of its high late endorsement rate of more than 40 percent during the period May 1, 2002, through April 30, 2004. National City originated/sponsored 171,079 Federal Housing Administration loans totaling more than \$21 billion.

Our objective was to determine whether National City complied with HUD's regulations, procedures, and instructions in the submission of insurance endorsement requests.

## RESULTS OF AUDIT

---

### Finding: National City Improperly Submitted Late Requests for Endorsement

National City improperly submitted 2,071 loans with mortgages totaling more than \$263 million for insurance endorsement when the borrowers did not make six monthly consecutive timely payments subsequent to delinquency, but before submission to HUD. Additionally, National City also incorrectly certified that both the mortgage and escrow accounts for 133 loans, and the escrow accounts for taxes, hazard insurance premiums, and mortgage insurance premiums for 497 loans were current when they were not. The problems occurred because National City lacked adequate procedures and controls to ensure its employees followed HUD's requirements regarding late requests for insurance endorsement. These improperly submitted loans increased the risk to the Federal Housing Administration insurance fund.

---

#### Improperly Submitted Late Requests for Endorsement

Our analysis of the mortgage payment histories provided by National City and endorsement data from HUD's systems showed that for the 68,730 loans tested, National City submitted 2,071 loans for endorsement even though the borrowers did not make six monthly consecutive timely payments subsequent to the delinquency, but before submission to HUD.

After endorsement, 611 of the 2,071 loans were paid in full and no longer represent a risk to the Federal Housing Administration insurance fund. Because these loans are no longer insured, we did not conduct further research or compliance testing of these loans. Of the remaining 1,460 loans, 1,435 are still insured and pose a risk to the insurance fund, as follows:

- For 102 loans having original mortgage amounts totaling \$11,108,518, HUD incurred a total loss of \$2,305,957 on 57 loans and paid \$3,194,948 in claims on 45 loans with an indeterminate loss as of July 25, 2005. HUD cannot identify the loss from the 45 loans until the associated properties are sold. These loans represent an increased risk to the insurance fund.
- The insurance was terminated without a claim on 195 of the loans, 170 of which totaling \$23,851,301 in original mortgages were streamline-refinanced to other Federal Housing Administration loans. Because these 170 loans were improperly submitted for insurance endorsement, the improper endorsement also applies to the refinanced loans. Therefore, we included these 170 loans as improperly endorsed loans. The remaining 25 loans were terminated for

reasons other than refinancing; therefore, these loans no longer represent a risk to the insurance fund.

- One thousand one hundred sixty-three loans hold active Federal Housing Administration insurance with \$139,355,542 in total original mortgage amounts.

Appendix C of this report provides details of federal requirements regarding late requests for insurance endorsement.

Further, National City signed certification letters for 630 loans it submitted for late requests for endorsement and certified that the mortgage and/or escrow accounts for these loans were current. However, the loans National City submitted to HUD for late endorsement had mortgage and/or escrow accounts that were not current at the time of submission.

### **Improvements Made to Procedures and Controls**

National City lacked adequate procedures and controls to ensure its employees followed HUD's mortgage payment requirements when submitting late requests for endorsement.

During our audit period of May 1, 2002, through April 30, 2004, National City's post closing department was responsible for submitting loans to HUD for late requests for endorsement. National City's post closing department was staffed with new and temporary employees. When processing loans for late requests for endorsement, the employees were required by National City to use a checklist. The checklist was not adequate in that it did not require the employees to ensure that the borrowers' mortgage payments met HUD's requirements regarding late requests for endorsement before they submitted the loans to HUD. Instead, the checklist required the employees to ensure the completeness of loan documents contained in National City's loan files.

In addition, National City was unable to meet the demands of the high volume of loans refinanced during 2002 and 2003. Thus, National City's employees committed more errors when processing and submitting loans for late endorsement. Although the new permanent and temporary employees received on-the-job training, they did not take time to properly read the borrowers' mortgage payment histories before they submitted the loans to HUD for late endorsement. National City also did not have an effective system for ensuring that its employees properly determined whether the loans were subject to late requests for endorsement requirements. When determining whether the loans were submitted for endorsement greater than 60 days from the date of closing,



National City's government insuring auditors were required to visually scan the closing dates of the loans and determine whether the submission dates exceeded the closing dates. The visual scanning process also resulted in the improper submission of loans for late requests for endorsement.

National City strengthened its procedures and controls over the submission of loans for late requests for endorsement based on the deficiencies it had during 2002 and 2003. Toward the end of 2003, National City enhanced its internal goal of submitting loans to HUD from 60 days to 55 days. The shorter time increased staff focus and urgency, and provided for timely transit and receipt time by HUD.

During the first quarter of 2004, National City implemented a new internal quality assurance process. In this new process, National City's government insuring auditors review the case binder, forwards it to a quality assurance auditor who does a second review and accuracy of any noted exceptions. For the new quality assurance process, National City designed and implemented new checklists for use by its government insuring auditors and the quality assurance auditors. In addition, National City also provided a refresh training course for all government insuring auditors. The training included a review of HUD's requirements.

During the third quarter of 2004, National City increased its focus on late endorsement and pay history review processes. National City established a quality control process for reviewing all Federal Housing Administration loans submitted the month before to determine if any loan was submitted with a delinquent payment. Additional training is imposed on employees who submit payment histories with delinquencies.

During the fourth quarter of 2004, National City initiated a system request to systematically check for the status of case binders before submission for endorsement. This helps National City track case binders with issues for immediate resolutions.

During the first quarter of 2005, National City's servicing department facilitated a training session on how to read and understand payment histories for all government insuring auditors involved in submitting case binders to HUD for endorsement. National City also focused on the timeliness for submitting case binders to HUD for endorsement, accuracy of documentation, and constant monitoring of employees and their work to ensure compliance with its own and HUD's requirements regarding loan endorsement.

The corrective actions taken by National City such as the strengthening of its procedures and controls over the submission of loans for late requests for endorsement should provide reasonable assurance that National City's staff follow HUD's mortgage payment requirements when submitting late requests for endorsement.

## Recommendations

We recommend that HUD's assistant secretary for housing-federal housing commissioner require National City to

- 1A. Indemnify HUD for any future losses on 529 loans (23 defaulted loans, 420 active loans with certifications that violated the Program Fraud Civil Remedies Act, and 86 active loans that violated HUD's Mortgagee Letter 2005-23) with a total mortgage value of \$63,543,359 and take other appropriate administrative actions up to and including civil money penalties.
- 1B. Reimburse HUD \$2,305,957 for the actual losses it incurred on 57 loans since the properties associated with these loans were sold.
- 1C. Reimburse HUD for any future losses from \$3,194,948 in claims paid on 45 insured loans with a total mortgage value of \$4,982,334 once the associated properties are sold.

We also recommend that HUD's assistant secretary for housing-federal housing commissioner

- 1D. Takes appropriate administrative action against National City for violating the requirements in effect at the time when it submitted 804 loans with a total mortgage value of \$99,643,484 without the proper six-month payment histories.

We recommend that HUD's associate general counsel for program enforcement

- 1E. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against National City and/or its principals for incorrectly certifying that the mortgage and/or the escrow accounts for taxes, hazard insurance premiums, and mortgage insurance premiums were current for 630 loans submitted for Federal Housing Administration insurance endorsement when the mortgage and/or escrow accounts were not current.

