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

<u>HIGHLIGHTS</u>

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.

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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.

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	11,089341,593
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
Loans tested	<u>68,730</u>	<u>\$8,698,570,290</u>

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. 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			\$63,543,359
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>

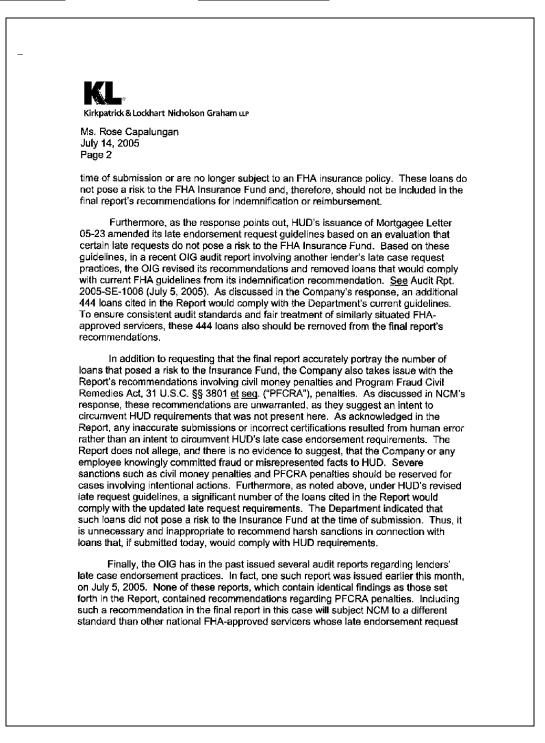
- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity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

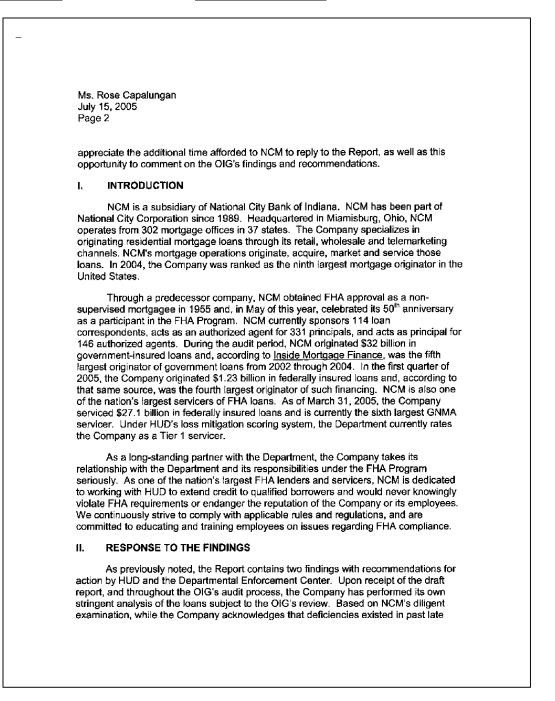
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July 14, 2005		Phillip L. Schulman 202.778.9027 Fax: 202.778.9100
VIA FEDERAL EXPR	RESS	pschulman@king.com
Ms. Rose Capalunga		
Assistant Regional In General for Audit	spector	
U.S. Department of H		
and Urban Develo Office of the Inspecto	•	
Region V 77 West Jackson Bou	levard	
Suite 2646		
Chicago, Illinois 6060	4-3507	
	Re: National City M	lortgage Co. Ispector General Audit
Dear Ms. Capalungar	1:	
Kirkpatrick & L Co. ("NCM") in conne General ("OIG") of the "Department"). NCM contains findings bass and June 2005, during case endorsement rei Company submitted in ("FHA") insurance end OIG provided the Con the final report. Enclo As discussed in	ockhart Nicholson Graham LLP rep ction with the above-referenced au e U.S. Department of Housing and is in receipt of the OIG's draft audii ed on the OIG's audit of the Compa g which it examined the Company's quest practices. Based on this revi naccurate case binders to HUD for Jorsement and made incorrect cert npany an opportunity to submit writ used please find NCM's response to n the attached response, NCM com-	dit by the Office of Inspector Urban Development ("HUD" or treport ("Report"), which any between November 2004 s compliance with HUD's late ew, the Report alleges that the Federal Housing Administration filcations in certain cases. The ten comments for inclusion in b the OIG's Report. ducted a thorough review of the
Kirkpatrick & L Co. ("NCM") in conne General ("OIG") of the "Department"). NCM contains findings bass and June 2005, during case endorsement rei Company submitted in ("FHA") insurance end OIG provided the Con the final report. Endo As discussed in loans cited in the Rep submissions and inco endorsement requests and the inexperienced audit period. While th resolve the cases in w	ockhart Nicholson Graham LLP rep ction with the above-referenced au e U.S. Department of Housing and is in receipt of the OIG's draft audit ed on the OIG's audit of the Company's gwhich it examined the Company's quest practices. Based on this revi naccurate case binders to HUD for dorsement and made incorrect cert npany an opportunity to submit writ used please find NCM's response to	dit by the Office of Inspector Urban Development ("HUD" or treport ("Report"), which any between November 2004 s compliance with HUD's late ew, the Report alleges that the Federal Housing Administration flications in certain cases. The ten comments for inclusion in the OIG's Report. ducted a thorough review of the certain inaccurate case binder high refinance volume xpanding business during the a OIG and the Department to is review demonstrated that all

