AUDIT REPORT

GUILD MORTGAGE COMPANY
DBA RESIDENTIAL MORTGAGE BANKERS
NON-SUPERVISED DIRECT ENDORSER
DOWNEY, CALIFORNIA

OFFICE OF HOUSING

2004-LA-1005

JULY 9, 2004

OFFICE OF AUDIT
PACIFIC/HAWAII REGION IX
LOS ANGELES, CALIFORNIA

audit report

Issue Date
July 9, 2004
Audit Case Number
2004-LA-1005

TO: John C. Weicher, Assistant Secretary, for Housing, Federal Housing Commissioner and Chairman, Mortgagee Review Board, H

Joan S. Hobbs

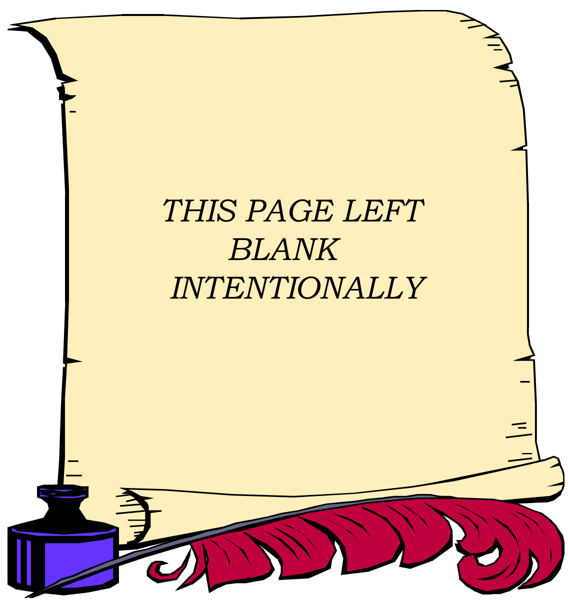
FROM: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

SUBJECT: Guild Mortgage Company
Doing Business As Residential Mortgage Bankers
Downey, California

We completed an audit of Guild Mortgage Company dba Residential Mortgage Bankers. The Guild Mortgage Company corporate office is located in San Diego, California. We selected Residential Mortgage Bankers for review because of a referral from the Santa Ana Homeownership Center's (HOC) Quality Assurance Division (QAD), to the Office of Investigation. During an on-site monitoring visit, the HUD QAD field representative identified several instances of false documents. HUD's Neighborhood Watch system also showed the branch had unusually high default and claim rates. The objectives of our review were to: (1) determine whether the mortgagee complied with HUD regulations, procedures, and instructions in the origination and underwriting of FHA insured loans selected for review; and (2) determine whether there were additional indications of irregularities or abuses.

Our report contains three findings with recommendations requiring action by your office. 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 issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Clyde Granderson, Assistant Regional Inspector General for Audit, at (415) 436-8291.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Executive Summary

We have completed an audit of the branch office of Guild Mortgage Company (GMC) doing business as (dba) Residential Mortgage Bankers (RMB) in Downey, California. The objective of our audit was to determine whether GMC approved loans in accordance with regulations and requirements of the U. S. Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices. The review covered the period between August 1, 1999, and November 30, 2002, and consisted of a review of 40 HUD/FHA insured loans that totaled $6,454,693. A summary of the results of our review is provided below.

GMC Allowed Predatory Lending Practices

GMC allowed RMB to charge loan discount points and premium rate pricing for which the interest rates were not reduced nor did the borrowers receive any value or service for the charges. We also determined a significant number of loans in our sample had some investors engaging in property flipping and the use of strawbuyers. In addition, RMB loan officers were allowed to charge excessive fees for underwriting and processing. These problems were caused by the lack of oversight on the part of GMC over the operations of RMB. Consequently, RMB FHA loan borrowers had unnecessarily high mortgage payments resulting in subsequent defaults and foreclosures.

RMB Was a Prohibited Net Branch Operation

GMC approved RMB, an independent mortgage corporation called Residential Mortgage Associates, to originate FHA mortgages without meeting HUD's application and asset requirements. This was caused because of improper GMC executive decisions when entering into branch manager agreements. As a result, this branch was a prohibited net branch office operation, was ineligible to originate FHA-insured loans, and therefore, caused increased risk to the FHA insurance funds on loans totaling over $160 million.

GMC Did Not Always Follow Prudent Lending Practices

GMC failed to establish appropriate loan processing and underwriting controls to ensure HUD requirements were followed during the loan origination process. In several instances, GMC dba RMB clearly disregarded HUD underwriting requirements and thus failed to identify and resolve questionable information and patterns in its loan origination files and approved loans that did not meet HUD requirements. GMC's lack of effective controls and its failure to use due care allowed its employees to manipulate the loan origination process and approve loans for unqualified borrowers. At least 29 of the 40 loans (72.5%) reviewed were processed and approved using falsified information. As a result, HUD and the FHA insurance fund assumed an unnecessary insurance risk and has incurred losses totaling over $811,000 on 27 of the 40 loans (67.5 percent) reviewed. In addition, GMC allowed its loan officers to be real estate agents and development company operators, which is a clear conflict of interest with their loan officer responsibilities. (See Appendices A and B)

Recommendations

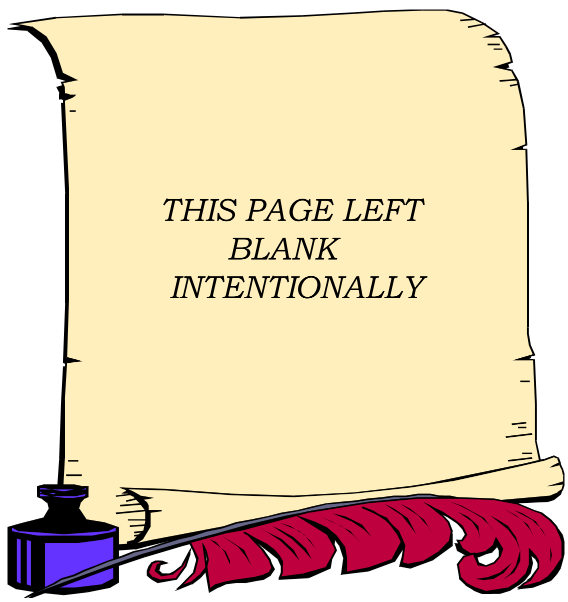
We recommend your office refer GMC to the Mortgagee Review Board (MRB) for engaging in predatory lending practices. We also recommend the MRB consider seeking civil money penalties for failure to comply with the provisions of the Real Estate Settlement Procedures Act (RESPA). GMC should also be required to establish policies and procedures to ensure its branches monitor the charges for FHA loans and do not engage in predatory lending. GMC should also be required to review and analyze all FHA-insured loans originated by the RMB branch with loan discount points where no interest rate reduction occurred and report the results to the MRB. Refunds should be made as follows:

- If the loan is current, a refund must be made to the borrowers.
- If the loan is delinquent, a refund must be applied to the delinquency.
- If a claim has been paid, a refund must be paid to HUD.

In addition you should take appropriate action against GMC for allowing RMB to be a prohibited net branch. GMC should be required to discontinue all similar net branch operations and establish policies prohibiting future net branch operations. In addition, we believe GMC should indemnify all remaining FHA loans originated by RMB.

We further recommend your office require GMC to indemnify HUD/FHA against current and future losses on all 40 loans identified in Appendix B of this report. We also recommend GMC provide your office with a corrective action plan containing assurances that all HUD/FHA guidelines regarding processing and underwriting HUD/FHA insured loans are followed.

We discussed the findings with GMC officials during the audit and at an exit conference held April 2, 2004. We also provided GMC and HUD a copy of the draft audit report for comments on April 27, 2004. GMC provided a written response on May 26, 2004. Their response and our evaluation are discussed in the findings, and the full text of their response is included at Appendix G.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Introduction

Guild Mortgage Company (GMC) has been an approved non-supervised, direct endorsement mortgagee since March 27, 1967. The company currently has 40 branches and its corporate office is located in San Diego, California. The major HUD program affecting the company is the Single Family Home Mortgage Program established under Section 203(b) of the National Housing Act. The program permits lenders that meet the requirements established by HUD to submit loans for insurance by FHA. Section 203(b), the basic home mortgage insurance program, provides for insurance on loans for single-family residences of one-to-four family structures and is the section of the Act under which most FHA loans are insured.

The vast majority of HUD/FHA loans are originated pursuant to the Direct Endorsement Program. This program provides lenders, who are specifically approved by the agency, with the authority to approve HUD/FHA insured loans without prior approval from HUD. It is the responsibility of the lender to determine whether the loan should be granted based on the information provided by the purchaser and the subsequent verification of that information conducted by the lender.

We conducted our audit of a GMC branch in Downey, California. The branch was doing business as (dba) Residential Mortgage Bankers (RMB) and was in operation between August 1999 and November 2002. The branch originated 968 FHA loans amounting to $164,390,657 during the time it was in operation. To date, HUD has incurred losses on 27 loans, totaling over $811,000.

Audit Objectives

The overall audit objective was to determine whether Guild Mortgage Company approved FHA insured loans in accordance with the HUD/FHA requirements, which require adherence to prudent lending practices. Additionally, we wanted to determine whether there were additional indications of irregularities or abuses of the loan origination process.

Audit Scope and Methodology

We performed audit work from June 2003 through November 2003. The audit covered the period August 1999 through November 2002.

The primary audit methodologies included:

- Evaluation of GMC's management and quality control structure and the assessment of risk.
- Interviews of current and prior GMC employees and Santa Ana Homeownership Center (HOC) staff in the Quality Assurance Division (QAD).

- Interviews of borrowers; escrow company employees; and individuals shown as employers, creditors, and gift fund providers on loan documents.

- Reviews of GMC, RMB branch, and FHA loan files. In addition, we reviewed selected GMC personnel files and escrow company files.

- Reviews of public records and databases.

When we began the review, we obtained information from HUD's Neighborhood Watch system that showed there were 98 defaults reported during the time RMB was in operation. Of those 98, there were 35 loans in claim status. Based on updated information, there are currently 41 loans in claim status and 122 in default.

We initially selected the 35 loans in claim status along with 15 other loans for our review. However, due to time constraints, we decreased our review to a total of 40 loans with mortgages totaling $6,454,693. The audit was conducted in accordance with generally accepted government auditing standards.

GMC ALLOWED PREDATORY LENDING PRACTICES

GMC allowed RMB to charge loan discount points and premium rate pricing for which the interest rates were not reduced nor did the borrowers receive any value or service for the charges. Many of the loans reviewed involved property flipping and/or strawbuyers. In addition, RMB loan officers were allowed to charge excessive fees for underwriting and processing. These problems were caused by the lack of oversight on the part of GMC over the operations of RMB. Consequently, RMB FHA loan borrowers had unnecessarily high mortgage payments resulting in subsequent defaults and foreclosures.

Lending Practice Rules and Policies

In April 2000, HUD/Treasury National Predatory Lending Task Force was convened. The Task Force drew its members from a large group of individuals interested in, and affected by, predatory lending, including consumer advocacy groups, industry trade associations, local and state government officials, and academics. In a report issued by the Task Force, it described predatory lending as "… engaging in deception or fraud, or taking unfair advantage of a borrower's lack of understanding of loan terms." The report further stated that "…practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices."

HUD Mortgagee Letter 94-16 Tiered Pricing Final Rule pertains to a lender's customary lending practices in regard to mortgage charge rates. In Section D, Other Comments on Mortgage Charge Rates, it states, "HUD does not agree that the law precludes review of one or more items of closing costs merely because actual payment may have been made by the seller in the particular transaction. The law applies to the mortgagee's customary lending practices, not to the terms negotiated between sellers and buyers."

HUD Handbook 4060.1, REV-1, paragraph 2-24B.3 does not allow a lender to "Pay any compensation or fee that is prohibited by the Real Estate Settlement Procedures Act (RESPA)."

24 CFR, 3500.14, Prohibition Against Kickbacks and Unearned Fees, states: "A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable" and "Any violation of this section is a violation of Section 8 of RESPA."

The Real Estate Settlement Procedures Act (RESPA) is a consumer protection statute, first passed in 1974. The purposes of RESPA are to:

- Help consumers become better shoppers for settlement services, and

- Eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services.

Section 8 of RESPA prohibits a person from giving or accepting anything of value for referrals of settlement service business related to a federally-related mortgage loan. It also prohibits a person from giving or accepting any part of a charge for services that are not performed (unearned fees).

According to Mortgagee Letter 94-7, "Premium rate mortgages, also known as "rebate pricing", permit the borrower to pay a higher interest rate in exchange for the lender paying the borrower's closing costs." If, however, a premium rate will result in excess funds exceeding closing costs and prepaids, the principal balance of the mortgage must be reduced by the overage. If the seller pays the borrower's closing costs, the lender should use the funds from a premium to fund the borrower's prepaid expenses or other remaining closing costs.

According to HUD Handbook 4060.1, paragraph 3.2B, "The mortgagee is fully responsible to HUD for the actions of its branch offices."

Predatory Lending Practices

GMC allowed RMB to employ predatory lending practices and to violate Section 8 of RESPA. We analyzed settlement charges on ten of the 40 loans reviewed. The loans closed in 2000 and involved loan amounts between $128,838 and $227,127. The settlement charges involved discount points, premium rate pricing, and miscellaneous charges for various fees, such as underwriting and processing. GMC's Corporate Office collected the settlement charges and shared these fees with RMB loan officers and Residential Mortgage Associates (RMA), the entity owned by RMB's branch managers. We determined a significant portion of the settlement charges provided no benefit to the borrowers. (See Appendix C)

Discount Points Did Not Reduce Interest Rates

In nine of the ten loans reviewed, discount points were charged. The discount points were between 1.5 and 3.5 percent of the loan amount. However, in five of the nine loans, borrowers did not receive an interest rate reduction on their loans. For example, one loan for $199,852 included 2 discount points. This amounted to a charge of $3,997.04; however, the borrower received no interest rate reduction. The only benefit derived from discount points was the additional income received by the loan officer. The loan officer received 100% of the points in addition to the one percent loan origination fee. The same scenario applied to the other four loans—the only difference involved the number of discount points charged.

Three of the nine borrowers actually received a two-year period of interest rate reduction (temporary buydown); however, in all cases, the reduction amount did not equal the charge. For instance, one loan for $172,081 included 3.5 discount points, or a charge to the seller of $6,023. The two-year buydown calculated to a savings of $4,376 in mortgage payments for the borrower. In this case, the loan officer got the difference between the amount charged, $6,023, and the mortgage payment savings, $4,376, or an unearned compensation amounting to $1,647.

Loan discount points are normally paid at closing and generally calculated as a percentage of the total loan amount. According to HUD, discount points are paid to reduce the interest rate on a loan.

GMC disguised unearned fees by calling them discount points on the HUD-1s. Although the HUD-1s showed an amount on line item 802 as Loan Discount Points, they were in actuality a charge to increase unearned compensation for GMC that was provided to its RMB loan officers. Anyone reviewing the HUD-1s, without benefit of GMC loan officer commission reports and/or price lists (rate sheets), would be unable to determine the true purpose of the hidden unearned fees (See Appendix F).

We found that loan officers routinely charged for loan discount points, performed no service for the fee, and simply kept the monies intended to lower the borrowers interest rate. In our opinion, these were unearned fees and a violation of Section 8 of RESPA.

Premium Rate Mortgages Provided No Benefit

We determined that nine of the same ten loans involved premium rate or rebate pricing. As previously stated, there is no prohibition of rebate pricing mortgages; however, the premium rate should be used to pay borrower closing costs or prepaids. In each of the nine loans reviewed, the loan officer received 100 percent of the rebate amount. Depending on the rebate percentage and the loan amount, this amounted to charges between $1,772 and $4,497.

We did not see evidence that rebate pricing was necessary, because in the majority of the cases we reviewed, the seller paid the borrowers closing costs. GMC management stated rebate pricing was negotiated between the loan officer and the buyer. However, most of the borrowers appeared to be non-English speaking, foreign-born individuals buying a home for the first time. In fact, we used a translator to interview many of the borrowers in our sample.