## SCOPE AND METHODOLOGY

---

We performed our audit work between October 2004 and June 2005. We conducted the fieldwork at National City’s Miamisburg, Ohio, and Dallas, Texas, offices and its lockbox payment-processing center located in Greenbelt, Maryland.

To achieve our objective, we relied on computer-processed and hard copy data from National City, and the data contained in HUD’s Single Family Data Warehouse. We relied on the loan payment histories provided by National City, the certifications and loan payment histories in the case binders that National City submitted to HUD, and the various dates in National City’s and HUD’s data systems, including loan-closing dates, notice of rejection dates, submission dates, resubmission dates, and endorsement dates. We assessed the reliability of computerized data, including relevant general and application controls, and found them to be adequate. We used mortgage amount and claim status from HUD’s systems for information purposes only. In addition, we interviewed HUD’s management and staff and National City’s management, staff, and lockbox payment processor. Further, we reviewed HUD’s rules, regulations, and guidance for proper submission of Federal Housing Administration loans and National City’s policies and procedures.

Using HUD’s data systems, we identified that National City originated/sponsored 171,079 Federal Housing Administration loans with closing dates from May 1, 2002, to April 30, 2004. The total mortgage value of these loans was more than \$21.6 billion. The following table depicts the adjustments made to the initial universe of 171,079 loans identified for testing. A narrative explanation follows the chart.

Description of Loans	Number of Loans	Original Mortgage Amounts
Originated and/or sponsored by National City from May 1, 2002, through April 30, 2004	171,079	\$21,620,914,242
Submitted but not endorsed	3,521	462,931,153
Submitted within 60 days of closing	87,783	11,089,341,593
Submitted within 61 to 66 days of closing	10,302	1,279,226,091
New construction	629	77,450,860
Home equity conversion	30	3,765,999
Submitted before the first payment was due	21	2,345,229
Transferred before submission	63	7,283,027
<b>Loans tested</b>	<b>68,730</b>	<b>\$8,698,570,290</b>

Of the 171,079 loans in the initial universe, we removed 3,521 loans that were originated but not endorsed, 629 new construction loans, 30 home equity conversion loans, and 21 loans that were submitted for endorsement before the first payment due date because these loans were not subject to the 60-day pre-April 2004 submission requirements.

We further limited our universe to only those loans received by HUD more than 66 days after the loans had closed. While HUD requires lenders to submit loans for endorsement within 60 days

of the loan closing and after April 12, 2004, an additional 30 days after closing, we allowed six additional days to ensure that we conservatively selected loans for further testing. We allowed six extra days because HUD's mailroom and endorsement contractor have three business days to process each loan and because any submission may be delayed in the mail for up to three days over a weekend.

As a result, for our testing purposes, we considered only those loans submitted more than 66 days after closing and returned to the lender with a notice of return. After removing the 87,783 loans submitted within 60 days after closing and the 10,302 loans that were submitted within 61 to 66 days after closing, there were 68,793 loans remaining as late requests for endorsement.

In evaluating the 68,793 loans, we identified 63 in which National City transferred the loan servicing to another lender/servicer before submission for endorsement; therefore, we also removed these loans from our testing universe. After removing the loans that were not subject to HUD's late endorsement requirements, we only tested 68,730 loans for compliance with HUD's late endorsement requirements.

The audit covered the period of May 1, 2002, through April 30, 2004. This period was adjusted as necessary. We conducted the audit in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

---

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

---

## Relevant Internal Controls

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

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our audit, we believe the following items are significant weaknesses:

- Program operations - National City did not operate its late requests for endorsements according to program requirements. National City lacked adequate procedures and controls to ensure it properly submitted late requests for endorsement (see finding).
- Compliance with laws and regulations – National City did not follow HUD’s regulation when it improperly submitted loans for insurance endorsement when the borrowers did not make six monthly consecutive timely payments subsequent to delinquency, but before submission to HUD (see finding).
- Safeguarding resources – National City improperly submitted 2,071 loans with mortgages totaling more than \$263 million for insurance endorsement when the borrowers did not make six monthly consecutive timely payments subsequent to delinquency, but before submission to HUD. The improper submission increased the risk to the Federal Housing Administration insurance fund (see finding).

## **FOLLOWUP ON PRIOR AUDITS**

---

This was the first audit of National City's late requests for endorsement by HUD's Office of Inspector General (OIG).

The last two independent auditor's reports for National City covered the years ending December 31, 2002, and December 31, 2003. Both reports resulted in no findings.

In March 2002, HUD's Quality Assurance Division performed a quality assurance review of National City. The review resulted in findings related to loan origination, underwriting, and late endorsements. All of the findings were resolved and closed.

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A			<u>\$63,543,359</u>
1B	<u>\$2,305,957</u>		
1C		<u>\$3,194,948</u>	
Totals	<u>\$2,305,957</u>	<u>\$3,194,948</u>	<u>\$63,543,359</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.



## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments



Kirkpatrick & Lockhart Nicholson Graham LLP

HUD-OIG  
OFFICE OF INSPECTOR  
GENERAL  
CHICAGO, ILLINOIS  
2005 JUL 18 AM 10:33

1800 Massachusetts Avenue, N.W.  
Suite 200  
Washington, DC 20036-1221  
202.778.9000  
Fax 202.778.9100  
www.klmg.com

RECEIVED

July 14, 2005

#### VIA FEDERAL EXPRESS

Ms. Rose Capalungan  
Assistant Regional Inspector  
General for Audit  
U.S. Department of Housing  
and Urban Development  
Office of the Inspector General  
Region V  
77 West Jackson Boulevard  
Suite 2646  
Chicago, Illinois 60604-3507

Phillip L. Schulman  
202.778.9027  
Fax: 202.778.9100  
pschulman@klmg.com

**Re: National City Mortgage Co.  
Office of the Inspector General Audit**

Dear Ms. Capalungan:

Kirkpatrick & Lockhart Nicholson Graham LLP represents National City Mortgage Co. ("NCM") in connection with the above-referenced audit by the Office of Inspector General ("OIG") of the U.S. Department of Housing and Urban Development ("HUD" or "Department"). NCM is in receipt of the OIG's draft audit report ("Report"), which contains findings based on the OIG's audit of the Company between November 2004 and June 2005, during which it examined the Company's compliance with HUD's late case endorsement request practices. Based on this review, the Report alleges that the Company submitted inaccurate case binders to HUD for Federal Housing Administration ("FHA") insurance endorsement and made incorrect certifications in certain cases. The OIG provided the Company an opportunity to submit written comments for inclusion in the final report. Enclosed please find NCM's response to the OIG's Report.

As discussed in the attached response, NCM conducted a thorough review of the loans cited in the Report. Based on this analysis, while certain inaccurate case binder submissions and incorrect certifications occurred in a small percentage of late endorsement requests, any oversights occurred as a result of high refinancing volume and the inexperienced staff it hired to accommodate its expanding business during the audit period. While the Company agrees to work with the OIG and the Department to resolve the cases in which deficiencies took place, NCM's review demonstrated that all but 1,137 of the loans cited in the Report either complied with HUD requirements at the

DC-730893 v1 0950000-0102  
BOSTON • DALLAS • HARRISBURG • LONDON • LOS ANGELES • MIAMI • NEWARK • NEW YORK • PALO ALTO • PITTSBURGH • SAN FRANCISCO • WASHINGTON



Kirkpatrick & Lockhart Nicholson Graham LLP

Ms. Rose Capalungan  
July 14, 2005  
Page 2

time of submission or are no longer subject to an FHA insurance policy. These loans do not pose a risk to the FHA Insurance Fund and, therefore, should not be included in the final report's recommendations for indemnification or reimbursement.