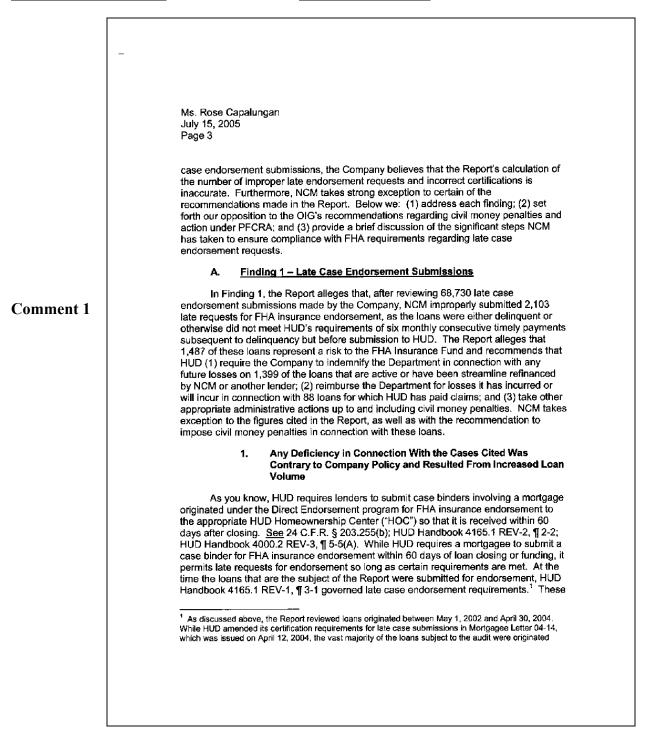


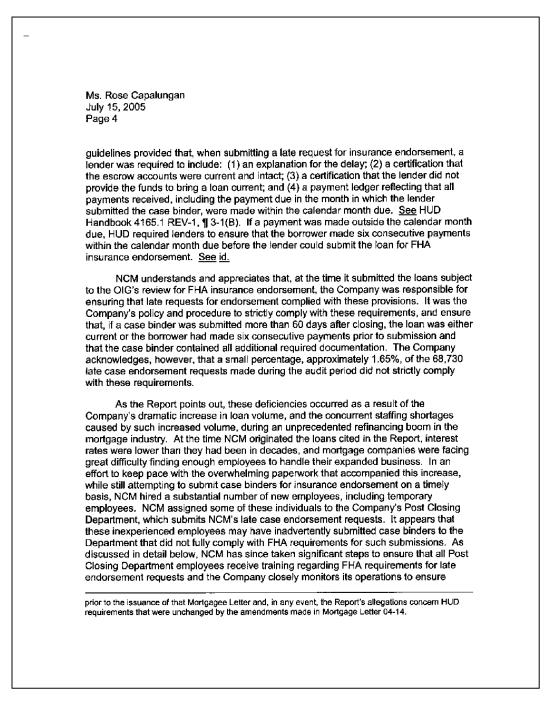
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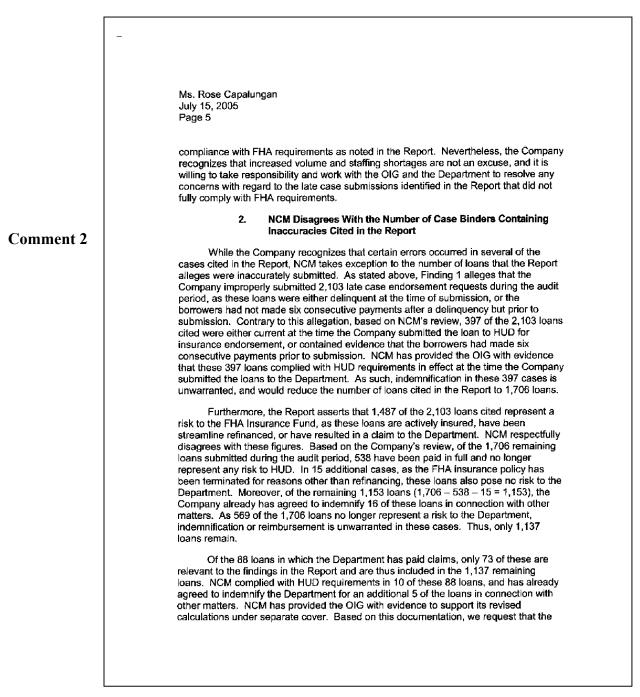
Kirkpatrick & Lockhart Nicholson Graham 🕮 Ms. Rose Capalungan July 14, 2005 Page 3 practices have been examined. The O/G should therefore ensure that NCM receives treatment consistent with the agency's recommendations in other cases. In summary, the Company respectfully requests that the OIG amend its 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, Puelip L. Or luelum Enclosure Rick Smalldon, President, NCM CC:

National City Mortgage	HUD - GIG OFFICE OF AUGU CHICAGO, PLENDIS	National City Mortgage C Corporato Headquarters 3232 Nowmark Drive Miamisburg, Ohio 45342 Telephone (937) 910-3675
	2005 JUL 1 8 AM 10: 33	Rick A. Smalldon President and
	RECEIVED	Chiel Operating Officer
	July 15, 2005	
VIA FEDERAL EXPRE	<u>SS</u>	
Assistant Regional Insp U.S. Department of Hou and Urban Developm Office of the Inspector G Region V 77 West Jackson Boule Suite 2646 Chicago, Illinois 60604-3	ising hent General vard 3507	
	Re: National City Mort HUD OIG Draft Au	
Dear Ms. Capalungan:		