There were no loan principal reductions nor did the lender pay closing costs or prepaids in the loans we reviewed. We believe these to be classic examples of predatory lending.

Property Flipping and Strawbuyers

We also determined 16 of the 40 loans we reviewed involved property flips and/or strawbuyers. We believe this was an additional resource the loan officers used to obtain unearned fees since for these type loans the investors needed to resell quickly and would generally not question paying discount points. A property flip occurs when a property is bought and sold in a short time period and the seller makes a large, unjustified profit. This frequently also involves an inflated or misleading appraisal to corroborate the property value. Strawbuyers generally do not occupy the property and are used to conceal the actual buyer or investor.

For one of the loans we tested, the investor purchased the property on July 5, 2000 for $63,000 and sold it on July 20, 2000 for $137,000. This property flip resulted in an increased resale price of $74,000 in only 15 days. The borrowers defaulted after only seven payments and HUD paid a claim on the foreclosed property. For another loan we reviewed, the investor purchased the property on May 1, 2000 for $35,000 and sold it on June 6, 2000 for $138,000. This property flip resulted in an increased resale price of $103,000 in slightly over one month. The borrower defaulted after only eight payments and HUD also paid a claim on the property. (See Appendix D)

Miscellaneous Charges Were Excessive

GMC documentation in support of compensation to RMB loan officers also showed excessive charges for underwriting and processing. According to GMC management, branch managers were allowed to determine the amount to be charged for underwriting and processing of the FHA loans. At RMB, loan officers were required to charge $300 for underwriting and $395 for processing. However, if the loan officer could "get" more than that, the "overage" would go into the loan officer's commission. One loan we reviewed showed $600 charged for underwriting and $995 charged for processing; therefore, an additional $900 was added to the loan officer's commission in addition to collecting the loan origination fee.

When we discussed loan officer compensation (rebate pricing and overages for underwriting and processing) with GMC management, they stated GMC had no prohibition against the practice and did not monitor these charges. However, they did acknowledge the charges were "high."

Auditee Comments

- GMC disagreed with the finding and stated they did not allow the Downey Branch to employ predatory lending practices. GMC does agree the loans we cited "…were expensive in that they involved high interest rates and substantial points and fees."

However, GMC believes neither civil money penalties nor refunds/principal reductions are appropriate. GMC's response also states, "Although the loans were expensive, they were sub-prime loans and… therefore carried higher costs to Guild than prime loans. For this reason, as is typical in the lending industry, the borrowers received higher interest rates and fees. The borrowers understood the expenses associated with their loans, and all fees were adequately disclosed."

- The response further states "…GMC complied with applicable HUD and RESPA rules and regulations." According to GMC, RESPA is merely "…a disclosure and anti-kickback statute…." GMC continues by stating, "Guild was permitted to charge whatever discount points it deemed appropriate, and it was not required to make corresponding reductions to the interest rates."

OIG Evaluation of Auditee Comments

We disagree with Guild's justification for higher fees. Since the loans in question were FHA-insured loans, they were not and did not result in an increased credit risk to Guild as claimed. In fact, with the backing of the FHA insurance fund, Guild had minimal risk compared to the risks it would take if it had to rely solely on the properties values, as would have been the case if these had been conventional loans. FHA borrowers are required to qualify for the loans using its published requirements. FHA relies on its direct endorsement lenders to ensure this happens and based upon that reliance, FHA endorses each loan through Mortgage Insurance Certificates.

In addition, we believe GMC disguised unearned fees by calling them discount points on the HUD-1s. Although the HUD-1s showed an amount on the line item for loan discount points, they were in actuality, a charge to increase unearned compensation for the loan officers. Anyone reviewing the HUD-1s, without benefit of GMC loan officer commission reports and/or price lists (rate sheets), would be unable to determine the true purpose of the hidden unearned fees. We believe the practice of charging for services not provided (discount points) and charging higher than necessary interest rates (premium pricing), without benefits being passed on to borrowers, were predatory lending practices that took unfair advantage of first-time and minority purchasers. We consider these types of practices to be abusive, unnecessary and price gouging. Keep in mind that these borrowers were minority first time homebuyers and English was a second language for most of them.

GMC concedes borrowers paid high interest rates and the FHA loans involved substantial points and fees. However, it states "…the loans cited in the Report were an anomaly and are not representative of either the Downey Branch's loan originations or Guild's portfolio." In addition to the ten loans on Appendix C, we tested 30 additional loans originated at the RMB net branch. We found similar rates, points and fees in many of those loans and firmly believe these were neither anomalies nor coincidences. We believe these borrowers were the victims of predatory practices and regardless of GMC's claims that the loans were anomalies and not representative, they occurred and GMC is ultimately responsible.

We also disagree with GMC's claim that the audit report is not correct in concluding that discount points are paid to reduce a loan's interest rate. RESPA published a booklet a number of years ago that lenders provide to purchasers during the loan process, called Buying Your Home. A copy is also on the HUD website, and in Section III it describes specific settlement costs and where they can be found on the HUD-1. The description for loan discount under line item 802 states, "Also often called "points" or "discount points," a loan discount is a one-time charge imposed by the lender or broker to <u>lower the rate</u> (emphasis added) at which the lender or broker would otherwise offer the loan to you."

RESPA Statement of Policy 1999-1 defines a two-part test to determine whether a payment is in violation of RESPA. The first question is whether goods or facilities were actually furnished or services were actually performed for compensation paid. However, the fact that goods or facilities have been furnished or that services have been actually performed by the lender does not by itself make the payment legal. The second question is whether the payments are reasonable related to the value of the goods or services that were actually provided or performed.

Since the borrower did not receive a reduced interest rate or any other service for the discount points, this fails the first part of the test. Since the borrower did not receive any service for the discount points charged, the payments were not reasonably related to the value of the services received, i.e., there is no value for services not provided. Therefore, the payments fail part two of the two-part test. This same analogy follows for charges for premium rate or rebate pricing. Simply delivering a loan with a higher interest rate is not a compensable service.

We strongly disagree with GMC's argument that predatory lending laws are aimed only at fees charged to the borrowers, not sellers. RESPA Statement of Policy 1999-1 states, "The consumer is ultimately purchasing the total loan and is ultimately paying for all services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower." RESPA Statement of Policy 1999-1 was affirmed and further clarified in RESPA Statement of Policy 2001-1. We firmly believe all unearned fees, regardless of source, victimize borrowers and are in violation of RESPA.

Although GMC stated they complied with applicable HUD and RESPA rules and regulations, we have clearly confirmed that GMC violated 24 CFR, 3500.14, Prohibition Against Kickbacks and Unearned Fees; and therefore, HUD Handbook 4060.1 REV-1, paragraph 2-24 B.3.

GMC also stated the loan officer proceeds were overstated in two instances in Appendix C. Their assertions are inaccurate and footnotes 4 and 5 explain the computations in the Appendix.

Recommendations

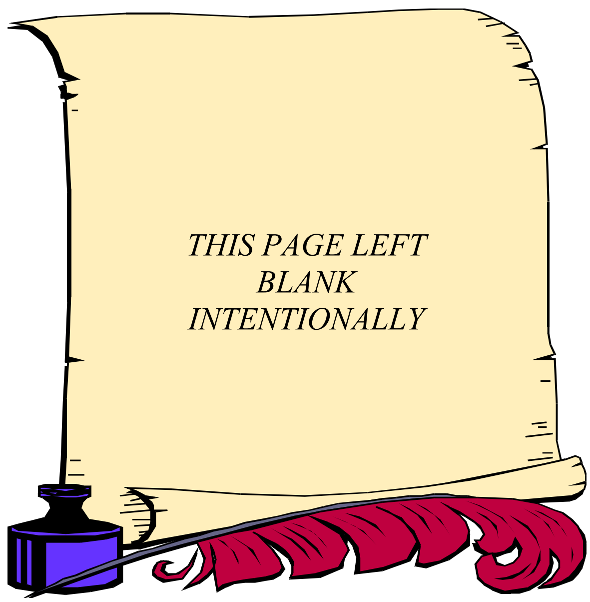
We recommend GMC be:

1A. Referred to the Mortgagee Review Board (MRB) for engaging in predatory lending practices. The MRB should also consider seeking civil money penalties for failure to comply with the provisions of RESPA.

1B. Required to establish policies and procedures to ensure its branches monitor the charges for FHA loans and to not engage in predatory lending.

1C. Required to review and analyze all FHA-insured loans generated by the RMB branch with loan discount points and/or premium rate pricing where no interest rate or principal balance reduction occurred. Report the results to the MRB. Refunds should be issued in the following order:

1. If the loan is current, a refund must be made to the borrowers.
2. If the loan is delinquent, a refund must be applied to the delinquency.
3. If a claim has been paid, a refund must be paid to HUD and sent to HUD Single Family Claims.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RMB WAS A PROHIBITED NET BRANCH

GMC approved RMB to originate FHA mortgages in violation of HUD requirements over third party loan originations. This was caused because of improper GMC executive decisions when entering into branch manager agreements. As a result, this branch was a prohibited branch office operation, was ineligible to originate FHA-insured loans, and therefore, caused increased risk to the FHA insurance funds on loans totaling over $160 million.

HUD Requirements

HUD Handbook 4060.1, REV-1, paragraph 1-2 specifies that HUD/FHA insured mortgages may only be originated, serviced, purchased, held, or sold by HUD/FHA approved mortgagees. Approved mortgagees are permitted to conduct such activities from branch offices. Mortgagee Letter 00-15 states "…separate entities may not operate as "branches" of a HUD/FHA approved mortgagee and if the separate entity lacks HUD/FHA approval, its mortgages constitute third party originations which violate Department requirements."

HUD Handbook 4060-1, paragraph 2-17 requires a HUD/FHA approved mortgagee to pay all of its operating expenses. These operating expenses include, but are not limited to, equipment, furniture, office rent, and other similar expenses incurred in operating a mortgage lending business. Mortgagee Letter 00-15 further elaborates that "…expenses paid by the branch from a personal or non-mortgagee account…is prohibited and a true branch does not exist." The Mortgagee Letter further states the following requirements in branch manager "employment agreements" are violations of "…Departmental branch requirements."

- "Contractual relationships with vendors such as leases, telephones, utilities, and advertising to be in the name of the "employee" (branch) and not in the name of the HUD/FHA approved mortgagee.

- The "employee" (branch) must indemnify the HUD/FHA approved mortgagee if it incurs damages from any apparent, express (sic), or implied agency representation by or through the "employee's" (branch's) actions."

Office Space Leases Were Executed by RMB

GMC required the Residential Mortgage Banker's branch manager, as part of the Branch Manager Agreement, to negotiate the RMB office space lease in his name. There were two agreements signed—one dated August 1, 1999 and another June 29, 2000. The agreement dated August 1, 1999 states, "Manager is responsible for negotiating the terms of the lease and executing the lease in Manager's name only. GMC will subsequently execute a month-to-month sublease at the actual rent between GMC as subtenant and Manager as landlord." In the June 29, 2000 branch manager's agreement it states, "Manager is responsible for negotiating the terms of the lease and executing the lease…".

The office lease, dated September 1, 1999, shows the landlord to be The Balco Company and the tenant as the independent mortgage corporation of Residential Mortgage Associates. This entity is owned by GMC's branch manager and is not the same entity as RMB. GMC and the two branch managers of RMB signed a sublease on September 1, 1999 for the space.

On March 1, 2001, Residential Mortgage Associates leased additional office space at the same location from The Balco Company. GMC also subleased this space as they had done in the earlier arrangement.

The Office rent for both leases was paid from personal or non-mortgagee accounts. These requirements in the GMC branch manager agreements, in our opinion, serve to maintain a clear separation between the HUD/FHA approved mortgagees and their RMB branch. This is inconsistent with the close supervisory control over all employees mandated by HUD Handbook 4060.1, REV-1, paragraph 2-13 that states, "Mortgagees are required to exercise control and responsible management supervision over their employees."

Required Indemnification

The GMC branch manager agreement contained an indemnification clause. In the August 1, 1999, agreement, it states, "Manager shall indemnify GMC against any loss or damage incurred by GMC which has resulted from Manager's gross negligence or willful or wanton actions during the term of this agreement, including but not limited to fraudulent action known to Manager or participated in by Manager in connection with any loan originated at or brokered by the branch." The June 29, 2000 agreement contains the same paragraph. This is a violation and serves as another example that RMB was a prohibited net branch.

Inadequate Control and Supervision

GMC did not always exercise adequate control and supervision over RMB employees. We interviewed the former RMB on-site underwriters and learned they both considered the two RMB branch managers their supervisors instead of the Corporate Underwriting Supervisor. A GMC internal personnel document also showed the two RMB branch managers as the supervisor of the branch on-site underwriter. However, the RMB Branch Manager Agreement clearly stated, "Managers shall have no control over the underwriting process."

GMC management believed managers could only be encouraged to perform personnel appraisals but not required. We believe this to be inconsistent with a traditional employer/employee relationship. We determined RMB branch managers rarely prepared performance appraisals for branch employees.

Auditee Comments

GMC disagrees with the finding and its recommendations. GMC states the Downey Branch was a legitimate branch office, the company paid all of its operating expenses, the indemnification provision in the branch manager agreement was permissible, and GMC exercised proper supervision and control over RMB employees. GMC concludes by stating "since the branch was legitimate and the borrowers qualified for FHA financing, therefore, indemnifications would be inappropriate."

OIG Evaluation of Auditee Comments

We believe RMB was a prohibitive net branch for all the reasons enumerated in this finding. We have documented that RMB was an existing mortgage corporation, Residential Mortgage Associates (RMA). State of California incorporation documentation shows the company was incorporated May 26, 1999. This was several months prior to the opening of the Downey Branch office. In addition, some expenses including the office leases were paid from a personal or non-mortgagee account. In this case, the leases were paid by RMA.

We also documented that a loan officer who worked in shared space at a real estate office paid half of the space rent and on more than one occasion loan officers paid for office equipment, office equipment repairs, and training. We also believe there was a lack of GMC supervisory control over the employees at RMB. This occurred, in our opinion, because this branch was a highly profitable separate entity and the relationship benefited both GMC and RMB. Taken as a whole and in accordance with the provisions of Mortgagee Letter 00-15, we still believe these issues indicate a clear separation between GMC and RMB and, therefore, GMC should be subject to the full range of HUD sanctions as recommended below.

Recommendations

We recommend GMC be required to:

2A. Sign an indemnification agreement with HUD for all remaining 938 loans (968 loans originated minus 27 loans with known losses minus 3 indemnification agreements already signed after QAD review) generated at the net branch. The total amount of the loans amounts to $159,865,833.

2B. Discontinue all similar net branch operations, immediately.

2C. Establish policies prohibiting net branch operations.

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GMC ALLOWED THE FHA LOAN PROCESS TO BE MANIPULATED

GMC failed to establish appropriate loan processing and underwriting controls to ensure HUD requirements were followed during the loan origination process. In several instances, GMC dba RMB clearly disregarded HUD underwriting requirements and thus failed to identify and resolve questionable information and patterns in its loan origination files and approved loans that did not meet HUD requirements. GMC's lack of effective controls and its failure to use due care allowed its employees to manipulate the loan origination process and approve loans for unqualified borrowers. At least 29 of the 40 loans (72.5%) reviewed were processed and approved using falsified information. As a result, HUD and the FHA insurance fund assumed an unnecessary insurance risk and has incurred losses totaling over $811,000 on 27 of the 40 loans (67.5 percent) reviewed. In addition, GMC allowed its loan officers to be real estate agents and development company operators, which is a clear conflict of interest with their loan officer responsibilities.

HUD's Loan Origination Requirements

Section 203 of the National Housing Act (12 U.S.C. 1709) states that HUD insures mortgages made by private lending institutions. Dependent upon their designation by HUD, the institutions have the authority to originate, purchase, sell, or service HUD FHA-insured mortgages.

