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| Issue Date | November 29, 2004 |
| Audit Case Number | 2005-CH-1002 |

TO: John C. Weicher, Assistant Secretary for Housing-Federal Housing
Commissioner and Chairman of Mortgage Review Board, H
Margarita Maisonet, Director of Departmental Enforcement Center, CV

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

SUBJECT: Washington Mutual Bank
Underwriting of Federal Housing Administration-Insured Loans
Downers Grove, Illinois

INTRODUCTION

We audited Washington Mutual Bank (Washington Mutual), a direct endorsement mortgagee, because we identified during our audit of A-Pan-American Mortgage Group (A-Pan-American) (see Office of Inspector General (OIG) Audit Report #2004-CH-1007, issued on August 9, 2004) that Washington Mutual had a high number of loans with over-insured Federal Housing Administration (FHA) loan amounts and invalid borrowers' Social Security numbers. The audit objectives were to determine whether Washington Mutual (1) exercised due diligence in resolving or following-up on warnings regarding borrowers' Social Security numbers and (2) funded FHA-insured loans without exceeding the Department of Housing and Urban Development's (HUD) maximum insurable limits.

The audit determined that Washington Mutual did not identify and follow-up on, or resolve warnings regarding borrowers' Social Security numbers during the underwriting process for 4 of the 22 loans reviewed. We also found that Washington Mutual funded 79 of the 94 loans (84 percent) above HUD's maximum insurable limits. Our report contains six recommendations to address the issues identified in this report.

To accomplish our audit objectives, we

- Interviewed HUD's staff and one of Washington Mutual's underwriters to obtain an understanding of the underwriting processes regarding borrowers' Social Security numbers and maximum insurable amounts,

- Verified the Social Security numbers of borrowers for 16 FHA-insured loans reviewed with assistance from the Social Security Administration,
- Calculated the total maximum allowable insurance amounts for 94 loans (9 purchases and 85 refinances) that Washington Mutual underwrote for A-Pan-American from October 2000 through September 2003,
- Requested the Insurance and Underwriting Branch for HUD's Atlanta Homeownership Center to verify our calculations of the total maximum allowable insurance amounts for 15 of the 79 (19 percent) loans with over-insured loan amounts,
- Analyzed 22 of the 94 loans to determine whether Washington Mutual exercised due diligence in identifying and resolving, or following-up on warnings regarding borrowers' Social Security numbers (selection criteria for the 22 sampled loans included defaulted loans, loans terminated with claims, and loans whose borrowers had invalid Social Security numbers), and
- Reviewed and evaluated Washington Mutual's management controls at its Downers Grove, Illinois office over the underwriting process regarding borrowers' Social Security numbers and maximum insurable amounts.

We performed our audit between January and July 2004 while we were also conducting our audit of A-Pan-American.

We presented our discussion draft audit report to Washington Mutual's Senior Credit Administration Officer and HUD's staff during the audit. We held an exit conference with Washington Mutual's Senior Credit Administration Officer, Credit Portfolio Analyst, and Area Risk Manager on October 13, 2004. Washington Mutual provided written comments to the draft memorandum report on November 5, 2004 that generally disagreed with the finding, but described steps Washington Mutual took to strengthen its policies and procedures, and the plans for enhancing its management controls to ensure strict compliance with HUD's requirements. We included paraphrased excerpts of the comments with the finding. We also received on November 9, 2004 a Compact Disc containing Washington Mutual's current procedures and controls for processing and underwriting loans.

The complete text of Washington Mutual's comments is in appendix B with the exception of the attachments on the Compact Disc. We provided HUD's Director of the Atlanta Homeownership Center with a complete copy of Washington Mutual's comments with the attachments.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days, please provide us for each recommendation without a management decision, a status report on (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after the report is issued for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the review.

If you have any questions, please contact Rose Capalungan, Assistant Regional Inspector General for Audit, at (312) 353-6236 extension 2679 or me at (312) 353-7832.

SUMMARY

Washington Mutual did not identify and follow-up on, or resolve warnings on borrowers' Social Security numbers during the underwriting process for 4 of the 22 loans reviewed. We reviewed 22 of the 94 (23 percent) FHA-insured loans that Washington Mutual underwrote for A-Pan-American from October 2000 through September 2003. We also found that Washington Mutual funded 79 of the 94 (84 percent) loans reviewed above HUD's maximum insurable limits. As a result of Washington Mutual's deficient underwriting process, HUD's FHA insurance fund incurred a loss of \$62,363 on four loans. Additionally, the insurance fund remains at risk by more than \$393,000 for 32 loans.