Report ("Report"), dated Urban Development ("H The Report is based on of loans to the Departme endorsement. The revie	tgage Co. ("NCM" or "Company") is July XX, 2005, from the U.S. Depar UD" or "Department") Office of the Ir a review of NCM's procedures and p ent for Federal Housing Administration w was conducted between Novemb between May 1, 2002 and April 30, 2	tment of Housing and hspector General ("OIG"). practices in the submission on ("FHA") insurance er 2004 and June 2005,
submitted late requests	ins two findings, alleging that the Co for FHA insurance endorsement to the certain late endorsement requests, that HUD require the Company to: is in connection with the improperty is	he Department and made Based on these findings, (1) indemnify or reimburse submitted loans, as well as
the Department for losse take administrative actio cases; and (2) in connec determine the legal suffi	n, including the imposition of civil mo tion with certain loans involving inco ciency and, if legally sufficient, pursu nedies Act, 31 U.S.C. §§ 3801 <u>et se</u>	rrect certifications, le remedies under the
the Department for losse take administrative actio cases; and (2) in connec determine the legal suffi Program Fraud Civil Rer The OIG provideo for inclusion in the final r operations, including sev	n, including the imposition of civil mo tion with certain loans involving inco ciency and, if legally sufficient, pursu	meet certifications, re remedies under the g. ("PFCRA"). b submit written comments ICM's history and nented in its case binder