Under HUD's Single Family Direct Endorsement Program, the mortgagee underwrites and closes the mortgage loan without prior HUD review or approval. HUD Handbook 4155.1 REV-4 CHG-1 contains the basic mortgage credit underwriting requirements for single-family (1-4 unit) mortgage loans insured under the National Housing Act.

HUD Handbook 4000.4 REV-1, CHG-2, Single Family Direct Endorsement Program, requires mortgagees to develop HUD/FHA insured loans in accordance with accepted sound lending practices, ethics, and standards. It also provides that mortgagees must obtain information with at least the same care that would be exercised if originating a mortgage when the mortgagee would be entirely dependent on the property as security to protect its investment. This would necessarily include ensuring employment verifications are properly confirmed, thoroughly reviewing all loan origination documents, and adopting and implementing a quality control plan that ensures compliance with applicable rules and regulations. In addition, HUD Form 92900-A, Addendum to the Uniform Residential Loan Application, requires the lender to certify that GMC has complied with all HUD's requirements.

HUD Handbook 4155.1, REV-4 CHG-1, Section 2-6 requires mortgagees "…verify borrower's employment for the most recent two years." HUD relies on mortgagees to obtain factual data from the borrower and to verify and analyze the information obtained.

HUD Handbook 4155.1, REV-4, Chapter 3-2C, states: "Each borrower must provide the lender with evidence of his or her social security number. While the actual social security card is not required, the social security number can be obtained from pay stubs, the driver's license, etc."

HUD Handbook 4155.1, REV-4, Chapter 3-1 states: "Verification forms must pass directly between lender and provider without being handled by any third party."

Mortgagee Letter 96-18, Section IV, Multiple Employers, states, "With the exception of receptionists, and technical staff such as appraisers and inspectors, lender employees may not work for more than one company engaged in the real estate finance business at the same time. This also includes working as a real estate agent or broker as well as originating or underwriting loans for more than one lending institution." HUD Handbook 4060.1, REV-1, paragraph 2-14, also states, "All employees of the mortgagee except receptionists, whether full time or part-time, must be employed exclusively by the mortgagee at all times, and conduct only the business affairs of the mortgagee…"

HUD Handbook 4060.1, REV-1, paragraph 2-16A provides the requirements for a mortgagee's main and branch offices. It states the mortgagee's facilities should meet the requirements in the indicated paragraphs:

- "A.3. Be located in a space that is separate and apart from any other entity.
- A.4. Be clearly identified to the public so that mortgagors will know, at all times, exactly with which business entity they are doing business.

- A.5. A mortgagee is required to have its own telephones."

We Reviewed 40 Loan Files

During our audit, we reviewed 40 loans. This review included loan origination files at GMC's corporate office and FHA loan files from the HUD Santa Ana HOC. We subsequently, learned there were RMB branch files in a storage facility in Cerritos, California. We were able to obtain and review all but four of the branch files. The other four branch files were never provided for review.

29 Loan Files Contained Falsified Information

During our review, we confirmed that 29 of 40 (72.5 percent) loans were approved based on false information. The misrepresented information included false employment, fictitious identification and alternative credit, false gift fund and explanation letters, and invalid social security numbers (SSN). The foregoing concerns are addressed below:

Employment Verifications Were Falsified

As part of the loan origination process, the potential borrower's employment must be verified. However, we determined that RMB Branch employees falsely claimed that employment information had been verified and re-verified. The re-verifications were supposedly done prior to closing but we confirmed that RMB employees falsely reported the employment was valid.

An RMB employee, generally a salaried Loan Processor or Junior Loan Processor, prepares the Request for Verification of Employment (VOE), Fannie Mae Form 1005, for each of the borrowers/co-borrowers on an FHA loan. The VOE should have been mailed to each employer in order to verify the borrower's employment, income, and potential for sustained employment. In some cases, the VOEs were faxed to the employer.

During our review, we identified 18 of the 40 (45 percent) loans with false employment information. We confirmed false employment by interviewing the owner/owner's representative, U.S. Postal Service employees, and information from the HUD Quality Assurance Division's on-site mortgagee monitoring review performed in November 2001.

For example, we interviewed the owner of a beauty salon and supply business in Huntington Park, California. The VOE indicated the owner had signed the VOE in February 2000 verifying the borrower had worked as a Receptionist for his business since 1996. When we showed the VOE to the owner, he stated it was not his signature and the borrower had never worked for him. According to a document in the loan origination file, the borrower's employment was subsequently "reverified" by RMB's loan closer prior to loan closing. Although the telephone number shown on the reverification was the actual number for the business, we concluded the reverification could not have been performed and was, therefore, a false statement since the owner stated the borrower had never worked for the business. Eight payments were made before the loan went into default and HUD subsequently incurred a loss of $70,719.

Borrowers Had Fictitious Identities

We determined five of the 40 loans contained eight instances of fictitious identifications. During our review of the loan origination and FHA files, we often found photocopies of the borrower(s) driver license. Based on the photos on the driver licenses, we determined the same individuals were using false identifications to obtain more than one FHA loan under different names.

A man and a woman, representing themselves to be a couple living together, obtained two FHA loans under different names. They each had a California driver's license with the same picture but a different license number. Both properties were eventually foreclosed and HUD incurred losses of $19,188 and $35,956 on the two properties. HUD's Neighborhood Watch System shows the first property was a 2-payment default and the second was a 1-payment default. We confirmed their employment documents were false. These loans were both originated by the same loan officer.

We also interviewed two brothers who obtained an FHA loan using false resident alien cards. The brothers stated the loan officer was aware the cards were falsified. The loan officer was also one of the RMB branch managers.

Other Documents Were Falsified

We determined 15 of 40 (37.5 percent) loans had other false documents. These documents included, but were not limited to: invalid or questionable social security numbers (SSN); false gift, credit, explanation, and relationship letters; an altered police report; and a falsified tax return.

We determined nine borrowers/co-borrowers on eight loans had questionable or invalid SSNs such as:

- SSNs were shown as issued after March 1, 1999; however, the borrowers had been using them prior to that date.

- SSNs were shown as issued prior to the borrowers' year of birth.

- An SSN was shown as unissued.

- Two SSNs were invalid based on interviews with the borrowers. Both individuals, who were brothers, admitted the SSNs were false. The brothers were borrowers on the same FHA loan.

- One co-borrower apparently used more than one SSN.

Four of the eight loans, where the borrowers had questionable or invalid SSNs, have gone to foreclosure. HUD has already incurred $71,195 in losses on these loans.

We also identified and confirmed five gift letters that were false. We interviewed the individuals identified as the donors and, in all instances the donors were not the actual source of the gift funds. We also determined relationship letters had been misrepresented. One borrower stated the co-borrower shown as his girlfriend was actually a friend of his mother's and had never been his girlfriend. She had only been added to the loan in order to help him to qualify. The co-borrower never helped with the mortgage payments and never lived at the residence.

Documents Faxed Through Interested Third Parties

During our review, we determined 15 loans contained documents relating to credit, employment or income of borrowers that were faxed from real estate companies. We confirmed that many of the pay stubs, W-2s, etc., had been falsified. These documents should not have been accepted and the loans should not have been submitted for endorsement until documents that had not passed through interested third parties had been obtained and re-verified. For these 15 loans, we identified seven RMB loan officers (including one of the branch managers) were involved in the loan originations.

Sales Contracts were not in the files

We determined that 13 of the 40 loans reviewed did not have a sales agreement in the file submitted to HUD for endorsement. These loans involved "for sale by owner" transactions. HUD Handbook 4155.1, REV-4, Chapter 3, paragraph 3-1 states, "The documents described below are typically required for mortgage credit analysis in all transactions except certain streamline refinances." Paragraph 3-1H continues: "Sales contract, and any amendments of other agreements and certifications."

We further determined in all 13 loans, the seller was an investor or strawbuyer. Strawbuyers generally do not occupy the properties and are often used to conceal the actual buyer or investor.

We reviewed public records and determined some of the investors had business connections with at least one RMB employee. These connections included working for the same real estate company or jointly investing in real estate. One investor, who was a partner in at least one property investment with an RMB loan officer, was involved in 6 of the 13 loans. He was the seller in three of the loans and received large unexplained payouts at closing in the remaining three loans. On one loan, the payout was over $140,000.

GMC Employee Conflicts of Interest

GMC allowed RMB to hire a licensed real estate agent as a loan officer. According to GMC personnel records, the loan officer/real estate agent was in GMC's employ between December 16, 2000, and December 14, 2001. The personnel records also show he was married to another GMC loan officer. According to loan origination files for one FHA loan, the loan officer/real estate agent was shown as the listing broker and agent (broker representing seller) on various documents including the sales contract. The real estate agent/loan officer signed the sales contract as real estate agent broker (listing firm). He also signed the Agent's Inspection Disclosure as agent (broker representing seller) on March 21, 2001. This loan also involved false employment documents. The real estate company received a $15,540 for commission on the sale. The loan officer's wife received a $5,192 commission for originating this loan.

On another FHA loan, the same loan officer/real estate agent was not shown as an agent on the sales contract. However, he received $6,632 as a real estate commission.

According to public records, another GMC loan officer operated a development company out of the RMB office. The business address of the development company was identical to the RMB office. The loan officer originated two FHA loans where the seller was a non-profit organization; however, his development company received $29,962 in sales proceeds on one loan and $33,378 on the other. According to escrow company records, the non-profit seller received $100 on the first loan and nothing for the second. We believe the non-profit was acting as a strawbuyer on behalf of the loan officer. This same loan officer earned commissions totaling $275,162 during the same year.

Leased Space was Located Inside a Real Estate Company

GMC approved a lease for workspace for one loan officer within a real estate company. The space was categorized as a workstation in the real estate office. The lease shows that there was a telephone answered by the real estate office receptionist. This was clearly in violation of HUD requirements.

See Appendix B for a summary of all deficiencies.

Auditee Comments

GMC disagreed with this finding and its recommendations. GMC believed it had not allowed the FHA loan process to be manipulated and continuously had controls in place to monitor loan origination, processing, and underwriting. GMC also stated it took swift action, including firing one of the RMB loan officers (July 2001) in connection with concerns raised about the Downey Branch. It further states it should not be held responsible for the alleged deficiencies and indemnifications were inappropriate. In summary, GMC stated it neither knew nor should have known:

- There was false information in the files.
- Some transactions may have involved property flipping and/or strawbuyers.
- There were any conflicts of interest.

OIG Evaluation of Auditee Comments

We believe this report clearly shows that GMC's controls over RMB loan oringination, processing and underwriting were inadequate and allowed the approval of loans based upon misrepresented and inaccurate information. We confirmed, during site visits and interviews with borrowers and employers, employment and income information used for qualifying the borowers was false.

As early as January 2000, GMC performed quality control early payment default reviews showing indications of misrepresented information. The review stated it appeared "…the $4,000 gift letter was misrepresented." One review dated in July 2000 stated it appeared "…employment, VOE, Paystubs and W-2's have been misrepresented. The Social Security number for the borrower was issued between 1999-2000. The 1998 W-2 statement uses the SSN."

In November 2001, HUD's Quality Assurance Division (QAD) performed a monitoring review of RMB. In its report dated January 14, 2002, QAD also cited GMC for failing to resolve false or conflicting information when originating HUD/FHA loans and obtaining FHA mortgage insurance. In fact , our review was initiated after a referral from QAD due to concerns they had resulting from their monitoring review.

We believe false and/or questionable information should have been detected by RMB employees such as loan processors, loan closers, and underwriters. In fact, we confirmed multiple instances where the RMB loan closer falsely claimed, in written statements in the loan files, that she had re-verified what we determined to be false employment. We visited a number of employers who confirmed the so called re-verified employment did not occur and the alleged employees did not work for them. When we interviewed former loan processors they reported verifications of employment sometimes "appeared" in the files or the in-box. It is abundantly clear RMB employees both knew of the false information and file deficiencies. Although GMC stated it "…took steps to terminate potentially responsible individuals", only one RMB employee was terminated and the others voluntarily resigned. In fact, after the Branch Managers and their staff resigned from GMC, they remained in the same location in Downey, CA and now operate under a different lender name.

We also determined through interviews with GMC officials that they were aware several appraisers who did appraisals for RMB were not doing a good job. In fact, GMC actually removed four appraisers from their approved panel. When QAD performed its review of RMB, the report cited four loans with appraisal deficiencies, including two appraisers removed from the Guild panel. During our review, we determined that 12 of 40 loans (30 percent) we reviewed had appraisals performed by appraisers subsequently removed from the panel. In addition, all 12 of these loans involved property flipping.

We obtained conclusive documentation from GMC loan files regarding the conflicts of interest with RMB employees. Although GMC stated "…it is not even certain…" one of their loan officers was considered an employee when the loans cited in the report were originated, we verified the GMC list of RMB employees and compared the property sale and closing dates. We documented that while a bona fide employee for GMC, the loan officer also was working for a real estate company and received a real estate commission on at least one of the loans.

Although GMCstated that they complied with applicable rules and regulations, our report cites many examples of non-compliance with HUD Handbooks and Martgagee Letters.

During our review, we confirmed GMC's controls over RMB loan oringination, processing and underwriting process were inadequate and allowed the approval of loans based upon misrepresented and inaccurate information. GMC is responsible and should be accountable; therefore, we believe the findings and recommendations are appropriate.

Recommendations

We recommend your office require GMC to:

3A. Indemnify HUD in the amount of $811,843 for losses incurred on foreclosed properties.
(See Appendix A)

3B. Provide your office with a corrective action plan to ensure that all HUD/FHA loan origination and underwriting guidelines are followed by its staff.

Management Controls

In planning and performing our audit, we considered the management controls of Guild Mortgage Company in order to determine our auditing procedures, not to provide assurance on the 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 its business operations. They include the systems for measuring, reporting and monitoring business performance.

Relevant Management Controls

We determined the following management controls were relevant to our audit 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 used during the mortgage loan origination process.

- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure that its loan origination process is carried out in accordance with applicable laws and regulations.

We assessed both of the relevant controls identified above.

Significant Weaknesses

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

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

- GMC provided inadequate supervision to the Downey Branch and did not ensure FHA loans were processed in compliance with HUD rules and regulations. In addition, GMC's inadequate oversight of the Downey Branch allowed unearned fees, which were not beneficial to the mortgagor.

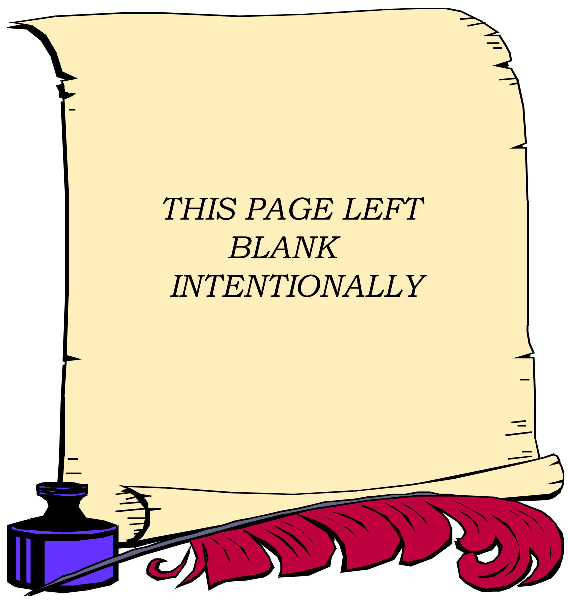
- GMC entered into sublease agreements with RMB, which resulted in an unauthorized net branch that was allowed to process high-risk FHA loans. In addition, manager agreements relieved GMC of any liability incurred by the net branch for processing high risks loans.

- GMC's management policies and procedures were inadequate to ensure valid and reliable data was obtained during the loan origination process.

- Loan officers had unlimited access to FHA loan files throughout the origination process.