BACKGROUND

Section 203(b)(1) of the National Housing Act, as amended, authorizes HUD to provide mortgage insurance for single-family homes. HUD must formally approve a mortgagee that originates, purchases, holds, or sells FHA-insured loans. Mortgagees must follow the statutory and regulatory requirements of the National Housing Act and HUD's instructions, guidelines, and regulations when originating insured loans. Mortgagees that do not follow these requirements are subject to administrative sanctions.

In 1990, Washington Mutual received FHA approval as a supervised mortgagee under HUD's Direct Endorsement Program, which authorized Washington Mutual to underwrite loans without HUD's prior review and approval. Under such an authorization, HUD relies upon Washington Mutual's certification and its underwriters to ensure that the loans comply with HUD's instructions, guidelines, and regulations. In 2001, Washington Mutual acquired Fleet National Bank. Fleet National Bank underwrote 39 of A-Pan-American's 79 originated loans with over-insurance amounts. Our review focused on loans that Washington Mutual, Fleet National Bank, and their branch offices underwrote for A-Pan-American in the State of Illinois from October 2000 through September 2003.

Washington Mutual is a subsidiary of Washington Mutual, Inc., which incorporated in 1889. Washington Mutual, Inc. is a publicly held company that provides financial services and products to consumer and commercial clients. As of June 30, 2004, Washington Mutual and its subsidiaries had total assets of \$278.54 billion. The company operates more than 2,400 offices throughout the United States. A 13-member board of directors governs Washington Mutual. Washington Mutual's home office is located at 1201 Third Avenue, Seattle, Washington and its Downers Grove, Illinois office is located at 3050 Highland Parkway.

FINDING

Washington Mutual Did Not Identify and Resolve, or Follow-Up on Warnings Regarding Borrowers' Social Security Numbers

Credit reports for 4 of 22 borrowers contained indicators that their Social Security numbers were invalid or did not belong to them. Washington Mutual did not exercise due diligence during its underwriting process to effectively identify and then resolve, or follow-up on warnings of

irregularities cited in the borrowers' credit reports. As a result, loans were approved based on false information causing HUD to assume unnecessary risks.

24 Code of Federal Regulations Part 203.5(c) requires mortgagees to exercise due diligence when underwriting loans. HUD Handbook 4000.4 REV-1, paragraph 2-4(c)(5), "Single Family Endorsement Program", states that mortgagees and their underwriters must maintain the ability to detect fraud and be aware of the warning signs that may indicate irregularities.

Washington Mutual did not exercise due diligence when it failed to identify and follow-up on, or resolve warnings regarding Social Security numbers of FHA loan borrowers. Although the credit reports of four borrowers had Hawk Alert warnings on the borrowers' Social Security numbers, Washington Mutual did not identify and take appropriate actions to resolve or follow up on the warnings. Washington Mutual lacked procedures and controls to ensure that its underwriters followed HUD's requirements and/or prudent lending practices regarding warnings about borrowers' Social Security numbers. The Hawk Alerts warnings indicated that one borrower had a Social Security number belonging to a deceased person, two borrowers had Social Security numbers that were not yet issued by the Social Security Administration, and another borrower had more than one Social Security number. As a result, loans were approved based on false information, thus increasing the risk to the insurance fund.

As of June 2004 for the four loans, one (\$114,187) was in foreclosure, two (\$223,314) were in default, and HUD had incurred a loss of \$43,617 on the remaining loan.

Washington Mutual Funded Insured Loans Above HUD's Maximum Insurable Mortgage Limits

Washington Mutual funded 79 of the 94 insured loans we reviewed above HUD's maximum insurable mortgage limits. This occurred because Washington Mutual included unallowable charges as part of the total loan amounts refinanced. As a result, HUD overinsured the loans by \$163,534, which caused an unnecessary risk to the insurance fund. Only the total excess insurance amounts for 36 of the 79 loans remained in question since the remaining 43 loans were no longer insured as of June 29, 2004.

Paragraph 1-12 of HUD Handbook 4155.1 REV-4 requires mortgagees to fund FHA streamline refinanced loans up to HUD's maximum insurable mortgage limits.