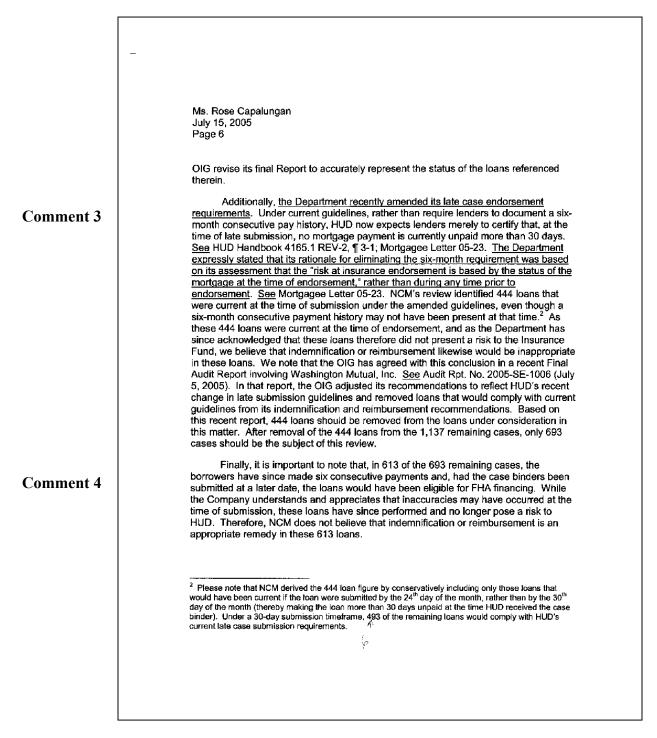






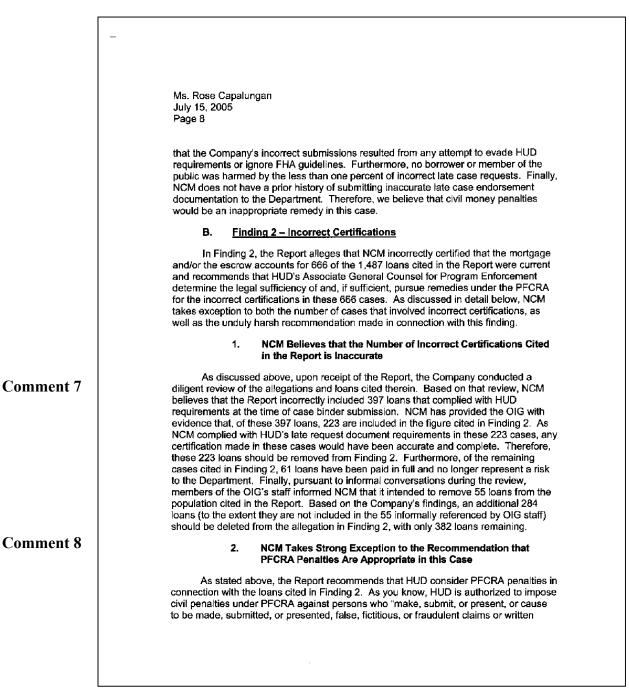


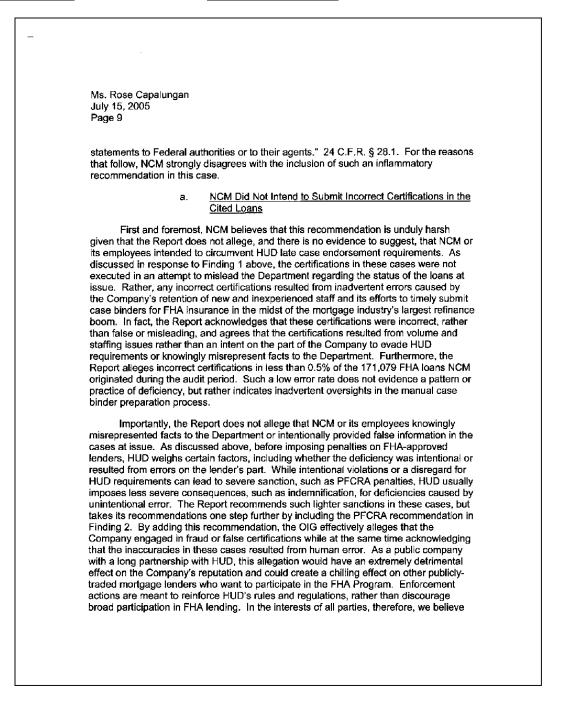