Follow Up on Prior Audits

This is the first HUD Office of Inspector General audit of Guild Mortgage.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Schedule of HUD Losses

FHA Case #	Loan Amount	Loss (Gain) to HUD
197-1750451	**$ 122,986**	$ 20,950.98
197-1754867	**$ 123,978**	$ 33,829.55
197-1612259	**$ 74,386**	$ 21,112.84
197-1936162	**$ 132,815**	$ (1,183.14)
197-1723722	**$ 148,773**	$ (7,142.54)
197-1836415	**$ 136,871**	$ 51,923.75
197-1633469	**$ 128,937**	$ 71,728.61
197-1546578	**$ 142,822**	$ 41,747.09
197-1689422	**$ 148,773**	$ 19,188.29
197-1748963	**$ 136,871**	$ 55,119.03
048-1971115	**$ 108,832**	$ (8,233.57)
197-1718751	**$ 133,896**	$ 21,127.03
197-1507518	**$ 146,294**	$ 79,947.19
197-1507474	**$ 145,798**	$ (32,435.33)
197-1645648	**$ 227,127**	$ 62,930.92
197-1527570	**$ 152,741**	$ (9,519.21)
197-1596389	**$ 146,790**	$ 70,719.25
197-1820756	**$ 135,880**	$ 36,168.01
197-1920162	**$ 199,852**	$ 35,955.97
197-1707736	**$ 128,838**	$ 9,326.96
197-1507206	**$ 132,116**	$ 52,453.64
197-1941439	**$ 127,991**	$ 23,940.72
197-1638539	**$ 223,160**	$ 55,551.84
197-1800637	**$ 137,863**	$ 30,664.34
197-1872782	**$ 123,978**	$ 26,059.70
197-1560559	**$ 136,871**	$ 57,007.47
197-1533950	**$ 123,978**	$ (7,096.42)
Total	**$3,829,217.00**	**$ 811,842.57**


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Summary of Loan Origination Deficiencies

Guild Mortgage Company
dba Residential Mortgage Bankers

	FHA Case #	2003	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	197-1633469	Claim	X	X	X	X						X				X	
2	197-1638539	Claim	X	X	X												
3	197-1645648	Claim															X
4	197-1689422	Claim	X			X									X		X
5	197-1693847	Claim														X	X
6	197-1707736	Claim										X					
7	197-1718751	Claim	X	X	X											X	X
8	197-1723722	Claim	X	X	X							X					
9	197-1748963	Claim	X	X	X	X	X									X	X
10	197-1750451	Claim										X				X	X
11	197-2035346	Terminated	X				X										
12	197-1873430	Terminated	X				X										
13	197-2033510	Terminated	X				X										
14	197-1375370	Active	X				X					X	X				
15	197-2044672	Active															
16	197-2141053	Active	X	X								X			X		X
17	197-2341820	Active													X		
18	197-1641413	Active	X					X				X				X	X
19	197-1658720	Active	X	X					X								
20	197-1728056	Terminated	X	X													
21	197-2813657	Active										X					X
22	048-1971115	Claim	X				X			X							X
23	197-1754867	Claim	X	X			X								X		X
24	197-1800637	Claim	X					X									
25	197-1820756	Claim	X	X	X							X				X	X
26	197-1836415	Claim	X	X												X	X
27	197-1872782	Claim	X	X	X						X	X		X			
28	197-1941439	Claim															X
29	197-1920162	Claim	X	X	X	X						X					
30	197-1936162	Claim	X							X							
31	197-2012214	Claim										X					
32	197-1507206	Claim	X	X	X							X				X	X
33	197-1507474	Claim	X	X				X	X	X							
34	197-1507518	Claim	X	X				X				X				X	X
35	197-1527570	Claim	X			X	X	X		X		X		X			
36	197-1533950	Claim	X	X	X												
37	197-1546578	Claim	X	X	X											X	X
38	197-1560559	Claim	X	X								X				X	X
39	197-1596389	Claim	X	X	X											X	X
40	197-1612259	Claim	X					X	X								
	Totals		31	20	12	5	8	6	3	4	1	16	1	2	4	13	19
	% of Total Loans		78%	50%	30%	13%	20%	15%	8%	10%	3%	40%	3%	5%	10%	33%	48%

Legend

1. False Documentation	6. False Gift Letter	11. False Tax Return
2. False Verification of Employment	7. False Relationship Letter	12. False Explanation Letter
3. False Telephonic Reverification of Employment	8. False Credit Letter	13. Employee Conflicts of Interest
4. False Identification	9. False Police Report	14. Investors
5. Invalid or Questionable Social Security Number	10. Faxed Documentation	15. Property Flipping / Strawbuyers


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Ten Cases of Predatory Lending

FHA Case #	Loan Amount	Interest Rate	Loan Origination Fee	Discount Points	Discount Amount	Buydown Amount	Rebate Points	Rebate Amount	Overages collected by Loan Officer	Loan Officer Gross Proceeds	Branch Gross Proceeds[1]	Total Gross Proceeds[2]
197-1707736	$128,838	8.875%	$1,260.03	3.5	$4,509.33	$3,235.80	-1.375	$1,771.52	$200.00	$4,505.08	$3,729.67	$8,234.75
197-1920162[3]	$199,852	8.500%	$1,954.55	2	$3,997.04	-	-2.25	$4,496.67	$950.00	$11,398.26	$4,908.41	$16,306.67
197-1596389	$146,790	9.250%	$1,435.60	1.5	$2,201.85	-	-2.75	$4,036.73	$900.00	$8,574.18	$3,937.33	$12,511.51
197-1527570[4]	$152,741	8.875%	$1,493.80	1.5	$2,291.12	$1293.60 (seller paid)	-1.25	$1,909.26	($195.00)	$5,499.18	$4,216.97	$9,716.15
197-1645648	$227,127	9.375%	$2,221.30	3	$6,813.81	$5,798.64	-1.875	$4,258.63	$600.00	$8,095.10	$5,492.72	$13,587.82
197-1693847	$134,888	9.500%	$1,319.20	1.5	$2,023.32	-	-2.5	$3,372.20	$900.00	$7,614.72	$3,064.66	$10,679.38
197-1641413	$172,081	9.250%	$1,682.95	3.5	$6,022.84	$4,375.80	-2.5	$4,302.03	$900.00	$8,532.02	$4,456.42	$12,988.44
197-1689422[3]	$148,773	9.000%	$1,455.00	-	$ -	-	-2.125	$3,161.43	$1,300.00	$5,916.43	$4,094.53	$10,010.96
197-1836415	$136,871	8.875%	$1,388.60	1.75	$2,395.24	-	-2.125	$2,908.51	$950.00	$7,592.35	$3,746.74	$11,389.09
197-1658720[5]	$217,209	8.750%	$2,124.30	2	$4,344.18	-	0.625	($1,357.56)	$605.00	$5,715.92	$5,351.66	$11,067.58

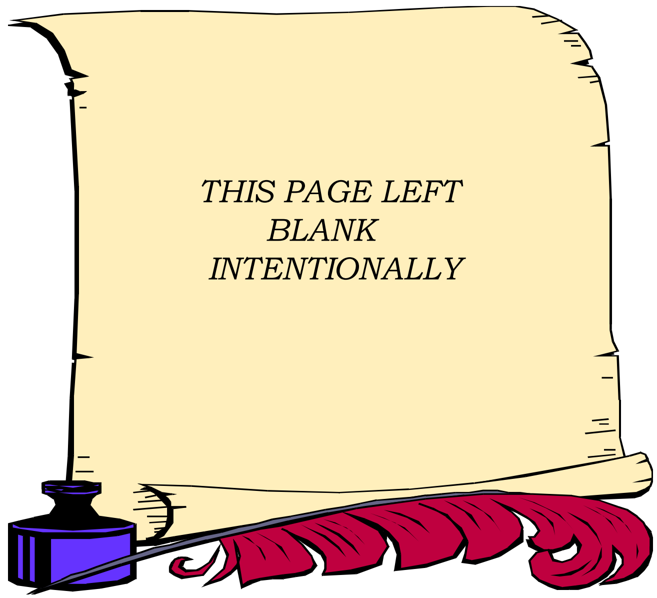
[1] Includes the branch's portion of service release premium, processing fee, underwriting fee, etc

[2] Does not include GMC's corporate revenue (GMC's portion of the service release premium (SRP), Admin Fee, etc.) from each loan

[3] Same borrower using fictitious identification and different name during a seven-month period

[4] Loan officer was a branch manager who elected to have a majority of the commission shown distributed through branch proceeds.

[5] Loan officer was given only a portion of the commission shown. The remainder went to the branch.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Flipping and Strawbuyer Cases

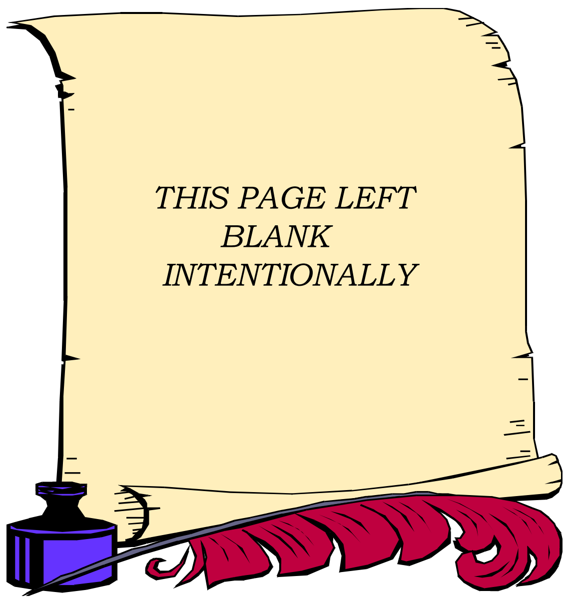
Flipping

	FHA Case #	Purchase		Sale		Result	
		Date	Price	Date	Price	Price Increase	Time Period
1	197-1693847	10/25/1999	$ 68,000.00	4/11/2000	$ 136,000.00	$ 68,000.00	6 months
2	197-2141053	12/5/2000	$ 155,000.00	4/6/2001	$ 259,000.00	$ 104,000.00	4 months
3	197-2813657	1/30/2002	$ 145,000.00	5/20/2002	$ 265,000.00	$ 120,000.00	3 months
4	048-1971115	5/20/1999	$ 70,000.00	9/20/1999	$ 109,000.00	$ 39,000.00	4 months
5	197-1941439[1]	5/18/2000	$ 81,500.00	11/28/2000	$ 130,000.00	$ 48,500.00	6 months
6	197-1596389[2]	9/24/1999	$ 49,000.00	2/24/2000	$ 149,000.00	$ 100,000.00	5 months
7	197-1718751[2]	2/22/2000	$ 52,500.00	5/18/2000	$ 135,000.00	$ 82,500.00	3 months
8	197-1748963	5/1/2000	$ 35,000.00	6/6/2000	$ 138,000.00	$ 103,000.00	1 month
9	197-1750451	3/16/2000	$ 67,000.00	4/20/2000	$ 124,000.00	$ 57,000.00	1 month
10	197-1641413[2]	2/22/2000	$ 83,300.00	3/23/2000	$ 173,500.00	$ 90,200.00	1 month
11	197-1820756	7/5/2000	$ 63,000.00	7/20/2000	$ 137,000.00	$ 74,000.00	15 days
12	197-1836415	7/13/2000	$ 72,000.00	9/27/2000	$ 138,000.00	$ 66,000.00	2 months
13	197-1507206	6/1/1999	$ 60,000.00	11/23/1999	$ 133,000.00	$ 73,000.00	5 months
14	197-1507518	7/22/1999	$ 73,500.00	11/23/1999	$ 147,500.00	$ 74,000.00	4 months
15	197-1546578	8/20/1999	$ 74,500.00	12/2/1999	$ 148,000.00	$ 73,500.00	4 months
16	197-1560559	7/22/1999	$ 67,000.00	12/28/1999	$ 138,000.00	$ 71,000.00	5 months

Strawbuyers

	FHA Case #	Purchase		Sale		Net Proceeds	
		Date	Price	Date	Price	Non-Profit Seller	Investor
1	197-1645648[3]	12/13/1999	$ 70,000.00	5/17/2000	$ 229,000.00	$ 2,000.00	$ 67,058.89
2	197-1689422[3,4]	4/11/2000	$ 81,200.00	4/28/2000	$ 150,000.00	$ 100.00	$ 29,962.17
3	197-1754867[3,4]	5/22/2000	$ 56,000.00	7/7/2000	$ 125,000.00	$ -	$ 33,377.70

[1] Investor gift deeded property to her corporation prior to sale
[2] Non-profit received a 30% discount on the property from HUD and deeded property to investor prior to sale
[3] Non-profit received a 30% discount on the property from HUD and acted as a strawbuyer
[4] Investor was an RMB Loan Officer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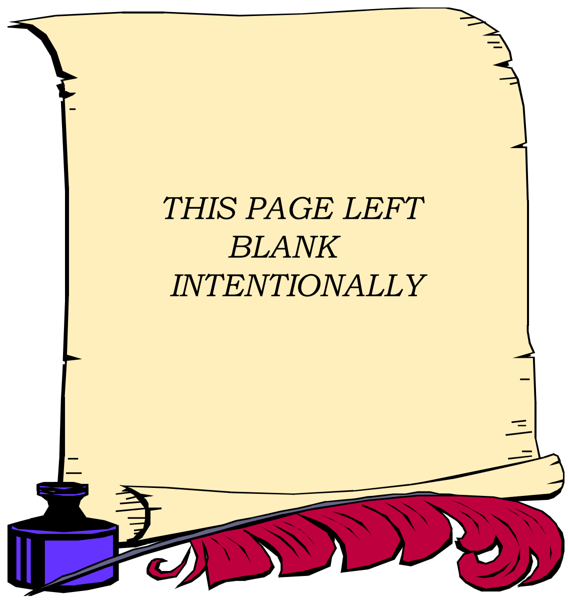
Schedule of Questioned Costs And Funds Put to Better Use

Finding Number	Type of Questioned Cost Ineligible 1/	Unsupported 2/	Funds Put to Better Use 3/
2A	0	0	$159,865,833
3A	$811,843		

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditors believed 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 the 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 future 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 put to better use are costs that will not be expended in the future if our recommendations are not implemented; for example, costs not incurred, de-obligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made and other savings.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HUD-1

A.

Final

SETTLEMENT STATEMENT

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

B. TYPE OF LOAN

1. [X]FHA 2. [ ]FMHA 3. [ ]CONV. UNINS.
4. [ ]VA 5. [ ]CONV. INS.
6. File Number: (Escrow) [redacted] 7. Loan Number: [redacted]
8. Mortgage Insurance Case Number: 197-1596399-703

Form approved OMB No. 2[illegible]

C. NOTE: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c)" were paid outside the closing; they are shown here for information purposes and are not included in the totals.