Furthermore, as the response points out, HUD's issuance of Mortgagee Letter 05-23 amended its late endorsement request guidelines based on an evaluation that certain late requests do not pose a risk to the FHA Insurance Fund. Based on these guidelines, in a recent OIG audit report involving another lender's late case request practices, the OIG revised its recommendations and removed loans that would comply with current FHA guidelines from its indemnification recommendation. See Audit Rpt. 2005-SE-1006 (July 5, 2005). As discussed in the Company's response, an additional 444 loans cited in the Report would comply with the Department's current guidelines. To ensure consistent audit standards and fair treatment of similarly situated FHA-approved servicers, these 444 loans also should be removed from the final report's recommendations.

In addition to requesting that the final report accurately portray the number of loans that posed a risk to the Insurance Fund, the Company also takes issue with the Report's recommendations involving civil money penalties and Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801 et seq. ("PFCRA"), penalties. As discussed in NCM's response, these recommendations are unwarranted, as they suggest an intent to circumvent HUD requirements that was not present here. As acknowledged in the Report, any inaccurate submissions or incorrect certifications resulted from human error rather than an intent to circumvent HUD's late case endorsement requirements. The Report does not allege, and there is no evidence to suggest, that the Company or any employee knowingly committed fraud or misrepresented facts to HUD. Severe sanctions such as civil money penalties and PFCRA penalties should be reserved for cases involving intentional actions. Furthermore, as noted above, under HUD's revised late request guidelines, a significant number of the loans cited in the Report would comply with the updated late request requirements. The Department indicated that such loans did not pose a risk to the Insurance Fund at the time of submission. Thus, it is unnecessary and inappropriate to recommend harsh sanctions in connection with loans that, if submitted today, would comply with HUD requirements.

Finally, the OIG has in the past issued several audit reports regarding lenders' late case endorsement practices. In fact, one such report was issued earlier this month, on July 5, 2005. None of these reports, which contain identical findings as those set forth in the Report, contained recommendations regarding PFCRA penalties. Including such a recommendation in the final report in this case will subject NCM to a different standard than other national FHA-approved servicers whose late endorsement request

Ref to OIG Evaluation

Auditee Comments



Kirkpatrick & Lockhart Nicholson Graham LLP

Ms. Rose Capalungan  
July 14, 2005  
Page 3

practices have been examined. The OIG should therefore ensure that NCM receives treatment consistent with the agency's recommendations in other cases.

In summary, the Company respectfully requests that the OIG amend its final report to accurately portray only those loans that pose a risk to the FHA Insurance Fund and remove its recommendations regarding civil money penalties and PFCRA penalties, as the inclusion of such severe recommendations in the final report will adversely affect a publicly-traded company and damage NCM's reputation.

If you have any questions, please call NCM's in-house counsel, Robert Ellis, at (937) 910-4174, or me, at (202) 778-9027. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'Phillip L. Schulman'.

Phillip L. Schulman

Enclosure

cc: Rick Smalldon, President, NCM

**National City**  
Mortgage

HUD - OIG  
OFFICE OF AUDIT  
CHICAGO, ILLINOIS

**National City Mortgage Co.**  
Corporate Headquarters  
3232 Newmark Drive  
Miamisburg, Ohio 45342  
Telephone (837) 910-3675

2005 JUL 18 AM 10:33

**Rick A. Smaldon**  
President and  
Chief Operating Officer

RECEIVED

July 15, 2005

**VIA FEDERAL EXPRESS**

Ms. Rose Capalungan  
Assistant Regional Inspector General for Audit  
U.S. Department of Housing  
and Urban Development  
Office of the Inspector General  
Region V  
77 West Jackson Boulevard  
Suite 2646  
Chicago, Illinois 60604-3507

**Re: National City Mortgage Co.  
HUD OIG Draft Audit Report**

Dear Ms. Capalungan:

National City Mortgage Co. ("NCM" or "Company") is in receipt of the Draft Audit Report ("Report"), dated July XX, 2005, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of the Inspector General ("OIG"). The Report is based on a review of NCM's procedures and practices in the submission of loans to the Department for Federal Housing Administration ("FHA") insurance endorsement. The review was conducted between November 2004 and June 2005, and it covers the period between May 1, 2002 and April 30, 2004.

The Report contains two findings, alleging that the Company improperly submitted late requests for FHA insurance endorsement to the Department and made incorrect certifications in certain late endorsement requests. Based on these findings, the Report recommends that HUD require the Company to: (1) indemnify or reimburse the Department for losses in connection with the improperly submitted loans, as well as take administrative action, including the imposition of civil money penalties in these cases; and (2) in connection with certain loans involving incorrect certifications, determine the legal sufficiency and, if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801 *et seq.* ("PFCRA").

The OIG provided the Company with an opportunity to submit written comments for inclusion in the final report. This response summarizes NCM's history and operations, including several improvements NCM has implemented in its case binder submission practices, and addresses the individual findings in the Report. We

Ms. Rose Capalungan  
July 15, 2005  
Page 2

appreciate the additional time afforded to NCM to reply to the Report, as well as this opportunity to comment on the OIG's findings and recommendations.

**I. INTRODUCTION**

NCM is a subsidiary of National City Bank of Indiana. NCM has been part of National City Corporation since 1989. Headquartered in Miamisburg, Ohio, NCM operates from 302 mortgage offices in 37 states. The Company specializes in originating residential mortgage loans through its retail, wholesale and telemarketing channels. NCM's mortgage operations originate, acquire, market and service those loans. In 2004, the Company was ranked as the ninth largest mortgage originator in the United States.

Through a predecessor company, NCM obtained FHA approval as a non-supervised mortgagee in 1955 and, in May of this year, celebrated its 50<sup>th</sup> anniversary as a participant in the FHA Program. NCM currently sponsors 114 loan correspondents, acts as an authorized agent for 331 principals, and acts as principal for 146 authorized agents. During the audit period, NCM originated \$32 billion in government-insured loans and, according to *Inside Mortgage Finance*, was the fifth largest originator of government loans from 2002 through 2004. In the first quarter of 2005, the Company originated \$1.23 billion in federally insured loans and, according to that same source, was the fourth largest originator of such financing. NCM is also one of the nation's largest servicers of FHA loans. As of March 31, 2005, the Company serviced \$27.1 billion in federally insured loans and is currently the sixth largest GNMA servicer. Under HUD's loss mitigation scoring system, the Department currently rates the Company as a Tier 1 servicer.

As a long-standing partner with the Department, the Company takes its relationship with the Department and its responsibilities under the FHA Program seriously. As one of the nation's largest FHA lenders and servicers, NCM is dedicated to working with HUD to extend credit to qualified borrowers and would never knowingly violate FHA requirements or endanger the reputation of the Company or its employees. We continuously strive to comply with applicable rules and regulations, and are committed to educating and training employees on issues regarding FHA compliance.