From October 2000 through September 2003, Washington Mutual funded 79 of the 94 streamline-refinanced loans above HUD's maximum insurable limits. Washington Mutual funded the 79 loans for a total of \$11,679,231. HUD's maximum insurable limit for the 79 loans totaled \$11,515,697; therefore, the 79 loans exceeded HUD's limit by \$163,534.

Washington Mutual over-funded the loans because it included unallowable charges as part of the total loan amounts refinanced. Such unallowable charges included commitment fees, pay-off costs, prior month's mortgage interest, late mortgage payment charges, prior year's property taxes, borrowers' credit card bills, excess cash back, and principal reduction amounts.

During our audit, we provided schedules showing the over-insured amounts for the 79 loans to HUD's Director of the Atlanta Homeownership Center, HUD's Director of the Atlanta Homeownership Center's Quality Assurance Division, and Washington Mutual's Senior Credit Administration Officer.

AUDITEE COMMENTS

Excerpts paraphrased from the comments provided by Washington Mutual on our discussion draft audit memorandum report follow. Appendix B, pages 10 to 13, contains the complete text of the comments for the finding.

Overall, Washington Mutual takes this finding very seriously. Its senior management examined the finding, and was actively involved in revising Washington Mutual's policies and procedures and implementing the appropriate remedial actions. As a mortgagee that has enjoyed a positive relationship with HUD, Washington Mutual has always been fully committed to strict compliance with HUD's requirements.

Washington Mutual generally disagrees with the finding on the issue regarding borrowers' Social Security numbers. A-Pan-American was one of Fleet Mortgage's loan originators that Washington Mutual acquired in 2001. Due to acquisitions of several institutions, Washington Mutual ended up managing record volumes and experienced an integration delay that consequently resulted in its inconsistent adherence to HUD's guidelines. Of these, Washington Mutual contends it cannot be fairly held accountable for any shortcomings regarding loans that were originated by entities and its loan originators that it acquired.

Washington Mutual is in the process of establishing consistent lending practices driven by its policies, standards, and procedures; and institutionalizing its credit and compliance culture. This includes communication of specific policies and procedures regarding allowable fees, and calculations of Upfront Mortgage Insurance Premium refunds and final loan amounts to ensure strict compliance with HUD's requirements. Also, Washington Mutual's newly established Corporate Risk Oversight Managers are tasked to manage the operations and personnel to improve loan underwriting processes and controls.

Regarding Washington Mutual's failure to effectively identify and then resolve, or follow-up on warnings of irregularities cited in the borrowers' credit reports, Washington Mutual emphasizes it was only in 2001 that security credit alerts first began to appear on credit reports. Thus at that time, Washington Mutual was in the early stages of establishing and redesigning its process controls, procedures, and standards to address and reconcile borrowers' credit report alerts. All four loans having credit report alerts were originated in 2001.

Washington Mutual's current loan processing procedures require that if an underwriter cannot resolve issues on borrowers' Social Security numbers, then the underwriter would refer the loans to Washington Mutual's centralized Risk Mitigation Division for thorough investigation of the issues. The Division subsequently would communicate the results and recommendations back to the underwriter. Additionally, Washington Mutual contracted with

AppIntel to provide scoring and fraud alert services to improve detection of invalid Social Security numbers, potential identity theft, and other types of fraud.

Regarding Washington Mutual's funding of 79 FHA loans over HUD's maximum insurable mortgage limits, Washington Mutual neither confirms nor denies that it over-funded FHA loans that resulted in an increase risk to the FHA insurance fund. Rather, Washington Mutual's current policies would assure strict compliance with HUD/FHA requirements. Also, Washington Mutual's Credit Quality Managers oversee and mentor underwriters to ensure institutionalization of consistent and compliant practices, and proactively promote Washington Mutual's credit culture.

OIG EVALUATION OF AUDITEE COMMENTS

We recognize Washington Mutual's enhancement of its underwriting procedures and controls. Although we concur with Washington Mutual's overall approach in addressing the issues and concerns raised in this report, we disagree with Washington Mutual's claim that it should not be held accountable for the loans it acquired from Fleet Mortgage in 2001. The fact that when it acquired Fleet Mortgage, Washington Mutual took over the responsibilities for the loans that Fleet Mortgage and its loan originators originated. Therefore, Washington Mutual is accountable for any shortcomings from the loans originated by Fleet Mortgage and A-Pan-American. Washington Mutual's Senior Credit Administration Officer confirmed that Washington Mutual was responsible for 30 of the 36 active, over-insured loans.