D. NAME OF BORROWER: [redacted], LOS ANGELES CA 90059

E. NAME OF SELLER: JORGE [redacted], BUENA PARK CA 90620

F. NAME OF LENDER: Guild Mortgage Company, 8141 East 2nd Street Suite 110, Downey, CA 90241

G. PROPERTY LOCATION: [redacted] LOS ANGELES, CA 90059

H. SETTLEMENT AGENT: South Coast Title Company, 917-A West Beverly Boulevard, Montebello CA 90640

I. SETTLEMENT DATE: May 2, 2000

J. SUMMARY OF BORROWER'S TRANSACTION		K. SUMMARY OF SELLER'S TRANSACTION	
100. Gross Amount Due From Borrower:		400. Gross Amount Due To Seller:	
101. Contract sales price	148,000.00	401. Contract sales price	148,000.00
102. Personal property		402. Personal property	
103. Settlement charges to borrower (line 1400)	5,241.88	403.	
104.		404.	
105.		405.	
Adjustments for items paid by seller in advance		Adjustments for items paid by seller in advance	
106. City/town taxes		406. City/town taxes	
107. County taxes 05/02/00-07/01/00	352.23	407. County taxes 05/02/00-07/01/00	352.23
108. Assessments		408. Assessments	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
113.		413.	
114.		414.	
115.		415.	
116.		416.	
117.		417.	
118.		418.	
120. Gross Amount Due From Borrower	153,594.11	420. Gross Amount Due To Seller:	148,352.23
200. Amounts Paid By or In Behalf of Borrower		500. Reductions In Amount Due From Seller:	
201. Deposit or earnest money	* 4,940.00	501. Excess deposit (see instructions)	
202. Principal amount of new loan(s) Guild Mortgage Company	146,790.00	502. Settlement charges to seller (line 1400)	146,246.54
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204. Second mortgage loan		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208. AGGREGATE CREDIT	127.92	508.	
209.		509.	
Adjustments for items unpaid by seller		Adjustments for items unpaid by seller	
210. City/town taxes		510. City/town taxes	
211. County taxes		511. County taxes	
212. Assessments		512. Assessments	
213. Seller to credit buyer	2,105.69	513. Seller to credit buyer	2,105.69
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
220. Total Paid By/For Borrower:	153,963.61	520. Total Reduction Amount Due	148,352.23
300. Cash At Settlement From/To Borrower:		600. Cash At Settlement To/From Seller:	
301. Gross amount due from borrower (line 120)	153,594.11	601. Gross amount due to seller (line 420)	148,352.23
302. Less amount paid by/for borrower (line 220)	153,963.61	602. Less reductions in amount due seller (line 520)	148,352.23
303. CASH [ ] FROM [X TO] BORROWER	369.50	603. CASH [X TO] [ ] FROM] SELLER	.00

SOUTH COAST TITLE ESCROW SERVICES
WE HEREBY CERTIFY THAT THIS IS A TRUE AND EXACT COPY OF THE ORIGINAL UNDER THE ABOVE NUMBERED ESCROW
SIGNATURE: [signature]

* REFER TO ATTACHED DETAIL STATEMENTS

Original

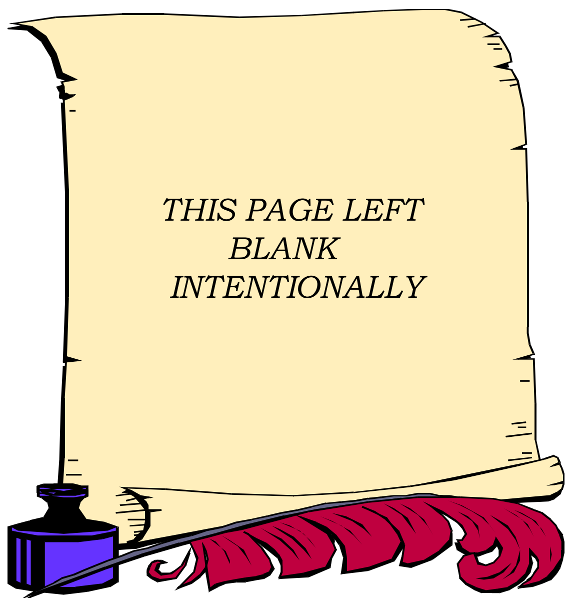
Final -2-

Escrow No.: [redacted]

SECTION L	PAID FROM BORROWER'S FUNDS AT SETTLEMENT	PAID FROM SELLER'S FUNDS AT SETTLEMENT
700. TOTAL SALES/BROKER'S COMMISSION Based on price $		
Division of Commission (Line 700) as follows:		
701. $ to		
702. $ to		
703. Commission Paid at settlement		
704.		
705.		
706.		
800. ITEMS PAYABLE IN CONNECTION WITH LOAN		
801. Loan Origination Fee Guild Mortgage Company		1,435.60
802. Loan Discount Guild Mortgage Company		2,201.85
803. Appraisal Fee Guild Mortgage Company		325.00
804. Credit Report Guild Mortgage Company		49.50
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee to		
807. Assumption Fee		
808. Document Preparation to Guild Mortgage Company		210.33
809. Tax Service to Guild Mortgage Company		75.00
810. Processing Fee to Guild Mortgage Company		695.00
811. PHOTO/INSPECTION FEE to Guild Mortgage Company		50.67
812. UNDERWRITING FEE to Guild Mortgage Company		600.00
813. FLOOD CERT. FEE to Guild Mortgage Company		23.50
814. WIRE FEE (ADDENDUM to Guild Mortgage Company		315.50
815.		
816.		
817.		
818.		
819.		
820.		
821.		
822.		
823.		
900. ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE		
901. Interest from 04/28/00 to 05/01/00 @$ 37.20 /day	111.60	
902. Mortgage Insurance Premium Guild Mortgage Company	3,230.10	
903. Hazard Insurance Premium to Safeco Insurance Inc	375.00	
904. Flood Insurance Premium to		
905.		
906.		
907.		
1000. RESERVES DEPOSITED WITH LENDER FOR		
1001. Hazard insurance 2 months @ $ 26.25 per month	52.50	
1002. Mortgage insurance months @ $ per month		
1003. City property taxes months @ $ per month		
1004. County property taxes 4 months @ $ 154.17 per month	616.68	
1005. Annual assessments months @ $ per month		
1006. Flood insurance months @ $ per month		
1007. Aggregate Account Adjustment months @ $ per month		
1100. TITLE CHARGES		
1101. Settlement or closing fee to South Coast Title Company	450.00	550.00
1102. Abstract or closing fee to		
1103. Title examination to		
1104. Title insurance binder to		
1105. Document preparation to		
1106. Notary fees to		
1107. Attorney's fees to		
1108. Title insurance to SOUTH COAST TITLE CO.	335.00	644.00
1109. Lender's coverage $ 75000.00/ 335.00		
1110. Owner's coverage $ 148000.00/ 644.00		
1111.		
1112.		
1113.		
1114. Lender's Endorsement(s)	100.00	
1115.		
1200. GOVERNMENT RECORDING AND TRANSFER CHARGES		
1201. Recording fees: Deed $ 11.00 Mortgage $ 31.00 Releases $ 26.00	31.00	37.00
1202. City/county tax/stamps: Deed $ 163.90 Mortgage $		163.90
1203. State tax/stamps: Deed $ 670.50 Mortgage $		670.50
1204.		
1205.		
1206.		
1207.		
1300. ADDITIONAL SETTLEMENT CHARGES		
1301. Survey to		
1302. Pest inspection to Atomic Exterminators		598.00
1303. NOTARY FEE To ALMA [redacted]		10.00
1304. RELEASE PER AMENDMENT To BENJAMIN [redacted]		85,000.00
1305. RELEASE PER AMENDMENT To JUAN [redacted]		3,000.00
1306. RELEASE PER AMENDMENT To JUAN [redacted]		3,400.00
1307. RELEASE PER AMENDMENT To JORGE [redacted]		5,000.00
1308. JORGE [redacted]		5,000.00
1309. JORGE [redacted]		5,000.00
1310. JORGE [redacted]		5,000.00
1311. SARA [redacted]		5,000.00
1312. SARA [redacted]		5,000.00
1313. SARA [redacted]		5,000.00
1314. SARA [redacted]		5,000.00
1315. SARA [redacted]		5,000.00
1316. SARA [redacted]		1,192.19
1317.		
1318.		
1319.		
1320.		
1321. Funds held for		
1400. TOTAL SETTLEMENT CHARGES (Enter on lines 103, Section J and 502, Section K)	5,241.88	146,246.54

SOUTH COAST TITLE ESCROW SERVICES
WE HEREBY CERTIFY THAT THIS IS A TRUE AND EXACT COPY OF THE ORIGINAL UNDER THE ABOVE NUMBERED ESCROW
SIGNATURE: [signature]

Original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Auditee Comments

Guild
MORTGAGE COMPANY

Closing Loans & Opening Doors Since 1960

May 21, 2004

VIA FEDERAL EXPRESS

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
Pacific/Hawaii Region IX
611 West Sixth Street
Suite 1160
Los Angeles, California 90017

Re: Guild Mortgage Company
HUD OIG Final Draft Audit Report

Dear Ms. Hobbs:

Guild Mortgage Company ("Guild" or "Company") is in receipt of the Final Draft Audit Report ("Report"), dated April 27, 2004, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of Inspector General ("OIG"). The Report is based on a review of a former Guild branch in Downey, California doing business as Residential Mortgage Bankers (hereinafter referred to as "RMB" or "Downey Branch"), pursuant to a referral from the HUD Santa Ana Homeownership Center's ("HOC") Quality Assurance Division ("QAD"). The OIG review was conducted between June and November 2003, covered the period between August 1, 1999 and November 30, 2002, and consisted of 40 HUD/Federal Housing Administration ("FHA") insured mortgage loans.

The Report contains three findings, alleging predatory lending, net branching and improper loan origination, with recommendations to the Department for administrative action against Guild. The Report states that the purpose of the OIG audit was to determine Guild's compliance with HUD/FHA requirements. The Report, however, fails to identify specific statutes, regulations, or guidelines that support its conclusions.

This response summarizes Guild's history and operations, as well as its former relationship with the Downey Branch. It also addresses the individual findings in the Report, which are at variance with the facts and/or do not constitute violations of FHA requirements or other rules or regulations cited in the findings. We appreciate this opportunity to comment on the findings and recommendations contained in the Report.

DC-637384 v3 1100137-0003

P.O. BOX 85304 ❑ SAN DIEGO, CALIFORNIA 92186-5304 ❑ PHONE 858.560.6330
9160 GRAMERCY DRIVE ❑ SAN DIEGO, CA 92123

Names have been redacted for privacy

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May 21, 2004
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I. INTRODUCTION

While Guild responds below to the OIG's individual findings, it is crucial in this instance to recognize that the loans referenced in the Report all were originated by a former branch office and do not reflect the Company's overall policies or procedures. Moreover, Guild at no time permitted predatory lending practices, and the Company complied with applicable rules and regulations.

A. THE DOWNEY BRANCH ORIGINATED ALL LOANS CITED IN THE REPORT AND NO LONGER IS ASSOCIATED WITH GUILD

All of the lending practices and individual transactions cited in the Report occurred at the Downey Branch. [redacted], a loan officer employed at the Downey Branch between December 3, 1999 and July 3, 2001, originated 17 of the 40 loans cited in the Report,[1] 16 of which are included in the 29 loans that have resulted in claims to HUD. In fact, these 16 claims account for 79% of the dollar losses to HUD in the 29 referenced cases. In addition, the same individual, [redacted] underwrote 35 of the 40 loans. Prior to the OIG audit, and as a result of routine Quality Control reviews, Guild identified concerns in these individuals' loans and took appropriate steps to investigate the Company's findings and terminate its relationship with the individuals involved.

To this end, after identifying irregularities in some of the loans that [redacted] originated in early 2001, Guild initiated a review of [redacted] loans and obtained the assistance of the RMB Branch Manager, [redacted]. There was no evidence, however, that [redacted] knew or should have known of any deficiencies in the loan files, and there was no evidence of fraud or misrepresentation by any Company employee. Nevertheless, Guild terminated [redacted] employment on July 3, 2001. Guild also increased communication with the underwriter involved in [redacted] loans, [redacted] in an effort to tighten the Company's underwriting controls. As a result of this increased scrutiny by the corporate office, the underwriter resigned in February 2001. In addition, due to increased scrutiny of the Downey Branch by the corporate office, the Branch Managers resigned in November 2002, and shortly thereafter Guild closed the Downey Branch office.

Guild acted prudently and as swiftly as possible in connection with the concerns raised about the Downey Branch. The Company's internal controls and Quality Control measures proved successful insofar as Guild identified the concerns, launched an investigation, and took prompt corrective action. In order to ensure file integrity and

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1 The remaining 23 loans were originated by 11 different loan officers.

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preserve the Company's reputation, it fired [redacted] and closed the Downey Branch. None of the employees who worked at the Downey Branch continue to work for the Company. Throughout this proceeding, we hope the Department will consider the fact that the Downey Branch was merely one of 51 branch offices maintained by Guild and that the Downey Branch loans are not representative of Guild's portfolio.

B. GUILD AT NO TIME PERMITTED PREDATORY LENDING PRACTICES

While Guild closed the Downey Branch for business reasons, contrary to the suggestion in the Report, Guild had at no time allowed the Downey Branch to employ predatory lending practices. Guild appreciates and commends recent federal and state efforts to combat abusive loan practices. For the past 40 years, the Company has prided itself on offering both superior and reliable service to consumers and on assisting all customers, including low- and moderate-income borrowers, in making financial decisions that best suit their individual and family needs. Guild at no time has condoned fraud or misrepresentation, and it does not permit employees to take advantage of borrowers or pressure them into accepting particular loan terms. Company personnel are required to ensure that borrowers understand their loan terms and are comfortable with the financing they ultimately receive.

Having said that, Guild recognizes that the Downey Branch loans cited in the Report were expensive in that they involved high interest rates and substantial points and fees. These loans, however, were not predatory, and their pricing terms did not violate any applicable requirements. Although the loans were expensive, they were subprime loans and, as recognized in the HUD/Treasury National Predatory Lending Task Force report (the "Task Force Report"), therefore carried higher costs to Guild than prime loans. For this reason, as is typical in the lending industry, the borrowers received higher interest rates and fees. The borrowers understood the expenses associated with their loans, and all fees were adequately disclosed. No borrowers were misled or deceived (nor does the Report suggest otherwise).

In addition, the Task Force Report, as well as the Truth in Lending Act ("TILA"), 15 U.S.C. §§ 1601 et seq., and state predatory lending laws, are aimed at fees imposed on borrowers, not sellers. Here, while the borrowers paid high interest rates, the discount points, closing costs and fees were paid by the sellers, not the borrowers. Although the OIG suggests that the interest rates were excessive in these cases, they were in fact only slightly above the prices on Guild's rate sheets (i.e., the par rates) at the time. With respect to the 10 loans cited in Appendix C of the Report, the interest rates ranged from 8.75% to 9.5%, which exceeded the par rates by, on average, 0.512%. None of the loans exceeded Guild's par rate by more than one percent, and nine of the ten loans exceeded the par rate by substantially less than one percent, as follows:

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	FHA Case Number	Interest Rate	Par Rate	Difference
1.	197-1707736	8.875	8.750	0.125
2.	197-1920162	8.500	7.500	1.000
3.	197-1596389	9.250	8.375	0.875
4.	197-1527570	8.875	8.750	0.125
5.	197-1645648	9.375	8.875	0.500
6.	197-1693847	9.500	8.875	0.625
7.	197-1641413	9.250	8.750	0.500
8.	197-1689422	9.000	8.375	0.625
9.	197-1836415	8.875	8.000	0.875
10.	197-1658720	8.750	8.875	– 0.125

Notably, considering that the points and fees were paid by the sellers, the interest rates were not high enough to render the loans high-cost loans under either TILA or the California high-cost laws.

Moreover, the only authority cited in the Report for the allegation that the Downey Branch engaged in predatory lending is the Task Force Report. As the OIG is aware, however, and as its name implies, the Task Force Report is merely a report. It is not a rule or regulation, or even a Handbook, Mortgagee Letter, policy statement or other form of bulletin. The Task Force Report expressly states that it was intended to "collect information about predatory lending, provide data on the impacts of predatory lending practices, and comment individually on existing proposals for reform in order to make recommendations for legislative action to Congress[.]" <u>The Task Force Report itself does not constitute a binding rule or regulation.</u> In fact, neither the Task Force Report nor any FHA guideline of which we are aware contains a clear definition of "predatory lending" or sets forth any requirements or prohibitions in connection with predatory lending. Thus, while we understand that the OIG may disapprove of the prices charged in the cases cited in the Report, there was no violation of FHA requirements.