**II. RESPONSE TO THE FINDINGS**

As previously noted, the Report contains two findings with recommendations for action by HUD and the Departmental Enforcement Center. Upon receipt of the draft report, and throughout the OIG's audit process, the Company has performed its own stringent analysis of the loans subject to the OIG's review. Based on NCM's diligent examination, while the Company acknowledges that deficiencies existed in past late

Comment 1

Ms. Rose Capalungan  
July 15, 2005  
Page 3

case endorsement submissions, the Company believes that the Report's calculation of the number of improper late endorsement requests and incorrect certifications is inaccurate. Furthermore, NCM takes strong exception to certain of the recommendations made in the Report. Below we: (1) address each finding; (2) set forth our opposition to the OIG's recommendations regarding civil money penalties and action under PFCRA; and (3) provide a brief discussion of the significant steps NCM has taken to ensure compliance with FHA requirements regarding late case endorsement requests.

**A. Finding 1 – Late Case Endorsement Submissions**

In Finding 1, the Report alleges that, after reviewing 68,730 late case endorsement submissions made by the Company, NCM improperly submitted 2,103 late requests for FHA insurance endorsement, as the loans were either delinquent or otherwise did not meet HUD's requirements of six monthly consecutive timely payments subsequent to delinquency but before submission to HUD. The Report alleges that 1,487 of these loans represent a risk to the FHA Insurance Fund and recommends that HUD (1) require the Company to indemnify the Department in connection with any future losses on 1,399 of the loans that are active or have been streamline refinanced by NCM or another lender; (2) reimburse the Department for losses it has incurred or will incur in connection with 88 loans for which HUD has paid claims; and (3) take other appropriate administrative actions up to and including civil money penalties. NCM takes exception to the figures cited in the Report, as well as with the recommendation to impose civil money penalties in connection with these loans.

**1. Any Deficiency in Connection With the Cases Cited Was Contrary to Company Policy and Resulted From Increased Loan Volume**

As you know, HUD requires lenders to submit case binders involving a mortgage originated under the Direct Endorsement program for FHA insurance endorsement to the appropriate HUD Homeownership Center ("HOC") so that it is received within 60 days after closing. See 24 C.F.R. § 203.255(b); HUD Handbook 4165.1 REV-2, ¶ 2-2; HUD Handbook 4000.2 REV-3, ¶ 5-5(A). While HUD requires a mortgagee to submit a case binder for FHA insurance endorsement within 60 days of loan closing or funding, it permits late requests for endorsement so long as certain requirements are met. At the time the loans that are the subject of the Report were submitted for endorsement, HUD Handbook 4165.1 REV-1, ¶ 3-1 governed late case endorsement requirements.<sup>1</sup> These

<sup>1</sup> As discussed above, the Report reviewed loans originated between May 1, 2002 and April 30, 2004. While HUD amended its certification requirements for late case submissions in Mortgagee Letter 04-14, which was issued on April 12, 2004, the vast majority of the loans subject to the audit were originated

## Ref to OIG Evaluation

## Auditee Comments

Ms. Rose Capalungan  
July 15, 2005  
Page 4

guidelines provided that, when submitting a late request for insurance endorsement, a lender was required to include: (1) an explanation for the delay; (2) a certification that the escrow accounts were current and intact; (3) a certification that the lender did not provide the funds to bring a loan current; and (4) a payment ledger reflecting that all payments received, including the payment due in the month in which the lender submitted the case binder, were made within the calendar month due. See HUD Handbook 4165.1 REV-1, ¶ 3-1(B). If a payment was made outside the calendar month due, HUD required lenders to ensure that the borrower made six consecutive payments within the calendar month due before the lender could submit the loan for FHA insurance endorsement. See id.

NCM understands and appreciates that, at the time it submitted the loans subject to the OIG's review for FHA insurance endorsement, the Company was responsible for ensuring that late requests for endorsement complied with these provisions. It was the Company's policy and procedure to strictly comply with these requirements, and ensure that, if a case binder was submitted more than 60 days after closing, the loan was either current or the borrower had made six consecutive payments prior to submission and that the case binder contained all additional required documentation. The Company acknowledges, however, that a small percentage, approximately 1.65%, of the 68,730 late case endorsement requests made during the audit period did not strictly comply with these requirements.

As the Report points out, these deficiencies occurred as a result of the Company's dramatic increase in loan volume, and the concurrent staffing shortages caused by such increased volume, during an unprecedented refinancing boom in the mortgage industry. At the time NCM originated the loans cited in the Report, interest rates were lower than they had been in decades, and mortgage companies were facing great difficulty finding enough employees to handle their expanded business. In an effort to keep pace with the overwhelming paperwork that accompanied this increase, while still attempting to submit case binders for insurance endorsement on a timely basis, NCM hired a substantial number of new employees, including temporary employees. NCM assigned some of these individuals to the Company's Post Closing Department, which submits NCM's late case endorsement requests. It appears that these inexperienced employees may have inadvertently submitted case binders to the Department that did not fully comply with FHA requirements for such submissions. As discussed in detail below, NCM has since taken significant steps to ensure that all Post Closing Department employees receive training regarding FHA requirements for late endorsement requests and the Company closely monitors its operations to ensure

---

prior to the issuance of that Mortgagee Letter and, in any event, the Report's allegations concern HUD requirements that were unchanged by the amendments made in Mortgage Letter 04-14.

**Comment 2**

Ms. Rose Capalungan  
July 15, 2005  
Page 5

compliance with FHA requirements as noted in the Report. Nevertheless, the Company recognizes that increased volume and staffing shortages are not an excuse, and it is willing to take responsibility and work with the OIG and the Department to resolve any concerns with regard to the late case submissions identified in the Report that did not fully comply with FHA requirements.

**2. NCM Disagrees With the Number of Case Binders Containing Inaccuracies Cited in the Report**

While the Company recognizes that certain errors occurred in several of the cases cited in the Report, NCM takes exception to the number of loans that the Report alleges were inaccurately submitted. As stated above, Finding 1 alleges that the Company improperly submitted 2,103 late case endorsement requests during the audit period, as these loans were either delinquent at the time of submission, or the borrowers had not made six consecutive payments after a delinquency but prior to submission. Contrary to this allegation, based on NCM's review, 397 of the 2,103 loans cited were either current at the time the Company submitted the loan to HUD for insurance endorsement, or contained evidence that the borrowers had made six consecutive payments prior to submission. NCM has provided the OIG with evidence that these 397 loans complied with HUD requirements in effect at the time the Company submitted the loans to the Department. As such, indemnification in these 397 cases is unwarranted, and would reduce the number of loans cited in the Report to 1,706 loans.

Furthermore, the Report asserts that 1,487 of the 2,103 loans cited represent a risk to the FHA Insurance Fund, as these loans are actively insured, have been streamline refinanced, or have resulted in a claim to the Department. NCM respectfully disagrees with these figures. Based on the Company's review, of the 1,706 remaining loans submitted during the audit period, 538 have been paid in full and no longer represent any risk to HUD. In 15 additional cases, as the FHA insurance policy has been terminated for reasons other than refinancing, these loans also pose no risk to the Department. Moreover, of the remaining 1,153 loans (1,706 - 538 - 15 = 1,153), the Company already has agreed to indemnify 16 of these loans in connection with other matters. As 569 of the 1,706 loans no longer represent a risk to the Department, indemnification or reimbursement is unwarranted in these cases. Thus, only 1,137 loans remain.

Of the 88 loans in which the Department has paid claims, only 73 of these are relevant to the findings in the Report and are thus included in the 1,137 remaining loans. NCM complied with HUD requirements in 10 of these 88 loans, and has already agreed to indemnify the Department for an additional 5 of the loans in connection with other matters. NCM has provided the OIG with evidence to support its revised calculations under separate cover. Based on this documentation, we request that the



Ref to OIG Evaluation

Auditee Comments

Ms. Rose Capalungan  
July 15, 2005  
Page 6

OIG revise its final Report to accurately represent the status of the loans referenced therein.