Although the security credit alerts began to appear on credit reports in 2001, Washington Mutual was subject to HUD's requirements since its approval as a supervised mortgagee in 1990. As a condition of its approval, HUD required Washington Mutual to exercise due diligence when underwriting FHA loans. If Washington Mutual exercised due diligence during the underwriting process of the loans, it should have immediately recognized the discrepancies in the borrowers' Social Security numbers as they were disclosed on the borrowers' credit reports.

We reviewed Washington Mutual's loan processing and underwriting-related procedures and controls. The procedures and controls appear adequate to ensure compliance with HUD's requirements. Specifically, Washington Mutual's

- April 2004 FHA Applicant Analysis Policy provides procedures for verifying and documenting a valid Social Security number of a loan borrower,
- July 2004 Suspicious Lending Activity Policy and Procedure Manual, Section 2, specifically provides the steps for resolving discrepancies of borrowers' Social Security numbers,
- April 2004 Policy Communications called Government Lending Announcement 04-018 details how to screen FHA loans for invalid borrowers' Social Security numbers, and
- October 2002 Policy Communications called Government Lending Announcement 02-037 provides guidelines and procedures for FHA streamline loan refinances with

appraisal reports, instructs how to calculate maximum loan amounts, and identifies which loan costs to be refinanced.

If Washington Mutual implements procedures and controls for the current policies previously mentioned, then it should help prevent the issues cited in this report from re-occurrence.

RECOMMENDATIONS

We recommend that HUD's Assistant Secretary for Housing-Federal Housing Commissioner and Chairman of the Mortgage Review Board require Washington Mutual to:

- A. Reimburse HUD \$43,617 for the actual loss incurred on one terminated loan (Case Number 137-1035745) underwritten in which the borrower had more than one Social Security number as shown on the borrower's credit report.
- B. Indemnify HUD \$337,501 against future losses from a foreclosed property associated with one loan and two defaulted loans in which the borrowers (Case Numbers 137-1035739, 137-1163520, and 137-1174619) had invalid Social Security numbers or a Social Security number belonging to a deceased person.
- C. Buy down \$56,300 for the excessive insurance amounts for the 31 active loans (\$54,905) and one loan with a claim paid, but HUD had not resold the property (\$1,395).
- D. Reimburse HUD \$18,746 for the losses incurred on four loans with over-insured loan amounts that were already sold by HUD.
- E. Implement procedures and controls to follow HUD's requirements and/or prudent lending practices regarding warnings about borrowers' Social Security numbers and maximum insurable limits.

We also recommend that HUD's Director of Departmental Enforcement Center:

- F. Seek Civil Monetary Penalties against Washington Mutual for the deficiencies cited in this report.

MANAGEMENT CONTROLS

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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

- 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 all of the relevant controls identified above during our audit of Washington Mutual's underwriting of FHA -insured loans.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Based upon our review, we believe the following items are significant weaknesses:

- Program Operations

Washington Mutual did not identify and follow-up on, or resolve warnings regarding borrowers' Social Security numbers during the underwriting process for 4 of the 22 loans reviewed and funded 79 of the 94 (84 percent) loans reviewed above HUD's maximum insurable limits (see Finding).

- Compliance with Laws and Regulations

Washington Mutual failed to identify and follow-up on, or resolve warnings regarding borrowers' Social Security numbers during the underwriting process for 4 of the 22 loans reviewed (see Finding).

- Safeguarding Resources

Washington Mutual did not identify and resolve, or follow-up on warnings regarding borrowers' Social Security numbers during the underwriting process for 4 of the 22 loans reviewed and funded 79 of the 94 (84 percent) loans reviewed above HUD's maximum insurable limits. Washington Mutual's deficient underwriting process caused HUD's insurance fund to incur a loss of \$62,363 on four loans. Additionally, the insurance fund remains at risk by more than \$393,000 for 32 loans (see Finding).

Appendix A

SCHEDULE OF QUESTIONED COSTS

| Recommendation Number | Type of Questioned Costs | |
|--------------------------|--------------------------|-----------------------|
| | Ineligible <u>1/</u> | Unsupported <u>2/</u> |
| A | \$43,617 | |
| B | | \$337,501 |
| C | | <u>56,300</u> |
| D | <u>\$18,746</u> | |
| Totals | <u>\$62,363</u> | <u>\$393,801</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 costs charged to a HUD-financed or HUD-insured program or activity, and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation, or there is a need for a legal or administrative determination on the eligibility of the costs. 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.