Furthermore, it is important to note that the sellers, not the borrowers, paid the points and fees in these cases. Significantly, the Department does not regulate fees paid by sellers. The FHA regulations addressing closing costs expressly refer to "fees and charges that may be collected <u>from the borrower</u>[.]" HUD Handbook 4000.2 REV-2, ¶ 5-3. HUD does not permit certain charges to be made to the borrower, but it will allow them to be charged to the seller. The only authority cited in the Report for the proposition that the Department may review charges to the seller is Mortgagee Letter 94-16, which the Report quotes as stating that: "HUD does not agree that the law precludes review of one or more items of closing costs merely because actual payment

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may have been made by the seller in the particular transaction. The law applies to the mortgagee's customary lending practices, not to the terms negotiated between sellers and buyers." This statement, however, is quoted out of context, and Mortgagee Letter 94-16 is inapplicable to the instant matter. Mortgagee Letter 94-16 announces and explains HUD's Tiered Pricing Final Rule. It sets forth the rule that a lender's customary lending practices may not provide for a variation in mortgage charge rates exceeding two percentage points on its FHA-insured single-family mortgages within a geographic area. The Report, however, does not allege tiered pricing violations, and it acknowledges that the discount points charged in the cited cases did not vary by more than two percentage points. Furthermore, the above-quoted statement in the final rule responds to two commenters' remarks regarding HUD's statutory authority to review closing costs paid by the seller in a particular transaction and expresses HUD's view that it has authority to review charges paid by a seller when reviewing a mortgagee's customary lending practices to determine whether there has been a violation of tiered pricing. As tiered pricing is not at issue here, review of the charges to the sellers is gratuitous and unsupported by FHA guidelines.

C. GUILD COMPLIED WITH APPLICABLE RULES AND REGULATIONS

Finally, the Report states that the OIG's "overall audit objective was to determine whether Guild Mortgage Company approved FHA insured loans in accordance with the HUD/FHA requirements, which require adherence to prudent lending practices." Throughout the audit process and after receiving both the initial and final draft audit reports from the OIG, Guild carefully reviewed the OIG's findings, including both the cited loan files and the Company's policies and procedures. Our stringent reviews revealed that, while the OIG may disagree with certain of the Downey Branch's pricing, Guild complied with FHA and other applicable requirements set forth in the Report, including the Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. §§ 2601 et seq. The Downey Branch was not required to offset the interest rates by any discount points charged to the sellers, there was no premium pricing, the subject properties were accurately valued, Guild neither knew nor should have known that any of the transactions may have involved strawbuyers, and all fees charged were permissible. In addition, the Downey Branch was a legitimate branch office of Guild, and there is no evidence that Company personnel either knew or should have known of any loan processing or underwriting deficiencies in the cited cases. For these reasons, the recommendations for HUD action against the Company, which include civil money penalties, principal reductions and indemnifications, are inappropriate.

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II. BACKGROUND

A. GUILD MORTGAGE COMPANY

Guild was founded in 1960 as a sister company to the American Housing Guild, a residential homebuilder for whose customers Guild provided residential mortgage financing in new home developments. In 1972, the Company expanded into the resale mortgage financing market. Headquartered in San Diego, California, Guild now operates in six states, maintains 51 branch offices, 39 of which are registered with HUD/FHA, and has over 430 employees. The Company is an approved lender with Fannie Mae, Freddie Mac, and the Veterans Administration, and its primary investors currently include, among others, Fannie Mae, Ginnie Mae, Chase Manhattan Mortgage, Countrywide Home Loans, Inc., Principal Residential Mortgage, and CitiMortgage.

Guild received approval to participate in HUD's FHA mortgage insurance programs over 37 years ago in March 1967. The Company now sponsors over 200 loan correspondents, is an authorized agent for 12 principals, and acts as a principal for 17 authorized agents. Approximately 12% of Guild's production involves FHA-insured mortgage loans.

Guild strives not only to provide professional service and achieve high levels of customer satisfaction, but to offer its time and resources to various community programs and initiatives. In this regard, the Company has a long history of community involvement and support. Among other things, it originates loans for various state affordable housing programs and other community assistance programs, and it partners with local state homebuyer assistance programs.

As a large lender with a strong dedication to low-income and minority borrowers, Guild takes its relationship with the Department seriously and is committed to educating and training its employees on issues regarding FHA compliance. For over 40 years, we have endeavored to provide dependable and professional service and have repeatedly demonstrated our commitment to borrowers and allegiance to the FHA program. The Company adheres to a detailed Quality Control Plan and outsources Quality Control reviews to an independent residential Quality Control and compliance firm, QC-Mac. Guild provides stringent in-house training for new personnel, and it offers numerous financing options and works closely with individual borrowers in an effort to ensure consumer satisfaction. In addition, <u>the Company's overall default/claim rate is extremely low</u>. According to HUD's Neighborhood Watch, for the two-year period ending March 31, 2004, Guild originated 2,750 FHA loans, only 47 of which have gone into default or claim, thereby yielding a default/claim rate of 1.71%, which is only 80% of the nationwide default/claim rate of 2.15%.

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B. RESIDENTIAL MORTGAGE BANKERS – THE DOWNEY BRANCH

The OIG Report is based on a review of RMB, the Downey Branch. RMB was a branch office of Guild between August 1999 and November 2002. During that time, it originated 968 FHA-insured loans, mostly to Hispanic borrowers. The office was fairly large, including at any given time, 20 to 25 loan officers, two to three loan processors, one underwriter, and at least one funder, all of whom were W-2 employees of the Company. Guild paid all operating expenses for the Downey Branch and exercised responsible management supervision and control over the branch. The underwriters, processors, and funders were required to attend training at Guild's home office, and the underwriters were required to perform well on live file test cases. In addition, the corporate office regularly communicated with the Downey Branch and included the Downey Branch's loan originations in its Quality Control reviews.

As explained above, Guild fired one of the Downey Branch's top-producing loan officers (i.e., [redacted]) on July 3, 2001, after identifying concerns with his loans through routine Quality Control reviews. The Downey Branch's underwriter (i.e., [redacted]) and Branch Managers (i.e., [redacted] and [redacted]) subsequently resigned due to increased scrutiny from the corporate office, and Guild closed the Downey Branch in November 2002, prior to the OIG audit.

III. RESPONSE TO FINDINGS

As previously noted, the Report contains three findings with recommendations for administrative action by HUD. Contrary to the allegations in the Report, however, Guild adhered to the FHA and RESPA requirements identified therein. We address each finding in turn below.

A. FINDING 1 – GUILD DID NOT ALLOW THE DOWNEY BRANCH TO EMPLOY PREDATORY LENDING PRACTICES

In Finding 1, the Report alleges that Guild allowed the Downey Branch to employ predatory lending practices and to violate Section 8 of RESPA. Specifically, Finding 1 cites 10 loans in Appendix C and alleges that, in these cases: (1) RMB charged discount points without reducing the borrowers' interest rates by a corresponding amount; (2) RMB charged premium interest rates without paying for the borrowers' closing costs and prepaid expenses; (3) some of the loans reviewed involved property flips and/or strawbuyers; and (4) certain miscellaneous charges were excessive. The Report suggests that the alleged violations were caused by Guild's lack of oversight over RMB's operations, and it recommends that HUD consider imposing civil money penalties against the Company, that Guild be required to establish policies and procedures to ensure that its branches monitor charges for FHA loans, and that Guild

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be required to review all FHA loans generated by the Downey Branch with discount points or premium pricing where no interest rate or principal balance reduction occurred and make appropriate refunds.

The allegations in Finding 1 are at variance with the facts and/or do not constitute violations of FHA or RESPA requirements. In compliance with FHA requirements, see HUD Handbook 4060.1 REV-1, ¶¶ 2-13, 3-2(B), Guild exercised control and responsible management supervision over its staff at the Downey Branch. Guild oversaw the Downey Branch's operation by, among other things, providing mandatory training for the Downey Branch's underwriters, processors and funders, requiring the underwriters to perform well on live file test cases, regularly communicating with the Branch Managers, and including the Downey Branch loans in the Company's Quality Control reviews. While Guild ultimately closed the Downey Branch, the Company adhered to applicable rules and regulations in originating and closing the cited loans, and neither civil money penalties nor refunds/principal reductions are appropriate in this instance.

Initially, please note that the table included in Appendix C of the Report misrepresents certain information. With respect to the "Branch Gross Proceeds," we are uncertain what figures were used to arrive at the amounts reflected, but the amounts are incorrect. While Appendix C states that the branch proceeds in the 10 cited cases totaled $42,999.11, the branch proceeds in fact totaled only $28,607.90. In addition, the "Loan Officer Gross Proceeds" were overstated in two cases: (1) for FHA Case No. 197-1527570, the loan officer received $746.90, not $5,499.18; and (2) for FHA Case No. 197-1658720, the loan officer received $2,777.68, not $5,715.92. We address the individual allegations within Finding 1 below.

1. The Downey Branch Was Not Required to Reduce Borrowers' Interest Rates by the Amounts of the Discount Points

Finding 1 states that, in nine of the ten loans cited in Appendix C, RMB charged discount points between 1.5 and 3.5 percent of the loan amount. It alleges, however, that five of these nine borrowers did not receive an interest rate reduction on their loans and that the only benefit derived from the discount points was the additional income to the loan officers insofar as the loan officers received both the discount points and the one-percent loan origination fees. Finding 1 states that three of the nine borrowers received two-year periods of interest rate reduction through temporary buydowns, but that the reduction amounts in these cases did not equal the charges for discount points. Finding 1 notes that discount points normally are paid at closing and generally are calculated as a percentage of the total loan amount, and it alleges that, according to HUD, discount points are paid to reduce the interest rate on a loan. Finding 1 further alleges that the loan officers performed no services in return for the discount points, which therefore constituted unearned fees in violation of Section 8 of RESPA.

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Contrary to the suggestion in the Report, HUD does not require that discount points be used to reduce the interest rate on a loan. Moreover, the loan officers did perform services in return for the fees they received, and their receipt of discount points in the cited cases did not violate RESPA.

a. HUD Does Not Require that Discount Points Reduce Interest Rates

HUD does not regulate interest rates and discount points. In 1983, Congress repealed the Department's authority to regulate interest rates (except in connection with Section 235 mortgages) and required that HUD insure FHA mortgage loans at interest rates agreed upon by the lender and borrower. See Housing and Urban-Rural Recovery Act of 1983, Public Law 98-191, § 404 (November 30, 1983). In compliance with this Congressional mandate, HUD confirmed that it would no longer regulate interest rates or discount points. See Mortgagee Letter 1983-27. HUD has reiterated this position several times since 1983. See, e.g., HUD Handbook 4000.2 REV-2, ¶ 1-10 (July 1991) (providing that "the interest rate and discount points are negotiated between the applicant and the mortgagee"); HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-7 (providing that the "FHA does not regulate the interest rate on loans it will insure").[2] In fact, there is no provision in the FHA rules or regulations suggesting that discount points must reduce the borrower's interest rate.[3]

Likewise, while HUD disallows compensation in FHA transactions that is prohibited by RESPA, see HUD Handbook 4060.1 REV-1, ¶ 2-24, RESPA does not prohibit the receipt of discount points or require that discount points be used to lower a borrower's interest rate. Not only do both the statute and implementing regulations fail to address this specific issue, but RESPA is a disclosure and anti-kickback statute, not a rate-setting statute. See 64 Fed. Reg. 10080, 10086 (HUD Statement of Policy 1999-1) (March 1, 1999). In enacting RESPA, Congress stated that:

> While there is undoubtedly a Federal interest in ensuring settlement costs . . . are not unreasonably high, it does not

[2] The prior Mortgage Credit Analysis Handbook, 4155.1 REV-4, CHG-1, was in effect at the time the loans cited in the Report were originated and closed. We therefore refer to this Handbook and accompanying Mortgagee Letters throughout this response. The new Mortgage Credit Analysis Handbook, 4155.1 REV-5, did not become effective until January 1, 2004.

[3] While Mortgagee Letter 2001-26 provides that it would be a best practice for a lender to inform a borrower that he or she may pay higher up-front costs for a lower interest rate or a higher interest rate for lower up-front costs, this Mortgagee Letter does not require that such a trade-off exist. The Mortgagee Letter simply states that, if a lender offers such a trade-off, it would be a best practice to disclose it to the borrower.

> follow that the Federal Government should place tens of thousands of individuals or businesses that supply settlement services under Federal rate-making simply because there are abuses or problems in certain areas of the country.

Senate Report No. 93-866, 93rd Cong., 2d Session (May 22, 1974). Congress expressly rejected several proposals to pass legislation that would allow HUD to regulate settlement service charges. In rejecting such proposals, the Senate Banking Committee stated that such regulation would be warranted only if settlement charges were unreasonably high on a widespread basis and there was no other practical way to deal with the problem, and that rate regulation would infringe on state and local concerns. See S. Rep. 93-866, at 4-5 (1974), reprinted in 1974 U.S. Code Cong. & Admin. News 6546. "HUD officials testified that the regulations were not developed on the basis of an analysis of cost and profits involved in providing these [settlement] services." Senate Report, No. 93-866, May 22, 1974; see also 1974 U.S. Code Cong. & Admin. News 6549-50 (concluding that the price of real estate settlement services should be set in the market). The Banking, Housing and Urban Affairs Committee further determined that "the Federal Government should not be involved in the fixing of rates for real estate settlement charges" and that Federal rate regulation of real estate settlement charges for federally related mortgage loans is unwarranted. Id.

The Report makes the bold statement that, "[a]ccording to HUD, discount points are paid to reduce the interest rate on a loan." The Report fails, however, to cite any authority for this allegation. Neither RESPA (or its implementing regulations) nor FHA guidelines regulate interest rates and discount points. Guild was permitted to charge whatever discount points it deemed appropriate, and it was not required to make corresponding reductions to the interest rates.

b. The Loan Officers' Receipt of Discount Points Did Not Violate RESPA

The Report suggests that the Downey Branch loan officers did not perform any services in return for the discount points they received and that the fees therefore constituted unearned fees in violation of Section 8 of RESPA. Contrary to these allegations, the loan officers performed actual services in connection with each transaction cited in the Report. Specifically, the loan officers performed those functions typically performed in the origination of a mortgage loan, including, among other things: meeting with the borrowers; taking the loan applications; analyzing the borrowers' income and debts and prequalifying them; educating and counseling the borrowers in the home-buying and financing processes; collecting financial information and documentation; ordering appraisals and inspections; providing disclosures; coordinating

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contact among the borrowers, real estate agents and settlement agents; and ordering legal documents. Thus, the loan officers performed real services in return for the compensation they received. The borrowers received valuable services, and loan officers are entitled to compensation for the origination of home loans. Even where the amount of compensation is disputed, there can be no dispute that value was received.

Furthermore, to the extent the OIG may disagree with the amount of compensation the loan officers received, such compensation was permissible under RESPA. Initially, the Department's regulations expressly state that "[h]igh prices standing alone are not proof of a RESPA violation." 24 C.F.R. § 3500.14(g)(2). Thus, there is no violation of Section 8 merely because Guild may have charged high interest rates or fees. Additionally, please note that the loan officers' compensation was paid by Guild, their employer. Guild charged the borrowers various fees in connection with the loan transactions, and the Company then paid its employees, including the loan officers. As you may know, Section 8 of RESPA is subject to a regulatory exception for payments by an employer to its employee. HUD has consistently taken the position that an employer may pay its employees any amount it desires for referring business to the employer. See, e.g., HUD Informal Advisory Opinions, dated June 15 and September 19, 1984, by Donald B. Alexander; HUD Informal Advisory Opinion, dated September 19, 1985, by Grant E. Mitchell. In 1992, HUD formalized its position and promulgated regulations that incorporate an exception for payments by an employer to its employees. The applicable provision exempts from the Section 8 prohibitions "an employer's payment to its own employees for any referral activities." 24 C.F.R. § 3500.14(g)(1)(vii). HUD reasoned that it would be "unreasonable" to prohibit an employer from making payments to its employees because "such an interpretation would effectively ban all referrals." 57 Fed. Reg. 49,600, *49,602 (Nov. 2, 1992). Thus, Guild's payment of the discount points charged in the cited transactions to the Company's loan officers was exempt from RESPA's prohibitions in Section 8.