**Comment 3**

Additionally, the Department recently amended its late case endorsement requirements. Under current guidelines, rather than require lenders to document a six-month consecutive pay history, HUD now expects lenders merely to certify that, at the time of late submission, no mortgage payment is currently unpaid more than 30 days. See HUD Handbook 4165.1 REV-2, ¶ 3-1; Mortgagee Letter 05-23. The Department expressly stated that its rationale for eliminating the six-month requirement was based on its assessment that the "risk at insurance endorsement is based by the status of the mortgage at the time of endorsement," rather than during any time prior to endorsement. See Mortgagee Letter 05-23. NCM's review identified 444 loans that were current at the time of submission under the amended guidelines, even though a six-month consecutive payment history may not have been present at that time.<sup>2</sup> As these 444 loans were current at the time of endorsement, and as the Department has since acknowledged that these loans therefore did not present a risk to the Insurance Fund, we believe that indemnification or reimbursement likewise would be inappropriate in these loans. We note that the OIG has agreed with this conclusion in a recent Final Audit Report involving Washington Mutual, Inc. See Audit Rpt. No. 2005-SE-1006 (July 5, 2005). In that report, the OIG adjusted its recommendations to reflect HUD's recent change in late submission guidelines and removed loans that would comply with current guidelines from its indemnification and reimbursement recommendations. Based on this recent report, 444 loans should be removed from the loans under consideration in this matter. After removal of the 444 loans from the 1,137 remaining cases, only 693 cases should be the subject of this review.

**Comment 4**

Finally, it is important to note that, in 613 of the 693 remaining cases, the borrowers have since made six consecutive payments and, had the case binders been submitted at a later date, the loans would have been eligible for FHA financing. While the Company understands and appreciates that inaccuracies may have occurred at the time of submission, these loans have since performed and no longer pose a risk to HUD. Therefore, NCM does not believe that indemnification or reimbursement is an appropriate remedy in these 613 loans.

<sup>2</sup> Please note that NCM derived the 444 loan figure by conservatively including only those loans that would have been current if the loan were submitted by the 24<sup>th</sup> day of the month, rather than by the 30<sup>th</sup> day of the month (thereby making the loan more than 30 days unpaid at the time HUD received the case binder). Under a 30-day submission timeframe, 493 of the remaining loans would comply with HUD's current late case submission requirements.

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 5**

Ms. Rose Capalungan  
July 15, 2005  
Page 7

In summary, evidence provided by NCM demonstrates that the Company in fact complied with HUD requirements at the time of submission in 397 loans and that 569 additional loans do not represent a risk to the FHA Insurance Fund. Based on this documentation, indemnification is unwarranted in these 966 cases, and the Department's figures should be reduced to 1,137 loans. Furthermore, of the remaining loans, 444 loans would have complied with current FHA guidelines for late endorsement requests. Based on HUD's recent statements regarding the absence of risk presented to the Department by these cases, as well as the OIG's recent adjustment to similar recommendations as a result of HUD's guidance, indemnification is not warranted in these cases, which reduces the loans under consideration to 693. Finally, 613 of these 693 borrowers have made six consecutive payments and eventually would have complied with HUD requirements in place at the time of case binder submission. Therefore, only 80 cases should be under consideration in connection with this review.

**Comment 6**

**3. Civil Money Penalties Would Be an Inappropriate Remedy Under the Circumstances**

Finally, in connection with the loans cited in Finding 1, the Report recommends that HUD take appropriate administrative action, including the imposition of civil money penalties. NCM disagrees that such action would be appropriate in this case because the circumstances present here do not meet the criteria HUD has set forth for imposition of such penalties.

As you know, HUD may impose civil money penalties against any mortgagee who knowingly and materially participates in one of several prohibited practices. See 24 C.F.R. § 30.35(a). "Knowing" is defined to include "having actual knowledge of or acting with deliberate ignorance of or reckless disregard for the prohibitions" in HUD regulations, and "material" is defined to mean "in some significant respect or to some significant degree." *Id.* § 30.10. Thus, a lender must intentionally violate a HUD requirement in order to be subject to civil money penalties. In determining whether to seek civil money penalties, HUD weighs a number of relevant factors including, among others, the gravity of the offense, the mortgagee's history of prior offenses, whether the actions were intentional or negligent, and whether there was any injury to the public. See *id.* § 30.80.

In this case, NCM does not believe that these factors weigh in favor of imposing civil money penalties. Importantly, as discussed above, at no time did NCM intentionally or knowingly submit late requests for endorsement in contravention of HUD requirements. Any deficient case binders resulted from a lack of understanding of HUD's late case endorsement requirements by an inexperienced and often temporary Post Closing staff, as well as the increased pressures of managing an historic peak in loan volume for the Company. The Report does not allege, and no evidence suggests,

Ms. Rose Capalungan  
July 15, 2005  
Page 8

that the Company's incorrect submissions resulted from any attempt to evade HUD requirements or ignore FHA guidelines. Furthermore, no borrower or member of the public was harmed by the less than one percent of incorrect late case requests. Finally, NCM does not have a prior history of submitting inaccurate late case endorsement documentation to the Department. Therefore, we believe that civil money penalties would be an inappropriate remedy in this case.

**B. Finding 2 – Incorrect Certifications**

In Finding 2, the Report alleges that NCM incorrectly certified that the mortgage and/or the escrow accounts for 666 of the 1,487 loans cited in the Report were current and recommends that HUD's Associate General Counsel for Program Enforcement determine the legal sufficiency of and, if sufficient, pursue remedies under the PFCRA for the incorrect certifications in these 666 cases. As discussed in detail below, NCM takes exception to both the number of cases that involved incorrect certifications, as well as the unduly harsh recommendation made in connection with this finding.

**1. NCM Believes that the Number of Incorrect Certifications Cited in the Report is Inaccurate**

As discussed above, upon receipt of the Report, the Company conducted a diligent review of the allegations and loans cited therein. Based on that review, NCM believes that the Report incorrectly included 397 loans that complied with HUD requirements at the time of case binder submission. NCM has provided the OIG with evidence that, of these 397 loans, 223 are included in the figure cited in Finding 2. As NCM complied with HUD's late request document requirements in these 223 cases, any certification made in these cases would have been accurate and complete. Therefore, these 223 loans should be removed from Finding 2. Furthermore, of the remaining cases cited in Finding 2, 61 loans have been paid in full and no longer represent a risk to the Department. Finally, pursuant to informal conversations during the review, members of the OIG's staff informed NCM that it intended to remove 55 loans from the population cited in the Report. Based on the Company's findings, an additional 284 loans (to the extent they are not included in the 55 informally referenced by OIG staff) should be deleted from the allegation in Finding 2, with only 382 loans remaining.