AUDITEE COMMENTS

Washington Mutual

*Via Electronic Mail with Hard Copy and CD
to follow via Federal Express*

November 5, 2004

Mr. Thomas Towers
Acting Regional Inspector General for
Office of Inspector General for Audit, Region V
77 W. Jackson Boulevard, Suite 2646
Chicago, IL 60604-3507

**Re: Audit Case Number 2005-CH-100X
Washington Mutual Bank, FA response to the Draft Audit Report regarding
Underwriting of Federal Housing Administration Insured Loans
Downers Grove, Illinois**

Dear Mr. Towers,

We are pleased to provide you with Washington Mutual Bank's FA ("Washington Mutual" or the "Company") response to the Office of Inspector General's draft audit report, Audit Case Number 2005-CH-100X.

Washington Mutual takes HUD's findings very seriously. The Company's senior management have examined HUD's findings and have been actively involved in revising the Company's policies and procedures, and implementing remedial actions, where appropriate. As a mortgagee that has enjoyed a positive relationship with HUD, Washington Mutual has always been committed fully to strict compliance with HUD-FHA requirements and demonstrating this through our loan origination practices.

This response addresses the individual findings in the Report and the steps taken by the Company to strengthen our current policies and procedures as well as our plans for enhancements of internal controls going forward to ensure strict compliance with HUD-FHA requirements. We appreciate the opportunity to comment on the findings contained in the Report.

Sincerely,



Ann Tierney
Senior Credit Administration Officer
Washington Mutual Bank FA
1201 Third Avenue, WMT 1140
Seattle, WA 98199

Attachment I**Washington Mutual's Response**

Washington Mutual respectfully notes that the loans subject to this review were all originated by A Pan American Mortgage. A Pan American Mortgage came to Washington Mutual as a part of the acquisition of Fleet Mortgage. The A Pan American Mortgage relationship was suspended by Washington Mutual FA in 2003 and no further production acquired. During the period of the loans that were reviewed by the OIG from 2000 to 2003, Washington Mutual acquired several institutions and like the rest of the industry was managing record volumes resulting from an extended refinance boom. This resulted in delayed integration of the acquisitions which in turn resulted in inconsistent adherence to HUD guidelines by the entities that Washington Mutual required.

Washington Mutual respectfully submits that it cannot fairly be held accountable for any shortcomings regarding loans that were originated by entities that the Company acquired.

Importantly, we have made significant progress over the last 12 to 18 months. We will have fully integrated all acquisitions in the first quarter of 2005 and are currently 98% complete in that process. We are in the process of establishing consistent lending practices driven by Washington Mutual policies, standards and procedures as well as institutionalizing Washington Mutual's credit and compliance culture. This includes communication of specific policies and procedures regarding allowable fees, calculation of Upfront MIP refunds and calculation of final loan amounts based upon allowable fees to assure strict compliance with HUD requirements. Significant progress has also been made in the endorsement process in the area of error reporting and trending. A key next step is enabling analysis of the detailed results by each Fulfillment Center and communicating those results to support identification of the root causes of any inconsistencies and implementing steps to improve performance. Our Corporate Risk Oversight (Quality Assurance) Department is also making improvements to its audit, analysis and reporting functions that will provide timely feedback to further support error reduction. Further, we now have Corporate Risk Oversight Managers established in every channel to fully engage operations management and personnel in active improvement of processes and controls.

HUD OIG Finding 1: Washington Mutual Did Not Identify and Resolve or Follow Up on Warnings Regarding Borrowers' Social Security Numbers

Credit reports for 4 of 22 borrowers contained indicators that their Social Security numbers were invalid or did not belong to them. Washington Mutual did not exercise due diligence during its underwriting process to effectively identify and then resolve, or follow up on warnings of irregularities cited in the borrowers' credit reports.

24 Code of Federal Regulations Part 203.5(c) requires mortgagees to exercise due diligence when underwriting loans. HUD Handbook 4000.4 REV-1, paragraph 2-4(c)(5), "Single Family

Endorsement Program," states that mortgagees and their underwriters must maintain the ability to detect fraud and be aware of the warning signs that may indicate irregularities.