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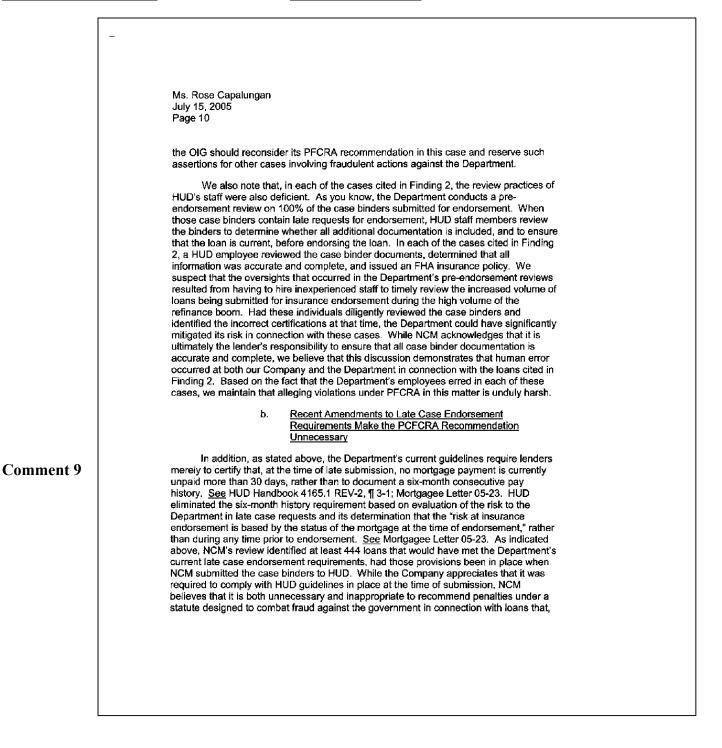