**2. NCM Takes Strong Exception to the Recommendation that PFCRA Penalties Are Appropriate in this Case**

As stated above, the Report recommends that HUD consider PFCRA penalties in connection with the loans cited in Finding 2. As you know, HUD is authorized to impose civil penalties under PFCRA against persons who "make, submit, or present, or cause to be made, submitted, or presented, false, fictitious, or fraudulent claims or written

Comment 7

Comment 8

Ms. Rose Capalungan  
July 15, 2005  
Page 9

statements to Federal authorities or to their agents." 24 C.F.R. § 28.1. For the reasons that follow, NCM strongly disagrees with the inclusion of such an inflammatory recommendation in this case.

a. NCM Did Not Intend to Submit Incorrect Certifications in the Cited Loans

First and foremost, NCM believes that this recommendation is unduly harsh given that the Report does not allege, and there is no evidence to suggest, that NCM or its employees intended to circumvent HUD late case endorsement requirements. As discussed in response to Finding 1 above, the certifications in these cases were not executed in an attempt to mislead the Department regarding the status of the loans at issue. Rather, any incorrect certifications resulted from inadvertent errors caused by the Company's retention of new and inexperienced staff and its efforts to timely submit case binders for FHA insurance in the midst of the mortgage industry's largest refinance boom. In fact, the Report acknowledges that these certifications were incorrect, rather than false or misleading, and agrees that the certifications resulted from volume and staffing issues rather than an intent on the part of the Company to evade HUD requirements or knowingly misrepresent facts to the Department. Furthermore, the Report alleges incorrect certifications in less than 0.5% of the 171,079 FHA loans NCM originated during the audit period. Such a low error rate does not evidence a pattern or practice of deficiency, but rather indicates inadvertent oversights in the manual case binder preparation process.

Importantly, the Report does not allege that NCM or its employees knowingly misrepresented facts to the Department or intentionally provided false information in the cases at issue. As discussed above, before imposing penalties on FHA-approved lenders, HUD weighs certain factors, including whether the deficiency was intentional or resulted from errors on the lender's part. While intentional violations or a disregard for HUD requirements can lead to severe sanction, such as PFCRA penalties, HUD usually imposes less severe consequences, such as indemnification, for deficiencies caused by unintentional error. The Report recommends such lighter sanctions in these cases, but takes its recommendations one step further by including the PFCRA recommendation in Finding 2. By adding this recommendation, the OIG effectively alleges that the Company engaged in fraud or false certifications while at the same time acknowledging that the inaccuracies in these cases resulted from human error. As a public company with a long partnership with HUD, this allegation would have an extremely detrimental effect on the Company's reputation and could create a chilling effect on other publicly-traded mortgage lenders who want to participate in the FHA Program. Enforcement actions are meant to reinforce HUD's rules and regulations, rather than discourage broad participation in FHA lending. In the interests of all parties, therefore, we believe

Ms. Rose Capalungan  
July 15, 2005  
Page 10

the OIG should reconsider its PFCRA recommendation in this case and reserve such assertions for other cases involving fraudulent actions against the Department.

We also note that, in each of the cases cited in Finding 2, the review practices of HUD's staff were also deficient. As you know, the Department conducts a pre-endorsement review on 100% of the case binders submitted for endorsement. When those case binders contain late requests for endorsement, HUD staff members review the binders to determine whether all additional documentation is included, and to ensure that the loan is current, before endorsing the loan. In each of the cases cited in Finding 2, a HUD employee reviewed the case binder documents, determined that all information was accurate and complete, and issued an FHA insurance policy. We suspect that the oversights that occurred in the Department's pre-endorsement reviews resulted from having to hire inexperienced staff to timely review the increased volume of loans being submitted for insurance endorsement during the high volume of the refinance boom. Had these individuals diligently reviewed the case binders and identified the incorrect certifications at that time, the Department could have significantly mitigated its risk in connection with these cases. While NCM acknowledges that it is ultimately the lender's responsibility to ensure that all case binder documentation is accurate and complete, we believe that this discussion demonstrates that human error occurred at both our Company and the Department in connection with the loans cited in Finding 2. Based on the fact that the Department's employees erred in each of these cases, we maintain that alleging violations under PFCRA in this matter is unduly harsh.

b. Recent Amendments to Late Case Endorsement Requirements Make the PCFCRA Recommendation Unnecessary

**Comment 9**

In addition, as stated above, the Department's current guidelines require lenders merely to certify that, at the time of late submission, no mortgage payment is currently unpaid more than 30 days, rather than to document a six-month consecutive pay history. See HUD Handbook 4165.1 REV-2, ¶ 3-1; Mortgagee Letter 05-23. HUD eliminated the six-month history requirement based on evaluation of the risk to the Department in late case requests and its determination that the "risk at insurance endorsement is based by the status of the mortgage at the time of endorsement," rather than during any time prior to endorsement. See Mortgagee Letter 05-23. As indicated above, NCM's review identified at least 444 loans that would have met the Department's current late case endorsement requirements, had those provisions been in place when NCM submitted the case binders to HUD. While the Company appreciates that it was required to comply with HUD guidelines in place at the time of submission, NCM believes that it is both unnecessary and inappropriate to recommend penalties under a statute designed to combat fraud against the government in connection with loans that,

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 10**

Ms. Rose Capalungan  
July 15, 2005  
Page 11

if submitted today, would fully comply with HUD requirements. Thus, at the very least, the Report should remove those loans that would comply with current HUD requirements from any recommendation regarding the imposition of PFCRA penalties.

c. The Recommendation Constitutes Selective Enforcement

Finally, NCM believes that it is being audited under different standards than other national lenders that the OIG determined were not in compliance with HUD's late case endorsement requirements. For instance, in recent years, the OIG has issued reports alleging that three national lenders submitted inaccurate information regarding the content of case binder documentation. See Audit Rpt. No. 2004-KC-1003 (July 16, 2004); Audit Rpt. No. 2003-KC-1004 (Jan. 17, 2003); Audit Rpt. No. 2003-KC-1001 (Oct. 2, 2002). Not one of these reports, however, recommended that the Department consider PFCRA penalties. Furthermore, in a recent audit report issued on July 5, 2005, the OIG took issue with another national lender's late case request practices, but refrained from including a recommendation that HUD consider PFCRA penalties. See Audit Rpt. No. 2005-SE-1006. NCM believes that the OIG should examine and make recommendations for national lenders based on a similar set of standards to ensure that lenders are not audited differently by different OIG offices or disadvantaged by their geographical location in one OIG jurisdiction versus another. Here, NCM believes that it is being held to a different standard than other national lenders that have raised late case endorsement concerns with the OIG. We therefore respectfully request that the OIG use its discretion in making recommendations to ensure that national lenders receive consistent treatment from the agency.

**C. Corrective Actions Taken By NCM**

Finally, while the Report alleges that the Company lacked adequate procedures and controls to ensure that it followed HUD requirements regarding late requests for insurance endorsement during the audit period, the Report acknowledges that the Company has taken significant steps to ensure that future case binder submissions made 60 days or more after loan closing fully comply with all applicable HUD guidelines and documentation requirements.

For example, in 2003, NCM improved its case binder submission goals, and currently attempts to submit FHA loans to the Department for insurance endorsement within 55, rather than 60, days from closing. This more aggressive submission schedule assisted the Company in reducing the number of late case endorsement requests it submits, and thereby reduced the volume of loans that must comply with HUD's increased late endorsement documentation and certification requirements. Furthermore, the Company has greatly enhanced its Post Closing quality control procedures to ensure that it fully complies with HUD's submission requirements.