Nevertheless, the Report suggests that unearned or excessive fees are prohibited under Section 8. To the contrary, even if the compensation to Guild or the loan officers was excessive, RESPA does not prohibit the mere receipt of unearned or excessive fees. Section 8(a) of RESPA prohibits the payment or receipt of referral fees. See 12 U.S.C. § 2607(a). Section 8(a), however, is not at issue in this case. There were no payments in return for referrals. Section 8(b) states: "No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed." 12 U.S.C. § 2607(b). While HUD has taken the position that two or more parties need not split a fee to violate Section 8(b) and that the mere charging of an unearned fee would be sufficient, see 24 C.F.R. § 3500.14(c), (g)(3), see also RESPA Statement of

Policy 01-1, the statutory language, legislative history, and court decisions all make clear that an actual split is required.

By its language, Section 8(b) prohibits only the splitting or sharing of fees between at least two parties, not the mere receipt of an unearned, excessive, or duplicative fee. The legislative history supports the statutory language. For example, when Senator Bill Brock (R. Tenn.) introduced the language for Section 8(b) to the Senate through S. 3164, he pronounced during a floor statement that the provision was intended to "prohibit any fee-splitting among persons who render settlement services unless the fee is paid in return for services actually rendered." 120 Cong. Rec. 6586 (March 13, 1974). Similarly, both the House and Senate Banking Committee reports described Section 8(b) as "prohibit[ing] a person or company that renders a settlement service from giving or rebating any portion of the charge to any other person except in return for services actually rendered." H.R. Rep. No. 93-1777, at 7 (1974); S. Rep. No. 93-866, at 6 (1974), 1974 U.S. Code Cong. & Admin. News 6546, 6551. Representative Ben Blackburn (R. Ga.) likewise announced that Section 8(b) "was intended to deal only with fee-splitting arrangements among participants in the settlement process." 120 Cong. Rec. 29442-43 (Aug. 20, 1974). Representative Blackburn stated:

> <u>there should be no question that section 106 does not in any way authorize a civil suit nor subject an attorney or anyone else who provides settlement services to civil or criminal penalties if the homebuyer believes that the charge made to him is in excess of the reasonable value of the services rendered</u>. <u>What is subject to civil and criminal penalties is if the person rendering the settlement service gives or splits a portion of the fee he receives with someone else</u> and the person receiving the payment provides no legitimate service in return.

120 Cong. Rec. 29442-43 (Aug. 20, 1974) (emphasis added). Congress thereby clarified its intent to prohibit only those situations where a fee is split between at least two parties. Consistent with the statutory language and legislative history of Section 8(b), most Federal courts that have addressed the matter have held that two or more

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parties must split the unearned portion of a fee in order for a violation of Section 8(b) to occur.[4]

In this case, there was no split of fees between Guild and any other individuals or entities. Guild received compensation in return for origination of the mortgage loans. To the extent the OIG may oppose the amounts received, RESPA is not a rate-setting statute and does not prohibit the mere receipt of excessive payments. Moreover, the Report offers no evidence that the payments were in excess of the market value for the services performed. Guild complied with both FHA and RESPA requirements. In addition, the Department traditionally has not attempted to enforce RESPA in a situation where it believes only that fees were high or excessive. Rather, it has taken action against settlement service providers that mark up third-party fees. Here, Guild was merely charging a fee for its product. Were HUD to take action against lenders that charge high interest rates and/or discount points because the Department disagrees with the pricing, it would not only be engaged in rate-setting, but would discourage companies from making FHA loans.

2. There Was No Premium Pricing

Finding 1 also alleges that nine of the ten loans cited in Appendix C involved premium rate pricing, but that such pricing was not used to pay borrower closing costs or prepaids and the loan officers received the rebate amounts. Finding 1 states that there were no loan principal reductions and alleges that rebate pricing was unnecessary because the seller paid the borrower's closing costs in most cases. It further alleges that, although Guild management indicated that rebate pricing was negotiated between the loan officer and homebuyer, most of the borrowers did not appear to speak English and the OIG needed a translator to interview them. Finding 1 concludes that the cited transactions are "classic examples of predatory lending."

Initially, note that the loans cited in the Report were an anomaly and are not representative of either the Downey Branch's loan originations or Guild's portfolio. The Report references only nine transactions out of 40 reviewed and a total of 968

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4 See, e.g., Mercado v. Calamet Federal Savings & Loan Association, 763 F.2d 269 (7th Cir. 1985); Durr v. Intercounty Title Company of Illinois, 14 F.3d 1183 (7th Cir. 1994), cert. denied, 513 U.S. 811 (1994); Echevarria v. Chicago Title & Trust Company, 256 F.3d 623 (7th Cir. 2001); Boulware v. Crossland Mortgage Corporation, 291 F.3d 261 (4th Cir. 2002); Krzalic v. Republic Title Company, 314 F.3d 875 (7th Cir. 2002), cert. denied, 123 S. Ct. 2641 (2003); Haug v. Bank of America, N.A317 F.3d 832 (8th Cir. 2003); Willis v. Quality Mortgage USA, Inc., 5 F. Supp. 2d 1306 (D. Al. 1998); Duggan v. Independent Mortgage Corp., 670 F. Supp. 652 (E.D. Va. 1987); Callahan v. Commonwealth Land Title Ins. Co., Civil Action Nos. 88-7656, 88-8319, 1990 U.S. Dist. LEXIS 14524 (E.D. Pa. 1990); Bloom v. Martin, 865 F. Supp. 1377 (N.D. Ca. 1994); Campbell v. Machias Savings Bank, 865 F. Supp. 26 (D. Me. 1994); Barbosa v. Targe Mortgage Corp., 968 F. Supp. 1548 (S.D. Fla. 1997); Christakos v. Intercounty Title Company, 196 F.R.D. 496 (N.D. Ill. 2000).

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originated by the branch. Moreover, six of these nine loans were originated by [redacted], whom the Company fired.

In addition, there appears to be a misunderstanding in this case. While the Downey Branch charged high prices insofar as the interest rates exceeded the Company's par rates and certain fees were high, there was no premium pricing in any of the transactions cited in the Report and the pricing complied with FHA requirements. Premium pricing refers to a particular type of FHA program. Specifically, HUD permits a lender to charge a higher interest rate in return for the lender's payment of the borrower's closing costs and/or prepaid expenses, so long as certain requirements are met. For example, the funds derived from the premium interest rate may not be used to pay any portion of the borrower's down payment or mortgage principal payments, the funds must be disclosed on the Good Faith Estimate ("GFE") and HUD-1 Settlement Statement ("HUD-1") with an itemized list of the items paid on the borrower's behalf, and funds exceeding the borrower's closing costs and prepaids must be used to reduce the principal balance of the loan. See Mortgagee Letter 94-7. Significantly, however, while Mortgagee Letter 94-7 permits a lender to use the funds derived from a premium interest rate to pay the borrower's up-front costs, it does not require that a lender do so. The requirements in Mortgagee Letter 94-7 are triggered when a lender opts to offer premium pricing to FHA borrowers, not when a lender simply chooses to charge a high interest rate. Thus, while the interest rates were above par in the cases cited in the Report, and while Guild paid the loan officers a portion of the funds received from the higher rates, there was no premium pricing according to Mortgagee Letter 94-7. Guild was neither required to use funds derived from the interest rates to pay the borrowers' closing costs or prepaid items nor required to make principal reductions to the loans.

Furthermore, Guild's pricing in the referenced cases did not violate any FHA requirements. Although the pricing was high and while the loan officers achieved overages through a combination of interest rates and discount points, as opposed to through only discount points, there was no violation of tiered pricing and the overages were permissible. The borrowers in these cases had marginal credit, therefore imposing higher lending risks and necessitating more expensive loans. Although the loans were expensive, as explained above, HUD does not regulate interest rates and is required to insure an FHA loan at the rate agreed upon by the borrower and lender. See Housing and Urban-Rural Recovery Act of 1983, Public Law 98-191, § 404 (November 30, 1983); Mortgagee Letter 1983-27; HUD Handbook 4000.2 REV-2, ¶ 1-10 (July 1991); HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-7. Here, contrary to the suggestion in the Report, the interest rates and discount points were negotiated between the buyers and loan officers. While it is true that most of the borrowers did not speak English well or at all, the loan officers spoke Spanish and were able to communicate with the borrowers easily. Each borrower understood and agreed to the loan terms, and no borrowers were misled or deceived.

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Guild objects to the statement that the cited transactions are "classic examples of predatory lending." Guild at no time allowed the Downey Branch to employ predatory lending practices, and it does not permit employees to take advantage of borrowers. The borrowers in these transactions received higher interest rates and costs because the loans were subprime loans that carried higher costs and risks to Guild than prime loans, but the borrowers understood the expenses associated with their loans and all fees were adequately disclosed. Moreover, as explained above, the Task Force Report, TILA, and state predatory lending laws are aimed at fees imposed on borrowers, not sellers. Here, while the borrowers paid high interest rates, the discount points and other closing costs and fees were paid by the sellers, not the borrowers. Although the interest rates were high in that they ranged from 8.75% to 9.5%, they were only slightly above Guild's par rates at the time,[5] and the loans did not constitute high-cost loans under either TILA or the California high-cost laws.

Finally, the Task Force Report acknowledges that "none of the statutes and regulations governing mortgage transactions provides a definition of predatory lending." It states that predatory lending "involves engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding about loan terms. These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices." The fact that the OIG believes the interest rates or fees were high in the cases cited in the Report, however, is not and should not be equated with instances of fraud or deception. In each case, the borrower understood and agreed to the loan terms. Moreover, the Task Force Report discusses specific characteristics of predatory loans. Notably, none of these characteristics are present in the Downey Branch loans. Unlike the examples in the Task Force Report, the Downey Branch loans did not involve "bait and switch" tactics, balloon payments, aggressive solicitation of borrowers, home improvement deficiencies, fees for no services performed, repeated refinancing of points and fees, prepayment penalties, or collaboration in fraudulent appraisals. The interest rates were not unreasonable given the borrowers' credit qualifications and the par rates at the time, the borrowers understood the loan terms, and the fees, though paid by the sellers, were properly disclosed to the borrowers. Each borrower also satisfied FHA criteria and thereby demonstrated the capacity to repay the loan. Guild did not permit loans with the expectation that borrowers would be unable to handle the payments. Guild at no time condoned predatory lending and there has been no violation of FHA requirements.

[5] As previously noted, with respect to the 10 loans cited in Appendix C of the Report, these loans exceeded Guild's par rate by, on average, 0.512%. None of the loans exceeded Guild's par rate by more than one percent, and nine of the ten loans exceeded the par rate by substantially less than one percent.

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3. The Properties Were Accurately Valued and Guild Neither Knew Nor Should Have Known of Strawbuyers

Finding 1 alleges that 16 transactions involved property flips and/or strawbuyers. While the Report does not detail the OIG's findings in these 16 cases, it notes that the purchase prices increased, on average, by $77,700 over a 3.5-month period. It further states the OIG's belief that the loan officers used the property flips and strawbuyers to obtain unearned fees because investors typically will not question the payment of discount points when they need to resell a property quickly. The Report cites two specific examples. In one case, the investor purchased the property on July 5, 2000 for $63,000 and sold it on July 20, 2000 for $137,000. In the other case, the investor purchased the property on May 1, 2000 for $35,000 and sold it on June 6, 2000 for $138,000.

Guild understands and appreciates an appraiser's duty to identify and analyze prior sales of the subject property, as well as a lender's responsibility to review the appraisal report to determine whether the appraiser's representations are accurate and conclusions acceptable. The Company's underwriters are intimately familiar with the appraisal process and consistently analyze property appraisals to ensure that they are consistent with other file documentation, satisfy FHA appraisal requirements, and contain sufficient data to reasonably support the appraisers' conclusions. Guild requires its underwriters to scrutinize each FHA appraisal report prior to closing, confirm the identity of the current property owner, and determine whether the appraised value is reasonable based on the appraisal report. The cases cited in Appendix D of the Report were no different. In each of these cases, the underwriter carefully reviewed the appraisal report and analyzed the subject properties' appraised value. The loan files contain appraisal reports prepared by FHA-approved roster appraisers that include detailed information about the subject properties, including comments on improvements made to the properties prior to resale, sufficient to justify the ultimate value conclusions. Each appraisal report relies on appropriate comparable properties that support the final value estimates, and most of the subject properties were located in neighborhoods undergoing revitalization efforts insofar as one or more of the comparables in each appraisal report reflect similar rehabilitation and resale conditions as the subject property. Guild properly analyzed the appraiser's conclusions in each case and reasonably determined that the properties were eligible for FHA insurance.

Moreover, please note that some of the loans cited in the Report were field reviewed by HUD prior to being insured by the FHA. After informing Guild that the Department was field reviewing all properties within certain zip codes to ensure that the properties were not overvalued, regardless of the lender that originated the loan, HUD suspended approximately 21 loans originated by Guild within those zip codes. Significantly, after obtaining review appraisals on these properties, HUD determined

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that the properties were not overvalued and issued a Mortgage Insurance Certificate ("MIC") for each one. In addition, in one case, the Department reviewed the appraisal report on a pre-closing basis. Notably, HUD issued a letter to Guild stating that, after reviewing the file, HUD determined that the transaction complied with FHA requirements and did not require any additional processing prior to closing. Thus, even if there were prior sales in some or all of such cases, the properties were accurately valued and were not over-insured.

Finding 1 cites two examples. The first example refers to the [redacted] case, FHA Case Number 197-1820756. In this case, [redacted] acquired the property through foreclosure on November 4, 1999. Mr. [redacted] subsequently sold the property unencumbered to [redacted] on July 13, 2000. Notably, the appraisal report in this case states that the subject property was purchased as an "REO fixer well below market, and had since [under]gone renovation." The appraisal report also notes that there was "new interior, exterior paint, new exterior stucco, new carpet and vinyl flooring throughout." The underwriter who reviewed the file at the time identified the fact that the appraisal report did not reference the most recent reconveyance of the property in July 2000 and therefore asked the appraiser to address this discrepancy. The appraiser responded by informing Guild that the prior sale was "not a typical sale, nor an arms-length transaction." Thus, the prior sales price of $63,000 did not reflect the subject property's market value. In addition, the comparable properties used in this case were all within a mile of the subject property, had all sold within the past 12 months (two had sold within the past two months), bracketed the subject property in sales price and gross living area, had adjustments well within the acceptable range, and had similar location influences. The market data supported the appraiser's estimate of value.

The second example in the Report refers to the [redacted] case, FHA Case No. 197-1748963. Here, the seller, [redacted] acquired the property from a private party on May 10, 2000. Although the resale value was substantially higher than the previous purchase price, the appraisal notes that the subject property had "new flooring throughout, remodeled kitchen, new appliances, countertops, new interior and exterior paint." In addition, all of the comparable properties were within a half mile of the subject property, had sold within the past six months, had minimal adjustments, and bracketed the subject property. The market data supported the FHA appraiser's estimate of value. Furthermore, note that the [redacted] loan was one of the files that underwent a HUD review appraisal prior to insuring. Significantly, HUD determined that the property was accurately valued and accordingly issued the MIC.

In sum, the appraisal reports in the [redacted] and [redacted] cases, as well as in the other cases cited in Finding 1, were detailed and complete. The comparable properties' specifications and sales histories, in conjunction with the improvements and repairs to

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the subject properties, confirmed the accuracy of the subjects' appraised values. Contrary to the allegations in Finding 1, the underwriter diligently reviewed each appraisal report, analyzed the appraiser's conclusions, and reasonably determined that the property was eligible for FHA insurance. The underwriter approved the loans in accordance with FHA guidelines in effect at the time and requested information on prior sales and/or rehabilitation work when such information appeared to be missing from the appraisal report. What's more, HUD obtained its own field review appraisals in some cases prior to issuing MICs, including the [redacted] case, and it determined that the property values were not inflated. The Report does not offer any evidence that the subject properties were over-appraised, and all information contained in the appraisal reports and elsewhere in the loan files supports the conclusion that the properties were accurately valued.