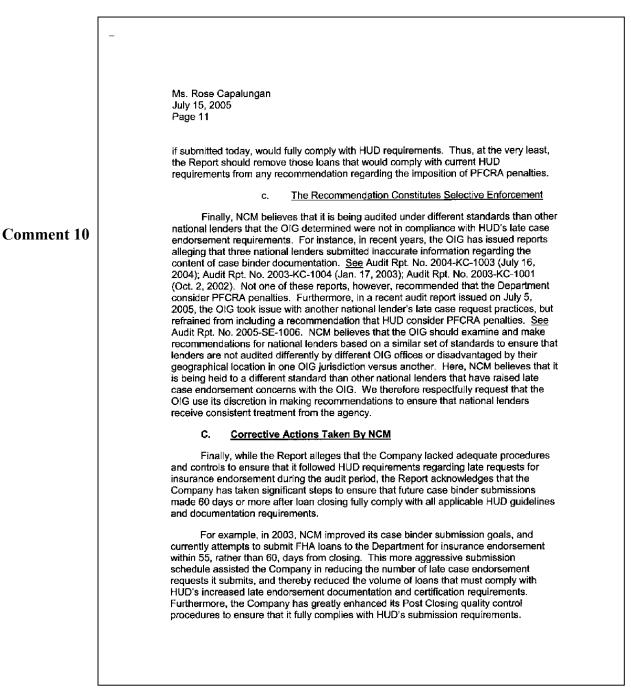
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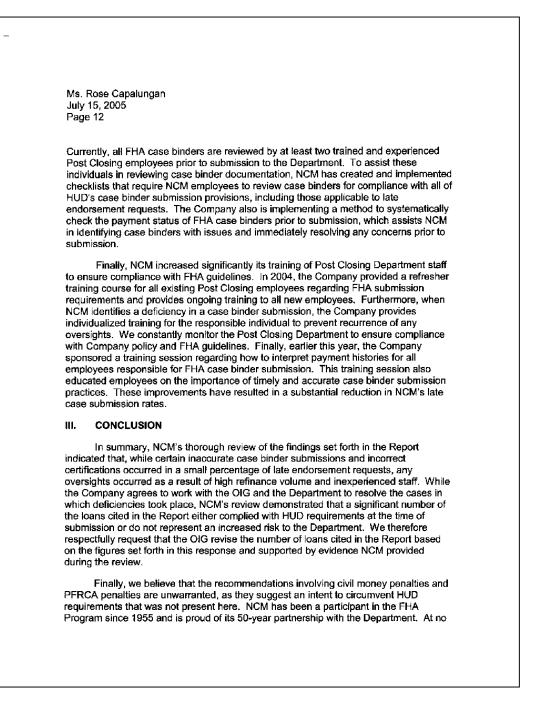
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	Ms. Rose Capalungan July 15, 2005 Page 7
Comment 5	In summary, evidence provided by NCM demonstrates that the Company in fact complied with HUD requirements at the time of submission in 397 loans and that 569 additional loans do not represent a risk 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 toans 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,



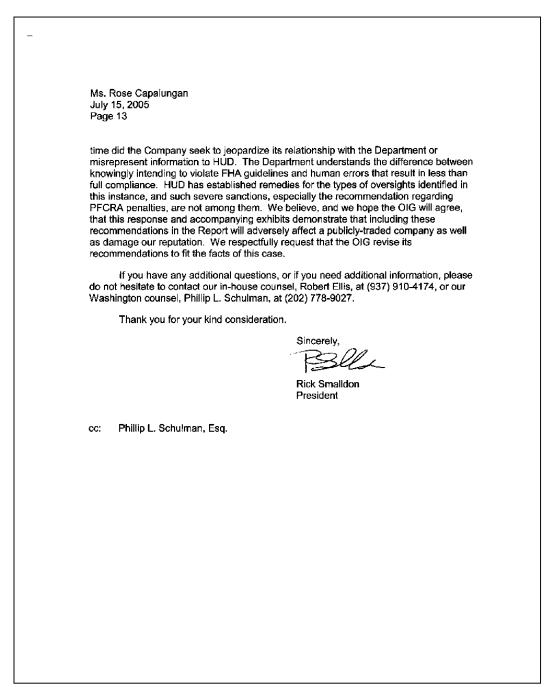








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Comment 1	We commend National City for making significant control improvements to ensure it complies with HUD's late endorsement requirements.
Comment 2	National City disagreed with the number of Federal Housing Administration loans cited in our discussion 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).
	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.
Comment 3	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.

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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 [<i>Code of Federal Regulations</i>], 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.

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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

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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 Mortgagee Letter 2005-23. We neither removed the loans from the

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

Comment 10

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.