Ms. Rose Capalungan  
July 15, 2005  
Page 12

Currently, all FHA case binders are reviewed by at least two trained and experienced Post Closing employees prior to submission to the Department. To assist these individuals in reviewing case binder documentation, NCM has created and implemented checklists that require NCM employees to review case binders for compliance with all of HUD's case binder submission provisions, including those applicable to late endorsement requests. The Company also is implementing a method to systematically check the payment status of FHA case binders prior to submission, which assists NCM in identifying case binders with issues and immediately resolving any concerns prior to submission.

Finally, NCM increased significantly its training of Post Closing Department staff to ensure compliance with FHA guidelines. In 2004, the Company provided a refresher training course for all existing Post Closing employees regarding FHA submission requirements and provides ongoing training to all new employees. Furthermore, when NCM identifies a deficiency in a case binder submission, the Company provides individualized training for the responsible individual to prevent recurrence of any oversights. We constantly monitor the Post Closing Department to ensure compliance with Company policy and FHA guidelines. Finally, earlier this year, the Company sponsored a training session regarding how to interpret payment histories for all employees responsible for FHA case binder submission. This training session also educated employees on the importance of timely and accurate case binder submission practices. These improvements have resulted in a substantial reduction in NCM's late case submission rates.

**III. CONCLUSION**

In summary, NCM's thorough review of the findings set forth in the Report indicated that, while certain inaccurate case binder submissions and incorrect certifications occurred in a small percentage of late endorsement requests, any oversights occurred as a result of high refinance volume and inexperienced staff. While the Company agrees to work with the OIG and the Department to resolve the cases in which deficiencies took place, NCM's review demonstrated that a significant number of the loans cited in the Report either complied with HUD requirements at the time of submission or do not represent an increased risk to the Department. We therefore respectfully request that the OIG revise the number of loans cited in the Report based on the figures set forth in this response and supported by evidence NCM provided during the review.

Finally, we believe that the recommendations involving civil money penalties and PFRCA penalties are unwarranted, as they suggest an intent to circumvent HUD requirements that was not present here. NCM has been a participant in the FHA Program since 1955 and is proud of its 50-year partnership with the Department. At no

Ref to OIG Evaluation

Auditee Comments

Ms. Rose Capalungan  
July 15, 2005  
Page 13

time did the Company seek to jeopardize its relationship with the Department or misrepresent information to HUD. The Department understands the difference between knowingly intending to violate FHA guidelines and human errors that result in less than full compliance. HUD has established remedies for the types of oversights identified in this instance, and such severe sanctions, especially the recommendation regarding PFCRA penalties, are not among them. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate that including these recommendations in the Report will adversely affect a publicly-traded company as well as damage our reputation. We respectfully request that the OIG revise its recommendations to fit the facts of this case.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our in-house counsel, Robert Ellis, at (937) 910-4174, or our Washington counsel, Phillip L. Schulman, at (202) 778-9027.

Thank you for your kind consideration.

Sincerely,



Rick Smalldon  
President

cc: Phillip L. Schulman, Esq.



## OIG Evaluation of Auditee Comments

<b>Comment 1</b>	<p>We commend National City for making significant control improvements to ensure it complies with HUD's late endorsement requirements.</p>
<b>Comment 2</b>	<p>National City disagreed with the number of Federal Housing Administration loans cited in our discussion draft audit report as improperly submitted for late requests for endorsement. National City provided additional documentation such as cancelled checks, payment ledgers, and other related-documents supporting its disagreement with 397 loans that were previously cited as improperly submitted for late requests for endorsement. The additional supporting documentation showed the required mortgage payments were made for 32 loans; however, the documentation did not show that the required mortgage payments were made for the remaining 365 loans. Thus, we decreased the number of Federal Housing Administration loans improperly submitted for endorsement by 32 loans (from 2,103 loans to 2,071 loans).</p> <p>In addition, we reduced the total number of loans recommended for indemnification to 529 in part due to HUD's new guidelines in Mortgagee Letter 2005-23. The reduction was made because 23 loans were in default as of July 25, 2005, 420 active loans had certifications that violated the Program Fraud Civil Remedies Act, and 86 active loans violated HUD's Mortgagee Letter 2005-23.</p>
<b>Comment 3</b>	<p>We adjusted our recommendation regarding loans for indemnification because of HUD's new Mortgagee Letter (ML-2005-23 Amended Late Request for Endorsement Procedures). However, we included a recommendation for HUD to take appropriate administrative action. During our audit, we used the applicable HUD regulations, guidelines, and other requirements when we reviewed National City's late requests for endorsement. According to 24 CFR [<i>Code of Federal Regulations</i>], part 203.255, for applications for insurance involving mortgages originated under the direct endorsement program, the lender shall submit to the secretary of HUD, within 60 days after the date of closing or the loan or such additional time as permitted by the secretary, properly completed documentation and certifications as set forth in the applicable handbook. As required by HUD's regulation, we used HUD Handbook 4165.1, REV-3, and Mortgagee Letter 2004-14 because these were applicable for reviewing loans that National City sponsored and submitted to HUD from May 1, 2002, through April 30, 2004.</p>

## OIG Evaluation of Auditee Comments

**Comment 4**

Although National City acknowledges the inaccuracies in its submission of 613 loans, National City contends that the loans had six consecutive monthly payments since the submission dates. Thus, the loans no longer pose a risk to the Federal Housing Administration insurance fund. Of this, National City does not believe that indemnification or reimbursement is an appropriate remedy for 613 loans improperly submitted. We disagree because according to 24 CFR [*Code of Federal Regulations*], part 203.255, by insuring the mortgage (or loan), the mortgagee (or lender) agrees to indemnify HUD under the conditions of section 256(c) of the National Housing Act (12 U.S. Code 1717z-21(c)). As authorized by HUD's regulations, indemnifying HUD begins when a mortgage is endorsed and not when a mortgage becomes in compliance with HUD's requirements after the endorsement date. We concluded that at endorsement, loans begin to pose a risk to the Federal Housing Administration insurance fund.

**Comment 5**

As discussed in our evaluation of National City's comments to the discussion draft report under Comment 2 above, we decreased the total number of loans that National City improperly submitted.

**Comment 6**

National City believes that our recommendation regarding civil money penalties is an inappropriate remedy. We did not change our recommendation regarding administrative actions, up to and including civil money penalties, because such a recommendation is appropriate based on the issues cited in this report. Violations of Federal Housing Administration rules are subject to administrative action, up to and including civil money penalties. The appropriateness of the civil money penalties will be determined by HUD.

**Comment 7**

We reduced the total number of incorrect certifications from 666 to 630 based upon additional documentation such as cancelled checks and other related documents showing that the receipt dates of the mortgage payments for 36 loans were earlier than the effective dates of the mortgage payments shown on National City's computer system. Therefore, this made the certifications correct that mortgage payments and/or escrow accounts were current at submission. National City had erroneously posted the mortgage payments late and therefore the payment data in its computer system did not show the correct payment receipt date.

## OIG Evaluation of Auditee Comments

### Comment 8

National City objected to the inclusion of an "inflammatory recommendation" in our discussion draft audit report. Specifically, National City objected to its being referred for administrative penalties under the Program Fraud Civil Remedies Act, 31 United States Code, section 3801 *et seq.*, arguing that enforcement-related actions are intended to reinforce HUD's rules and regulations, rather than to discourage broad participation in HUD's Federal Housing Administration lending. Our administrative penalties recommendation is not inflammatory, nor was it intended as such. Rather, it is a reasonable and appropriate recommendation based upon the volume of false certifications regarding the status of loans and currency of escrows that National City submitted to HUD for insurance endorsement.