Washington Mutual did not exercise due diligence when it failed to identify and follow up on or resolve warnings regarding Social Security numbers of FHA loan borrowers. Although the credit reports of four borrowers had Hawk Alert warnings on the borrowers' Social Security numbers, Washington Mutual did not identify and take appropriate actions to resolve or follow up on the warnings because not only the underwriters ignored the warnings but also Washington Mutual did not have controls and procedures to ensure that the underwriters followed HUD's requirements and/or prudent lending practices regarding warnings about borrowers' Social Security numbers. The Hawk Alerts warnings indicated that one borrower had a Social Security number belonging to a deceased person, two borrowers had Social Security numbers that were not yet issued by the Social Security Administration, and another borrower had more than one Social Security number. As a result, loans were approved based on false information, thus increasing the risk to the insurance fund.

As of June 2004 for the four loans, one (\$114,187) was in foreclosure, two (\$223,314) were in default, and HUD had incurred a loss of \$43,617 on the remaining loan.

Washington Mutual's Response

It is important to understand that it was only in 2001 that security credit alerts first began to appear on credit reports. During 2001, Fleet, Washington Mutual and others in the industry were in the early stages of establishing procedures and standards to address and reconcile the newly available credit report alerts and redesigning process controls. All four of the loans cited in the Report were originated in 2001.

Our Current Procedures: When a fraud alert appears on a credit report as an invalid or un-issued social security number; if the underwriter is unable to resolve the matter, the loan is referred to our centralized Risk Mitigation (fraud investigation) unit located in Jacksonville FL. An analyst in Risk Mitigation thoroughly investigates the issues and communicates results and recommendations back to the underwriter within 48 hours.

Going forward: Washington Mutual has contracted with AppIntel, a highly regarded fraud tool in the mortgage industry, to provide DISSCO scoring and fraud alert services to improve detection of invalid social security numbers, potential identity theft and other types of fraud. The initial implementation will begin in our Correspondent Lending Department in late 2004 and completion's targeted for 1Q2005. The next phase will include Wholesale and Retail Operations to be completed by 3Q2005.

HUD OIG Finding 2: Washington Mutual Funded Insured Loans Above HUD's Maximum Insurable Mortgage Limits

Washington Mutual funded 79 of the 94 insured loans we reviewed were above HUD's maximum insurable mortgage limits. This occurred because Washington Mutual included unallowable charges as part of the total loan amounts refinanced. As a result, HUD overinsured the loans by \$163,534, which caused an unnecessary risk to the insurance fund. Only the total excess insurance amounts for 36 of the 79 loans remained in question since the remaining 43 loans were no longer insured as of June 29, 2004.

Paragraph 1-12 of HUD Handbook 4155.1, REV-4, requires mortgagees to fund FHA streamline refinanced loans up to HUD's maximum insurable mortgage limits.

From October 2000 through September 2003, Washington Mutual funded 79 of the 94 streamline refinanced loans above HUD's maximum insurable limits. Washington Mutual funded the 79 loans for a total of \$11,679,231. HUD's maximum insurable limit for the 79 loans totaled \$11,515,697; therefore, the 79 loans exceeded HUD's limit by \$163,534.

Washington Mutual overfunded the loans because it included unallowable charges as part of the total loan amounts that were refinanced. Such unallowable charges included commitment fees, payoff costs, prior month's mortgage interest, late mortgage payment charges, prior year's property taxes, borrowers' credit card bills, excess cash back, and principal reduction amounts.

During our audit, we provided schedules showing the overinsured amounts for the 79 loans to HUD's Director of the Atlanta Homeownership Center, HUD's Director of the Atlanta Homeownership Center's Quality Assurance Division, and Washington Mutual's Senior Credit Administrative Officer.

Washington Mutual's Response

Attached are a number of our current policies that reflect that our effort to ensure that our loan production offices and fulfillment centers have the appropriate tools to assure strict compliance with HUD-FHA requirements. In addition, our incentive plans for the Fulfillment Centers are now quality balanced, rather than production focused. Further, Credit Quality Managers, reporting directly to Credit Risk Management, have been implemented in every Fulfillment Center, to oversee and mentor underwriters to ensure institutionalization of consistent, compliant practices, and proactively promote the Washington Mutual credit culture.

Summary

Washington Mutual has set a strong foundation for achieving operational excellence through realization of full integration. We understand the importance of complying with HUD-FHA requirements and are committed to demonstrating this understanding through our loan origination practices.