Moreover, we disagree with National City's argument that holding mortgagees responsible for failing to abide by applicable late endorsement requirements and the falsely certifying as to the status of loans and the currency of loan escrows will "discourage broad participation in Federal Housing Administration lending". Rather, we believe that the overwhelming majority of lenders recognize the importance of Federal Housing Administration's requirements and compliance with the same, and this recommendation reinforces that understanding.

Further, National City concedes that it is fully responsible for its employees' actions, including those of its approved branch offices. Thus, we correctly conclude that National City is responsible for 630 false certifications created by those employees. Generally, direct endorsement loans must be submitted to HUD within 60 days after closing. *See* 24 CFR [*Code of Federal Regulations*], part 203.555, and HUD Handbook 4165.1, chapter 2, section 2-1. However, mortgagees may make a late request for endorsement. *See* HUD Handbook 4165.1, REV-1, chapter 3, section 3-1. HUD will evaluate the circumstances and make a determination to accept or reject such requests. A mortgage that is in default when submitted for endorsement cannot be endorsed for insurance. Thus, lenders must certify as part of the late

## OIG Evaluation of Auditee Comments

endorsement request, among other things, that the escrow accounts for taxes, hazard insurance and mortgage insurance premiums are current and intact except for disbursements which may have been made from the escrow accounts to cover payments for which the accounts were specifically established. Lenders seeking late endorsement were also required to submit a payment ledger that reflects the payments received, including the payment due date for the month in which the late endorsement is requested.

National City submitted 630 requests for late endorsement forms, which included the requisite certifications. Attached to each request document was a payment history ledger from National City. A review of the payment histories indicates that as to each of these loans either the loan was in default or at least one monthly payment had not been made or cured during the history of the mortgage. Accordingly, each of the loans was at least one payment in arrears at the time the late endorsement request was submitted by National City. Notwithstanding this fact, National City certified that the loans and/or the escrow accounts were current at the time of the requests for endorsement. The certification is a condition of eligibility for insurance endorsement, and, thus, is patently material. Further, actual knowledge of the status of the loans and escrows (for example, maintenance of the payment histories), in combination with the act of affirmatively certifying the status of the loan and escrows, demonstrates that the false certifications were intentional as opposed to inadvertent.

In addition, precedent establishes that, since the focus of a False Claim/Program Fraud Civil Remedies Act case is the conduct of the presenter/claimant, the fact that HUD may have had documentation with which it could have ascertained the falsity of the certifications made by National City is of no consequence with respect to the issue of whether it submitted false certifications.

### **Comment 9**

National City contends that 444 of the loans with incorrect certifications should be removed from this report and that our recommendation related to these incorrect certifications is unnecessary. National City's basis for its contention is that these loans now comply with HUD's new guidelines in Mortgage Letter 2005-23. We neither removed the loans from the

## OIG Evaluation of Auditee Comments

### **Comment 10**

revised 630 loans with incorrect certifications nor the related recommendation because the certifications were false.

National City states that our recommendation constitutes selective enforcement in that it believes that National City is being audited under different standards than other national lenders we determined did not comply with HUD's late endorsement requirements. National City respectfully requested that we use our discretion in making recommendations to ensure that national lenders receive consistent treatment. National City states that OIG's audit report (audit report #2005-SE-1006) on another lender cited the same late endorsement-related issues as cited in this report, but refrained from including a recommendation related to Program Fraud Civil Remedies Act. We disagree with National City's belief. We are consistent in the treatment of National City and other lenders since we have discretion when making audit recommendations. Specifically, we either refer cases to HUD related to violations of the Program Fraud Civil Remedies Act outside of our audit reports or to cite such cases with the appropriate recommendations in our audit report. In this case, we cited such cases with the appropriate recommendation in this report.

## Appendix C

### FEDERAL REQUIREMENTS

---

According to 24 CFR [*Code of Federal Regulations*], part 203.255(b), for applications for insurance involving mortgages originated under the direct endorsement program, the lender shall submit to the secretary of HUD, within 60 days after the date of closing of the loan or such additional time as permitted by the secretary, properly completed documentation and certifications.

HUD Handbook 4165.1, REV-1, “Endorsement for Insurance for Home Mortgage Programs (Single Family),” dated November 30, 1995, chapter 3, section 3-1(A), states late requests for endorsement procedures apply if

- The loan is closed after the firm commitment,
- Direct endorsement underwriter’s approval expires, and/or
- The mortgage is submitted to HUD for endorsement more than 60 days after closing. Section 3-1(B) states that a loan request for endorsement from the lender must include
  - (1) An explanation for the delay in submitting for endorsement and actions taken to prevent future delayed submissions.
  - (2) A certification that the escrow account for taxes, hazard insurance, and mortgage insurance premiums is current and intact except for disbursements which may have been made from the escrow accounts to cover payments for which the accounts were specifically established.
  - (3) A payment ledger that reflects the payments received, including the payment due for the month in which the case is submitted if the case is submitted after the 15th of the month. For example, if the case closed February 3 and the case is submitted April 16, the payment ledger must reflect receipt of the April payment even though the payment is not considered delinquent until May 1. Payments under the mortgage must not be delinquent when submitted for endorsement.
    - (a) The lender must submit a payment ledger for the entire period from the first payment due date to the date of the submission for endorsement. Each payment must be made in the calendar month due.
    - (b) If a payment is made outside the calendar month due, the lender cannot submit the case for endorsement until six consecutive payments have been made within the calendar month due.
  - (4) A certification that the lender did not provide the funds to bring the loan current or to affect the appearance of an acceptable payment history.

Mortgagee Letter 2004-14, "Late Request for Endorsement Procedures," clarifies procedures for mortgage lenders when submitting mortgage insurance case binders to the Federal Housing Administration for endorsement beyond the 60-day limit following closing. It replaces the instructions found in the section "Late Request for Endorsement," contained in chapter 3 of HUD Handbook 4165.1, REV-3.

A request for insurance is considered "late" and triggers additional documentation whenever the binder is received by HUD more than 60 days after the mortgagee loan settlement or funds disbursement, whichever is later.

If HUD returns the case binder to the lender by issuing a notice of rejection (or a subsequent notice of rejection), HUD's Homeownership Center must receive the reconsideration request for insurance endorsement within the original 60-day window or 30 days from the date of issuance of the original notice of rejection, whichever is greater.

When submitting a late request for endorsement, in addition to including a payment history or ledger, the mortgage lender is required to include a certification, signed by the representative of that lender on company letterhead, which includes the lender's complete address and telephone number. This certification must be specific to the case being submitted (i.e., identify the Federal Housing Administration case number and the name(s) of the borrower(s)) and state that

- 1) All mortgage payments due have been made by the mortgagor before or within the month due. If any payments have been made after the month due, the loan is not eligible for endorsement until six consecutive payments have been made before and/or within the calendar month due.
- 2) All escrow accounts for taxes, hazard insurance, and mortgage insurance premiums are current and intact, except for disbursements that may have been made to cover payments for which the accounts were specifically established.
- 3) The mortgage lender did not provide the funds to bring and/or keep the loan current or to bring about the appearance of an acceptable payment history.

Title 31, *United States Code*, section 3801, "Program Fraud Civil Remedies Act of 1986," provides federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy to recompense such agencies for losses resulting from such claims and statements; to permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and to deter the making, presenting, and submitting of such claims and statements in the future.