Guild would also like to take this opportunity to note that the referenced transactions generally occurred in 1999 and 2000. At that time, "property flipping" was just beginning to be recognized as a national concern. The Department had not yet focused its attention on frequent property turnover, but rather focused on proper valuation techniques. Both HUD and state appraisal boards subsequently identified property flipping itself as a problem, and lenders, including Guild, have since become active in encouraging efforts to both detect and report property flipping and deficient appraisals. Guild has provided training to its employees with regard to the proper review of appraisal reports and informed employees that Guild will not tolerate non-compliance with either Company or FHA requirements. We have emphasized the importance of accurate appraisals and reminded our staff that diligent adherence to the applicable rules and regulations is crucial to ensure proper financing. The Company's success in this area is evidenced by the fact that the Report identifies only 16 loans of the thousands of FHA loans that Guild originates each year, and that all 16 were originated during the same time period several years ago.

Moreover, HUD did not issue its final rule prohibiting property flipping until May 2003, <u>see</u> 68 Fed. Reg. 23375, Mortgagee Letter 2003-07, at least three years after the loans in question were originated. At the time the loans were originated, the underwriter met the existing minimum underwriting requirements for these types of loans. There was no prohibition against the sale of recently purchased property, and the appraisal reports justified the increased values. <u>Notably, however, many of the 16 transactions appearing in Appendix D of the Report would have been acceptable even under the new anti-flipping requirements.</u> As you know, the new requirements prohibit FHA mortgage insurance on properties that have been resold within 90 days of the seller's acquisition of the property, but permit resales between 91 and 180 days so long as the increased value is supported by a new appraisal if the resale price is over 100% of the seller's acquisition price. Here, 10 of the 16 cited transactions were resold more than 90 days after the seller's acquisition of the property; while five of the resale prices were greater than or equal to 100% of the seller's acquisition price, the property value in each case was supported.[6]

Finally, the Department has indicated that, depending upon the circumstances in a particular case, if the Department finds that an appraisal is so deficient that the adequacy of the security for the loan is compromised or that the Department's risk has been substantially increased, the Department may look to a lender for risk mitigation. See Mortgagee Letter 94-54. In this instance, however, there is no evidence that the appraisals are so deficient that the adequacy of the security for the loans is compromised or that HUD's risk has been substantially increased. In fact, there is no evidence that the properties were incorrectly valued or over-appraised, or that the loans were over-insured.

4. The Downey Branch Charged Only Permissible Fees

Finally, Finding 1 alleges that RMB charged excessive fees for underwriting and processing the loans. It states that, according to Guild's management, Branch Managers were permitted to determine the amount to be charged for these services. Finding 1 notes that, at RMB, loan officers were required to charge $300 for underwriting and $395 for processing, but that if a loan officer was able to charge more than those amounts in a particular case, the loan officer would receive the difference between the required charge and the actual charge as part of his or her commission.

In compliance with FHA guidelines, the Downey Branch did not charge processing or underwriting fees to the borrowers. See HOC Reference Guide, Page 2-15. In every case, the seller paid these fees. As explained above, the Department does not regulate fees paid by sellers. The FHA regulations addressing closing costs expressly refer to "fees and charges that may be collected from the borrower[.]" HUD Handbook 4000.2 REV-2, ¶ 5-3. HUD does not permit certain charges to be made to the borrower, but it will allow them to be charged to the seller. The only authority cited in the Report for the proposition that the Department may review charges to the seller is Mortgagee Letter 94-16, which the Report quotes as stating that "HUD does not agree that the law precludes review of one or more items of closing costs merely because actual payment may have been made by the seller in the particular transaction. The law applies to the mortgagee's customary lending practices, not to the terms negotiated between sellers and buyers." This statement, however, is quoted out of context and

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[6] At the time the loans cited in the Report were originated, the closest rules to "anti-flipping regulations" that HUD had in place concerned the resale of HUD REO properties by non-profit organizations. These guidelines, however, did not apply to the 16 cases where the Report alleges property flipping. Having said that, Finding 1 does reference three transactions involving non-profit sellers and suggests that these cases involved strawbuyers. We address these cases below in response to Finding 3.

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Mortgagee Letter 94-16 is inapplicable to the instant matter. The quoted statement responds to two commenters' remarks regarding HUD's statutory authority to review closing costs paid by the seller in a particular transaction and expresses HUD's view that it has authority to review charges paid by a seller when reviewing a mortgagee's customary lending practices to determine whether there has been a violation of tiered pricing. As tiered pricing is not at issue here, further review of charges to the sellers is gratuitous and unsupported by FHA rules and regulations.

While the processing and underwriting fees were high, and while such fees are not typical of Guild transactions, there was no prohibition against charging them to the sellers. In fact, the Report fails to cite any authority suggesting that the fees were impermissible. FHA rules and regulations address fees to borrowers, not sellers, and all charges to the borrowers were permissible. Guild adhered strictly to FHA requirements.

B. FINDING 2 – THE DOWNEY BRANCH WAS A LEGITIMATE BRANCH OFFICE

In Finding 2, the Report alleges that, as a result of improper executive decisions when entering into Branch Manager Agreements, Guild approved RMB to originate FHA mortgages in violation of HUD requirements concerning third-party loan originations. It alleges that, as a result, RMB was a prohibited branch office operation and was ineligible to originate FHA-insured loans. Specifically, Finding 2 makes three allegations concerning the rental of office space, the Branch Managers' obligation to indemnify Guild for gross negligence or fraud, and underwriter supervision. It recommends that Guild be required to indemnify HUD for every loan originated by RMB.

Guild currently has 51 branch offices. In compliance with FHA requirements, each branch office either is registered with HUD/FHA or constitutes a satellite office located within the HUD field office jurisdiction of the Company's home office or a registered branch. Each office: is situated in a location conducive to performing mortgage lending business; is separate and apart from other entities; is clearly identified to the public through adequate signage; has separate telephone lines; is staffed by W-2 employees of the Company who are required to work exclusively for Guild; has a designated Branch Manager; is subject to Guild's supervision and control; and is included in the Company's Quality Control reviews. In addition, Guild pays all operating expenses, including rent, for every office location. Each office undergoes training with corporate personnel, and the corporate office is responsible for all marketing, insuring, secondary market functions, data processing, human resources, accounting, regulatory approvals and licenses, funding, and loan shipping. All branches are fully integrated into the Company. They are not separate entities, and Guild takes responsibility for the actions of branch office personnel.

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Since its inception, Guild has been cautious to ensure that its branch offices comply with FHA requirements. Thus, when HUD issued Mortgagee Letter 00-15 to clarify branch office requirements and cure widespread confusion in the lending industry, Guild diligently hired a local attorney to review its branch office operations and Branch Manager Agreements, including the agreements that are the subject of Finding 2. Notably, Guild made any changes recommended by the outside counsel and was advised that its operations and agreements were compliant.

As explained below, contrary to the suggestion in the Report, the Downey Branch was a legitimate branch office of Guild. The Company paid all of its operating expenses, including rent, the indemnification provision in the Branch Manager Agreement was permissible, and Guild exercised proper supervision and control over the Downey Branch employees. The Downey Branch was not a separate entity and its loans did not constitute third-party originations. Moreover, Finding 2 does not allege any deficiencies in the Downey Branch files themselves, but only technical violations unrelated to the loan transactions. Given that the Downey Branch was a legitimate Guild operation and that the borrowers qualified for FHA financing, indemnifications would be inappropriate. We address each matter raised in Finding 2 in turn below.

1. **Guild Paid for the Downey Branch's Rent and All Other Operating Expenses**

Finding 2 alleges that Guild required the RMB Branch Manager, as part of the Branch Manager Agreement, to negotiate the RMB office space leases in his name. It alleges that there were two agreements, which required the Branch Manager to negotiate the terms of the leases and execute the leases in his name after which Guild would enter into a sublease agreement for the amount of the actual rent. Finding 2 notes that the Branch Manager executed the leases in the name of his independent mortgage corporation, Residential Mortgage Associates ("RMA"), which in turn sub-leased the space to Guild, and that the rents were paid from personal or non-mortgagee accounts. Finding 2 concludes that there was a clear separation between Guild and RMB, which is inconsistent with the requirement that mortgagees exercise control and responsible management supervision over their employees.

There is no requirement that a mortgagee's name appear on any vendor contracts, including leases for office space. FHA guidelines provide only that a mortgagee must pay for all operating expenses, including rent, and that an "employment" agreement may not contain "provisions that require all contractual relationships with vendors such as leases, telephones, utilities, and advertising to be in the name of the 'employee' (branch) and not in the name of the HUD/FHA approved mortgagee." Mortgagee Letter 00-15. Here, Guild's Branch Manager Agreements did not require that "all contractual relationships with vendors" be in the Branch Managers' names. Although they provided that the Branch Managers would negotiate the leases for the Downey Branch, they required the Company to pay all operating expenses, even where the Branch Managers were named in the lease agreements. In fact, as recognized in the Report, Guild executed sublease agreements for the office space and therefore was contractually obligated to pay the rent. Note that such sublease arrangements are typical in the lending industry. Within any mortgage company, it is possible that the relationship between the mortgagee and an employee will sour and ultimately result in termination of the office to which the employee is assigned. In order to avoid long-term liability on a lease agreement for such an office, the lease agreement may be in the name of the employee so that the employee will remain responsible for rent payments after the mortgagee terminates him/her and his/her branch office. The mortgagee, however, will be responsible for the rent payments under a sublease arrangement for the duration of the employee's work with the company. This is precisely the type of arrangement that existed for the Downey Branch, and it complied strictly with FHA program requirements.

Again, FHA guidelines require only that the mortgagee "pay" the operating expenses. Mortgagee Letter 00-15 expressly states that "<u>[i]f the expenses are paid by the HUD/FHA approved mortgagee, the arrangement is acceptable</u>." (emphasis added). We also understand from the HUD Lender Approval and Recertification Division that the purpose for issuing Mortgagee Letter 00-15 was to remind lenders that they, and not their Branch Managers, must pay all operating expenses. Here, as detailed below, Guild consistently has done precisely that. The Company, and not its Branch Managers or other employees, paid all operating expenses for the Downey Branch. Thus, according to the language of Mortgagee Letter 00-15, Guild complied with FHA requirements.

Not only was Guild contractually obligated to pay the Downey Branch's rent under sublease agreements, but the Company paid both the rent and all other operating expenses for the entire time that the Downey Branch was operational.

- <u>Rent</u> – While RMA, the Branch Manager's company, paid the landlord, Guild reimbursed RMA in full. RMA did not mark up the rent and Guild reimbursed RMA for the exact amounts that RMA paid to the landlord. Guild furnished to the OIG copies not only of the lease and sublease agreements, but of the cancelled checks evidencing Guild's payment of the rent.

- <u>Contracts With Vendors</u> – Other than the lease agreements for office space, all other contractual agreements with vendors were in the name of Guild and payments under such agreements were made directly by Guild from its operating accounts to the vendors. Neither the Downey Branch nor any other branch offices have maintained separate accounts, and Guild pays all operating expenses for branch offices "off the top."

- Branch Office Accounting – As is typical in the lending industry, Guild creates a profit and loss account through its corporate account for each branch, collects revenue from the branch, pays the branch expenses, and then pays certain employees the remaining revenue as a commission. While Guild realizes all income from the office and bears all office expenses as they are incurred, it credits and debits income and expenses to and from the office account that are attributable to the office in order to determine the net compensation due employees.[7] If there is a loss to a branch in any given month, Guild, not the branch, covers the loss and recovers it from the following month's profits. The Department has stated that "[s]uch an arrangement is, essentially, an alternative compensation program for the branch manager and is an acceptable branch arrangement if all other branch requirements are met." Mortgagee Letter 00-15.

  More specifically, Guild did not permit the Downey Branch, nor does it permit any other branch office, to access corporate operating or custodial accounts. Guild's corporate finance department pays all operating expenses directly. All original invoices are sent to the accounts payable clerk in the corporate office for processing and payment, and all checks are drawn on Guild's operating account and signed by a corporate officer.

- Payment of Expenses – Guild purchases all branch office equipment, and it has a fixed asset listing with copies of the invoices paid and cancelled checks in Guild's name. In this regard, Guild paid all of the Downey Branch's office expenses, and it had corporate vendor accounts and centralized billing for numerous expenditures, including among other things:

  - office supplies;
  - telephone service;
  - data lines;

[7] For example, Guild credits to a branch such items as: origination fees; discount points in excess of those required on the loan by the mortgagee or investor; and miscellaneous fee income not paid to a third-party service provider and received in connection with any particular mortgage loan in excess of that required by the mortgagee. In contrast, while Guild pays all operating expenses of each branch as they come due, it debits the expenses from the office account, including such expenses as: advertising costs; employee wages, benefits, payroll taxes and other contributions required by law or contract related to employment taxes, workers' compensation insurance or employee pension or retirement plans; rent; utilities; office supplies; furniture; equipment; overhead and administrative fees; shipping expenses; costs of government auditing and storage; appraisals; credit reports; carrier services; surveys; title charges; Quality Control fees; and any other administrative fees associated with maintaining and running the office.

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- credit reports;
- computer purchases;
- courier services;
- tax service contracts;
- flood certification contracts;
- express mail services; and
- mail services.

Guild's general ledger details all vendor expenses for the Downey Branch that Guild paid. In addition, Guild purchased point of sale software (i.e., Loan Officer Plus) for the Downey Branch and required the Downey Branch to use Guild's software and support services in connection with the Downey Branch's processing and underwriting of loans on Guild's proprietary mainframe.

- Employees – All employees working at the Downey Branch were W-2 employees of Guild and received payroll checks in Guild's name. They were required to complete the Guild employment application and follow Guild's employment policies.

Finally, we understand and appreciate the Department's concern that some FHA-approved mortgagees may allow non-approved entities to originate FHA loans using their HUD Identification Numbers. The Department expressed this concern in Mortgagee Letter 00-15, where it indicated that the FHA branch office requirements are based on HUD's concern that some HUD/FHA approved mortgagees have taken on existing, separate mortgage companies/brokers as branches and allowed those separate entities to originate insured mortgages under the approved mortgagee's HUD Identification Number, thereby creating a "clear separation" between the approved mortgagee and its branches. These concerns, however, do not exist in this case. The Downey Branch was fully integrated into Guild. Unlike situations where individual Branch Managers are responsible for paying operating expenses for their own offices, thereby raising the concern that such individuals/offices are separate and distinct from the FHA-approved entity, the Downey Branch was never responsible for paying its own operating expenses and all Downey Branch employees were W-2 employees of Guild. The Downey Branch was not a separate entity, and there was no separation between the Downey Branch and Guild. All individuals working for the Downey Branch were subject to Guild's supervision and control and were required to work exclusively for the Company during normal business hours. The arrangement therefore is consistent with the Department's goals underlying the FHA mortgagee approval and employment requirements.

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In sum, Guild paid all operating expenses for the Downey Branch, including the rent. In an effort to avoid a situation involving long-term liability under a lease agreement for office space even after the office closed, Guild executed a sublease agreement for the space rather than a contract directly with the landlord. The use of sublease agreements is typical in the mortgage industry and does not render a branch office a separate entity. The fact that the name of the Branch Manager's company appeared on the lease agreements in no way suggests that Guild did not pay operating expenses or that the branch was somehow separate and distinct from the Company. To the contrary, Guild was contractually obligated to and in fact did reimburse RMA for all rental expenses, as evidenced by cancelled checks, and the Company paid all other operating expenses directly. We understand the Department's requirement that a mortgagee pay all operating expenses of its branch and satellite offices, see HUD Handbook 4060.1 REV-1, ¶ 2-17, Mortgagee Letter 00-15, and Guild has adhered strictly to this requirement. Thus, according to the language of Mortgagee Letter 00-15, Guild has satisfied the applicable FHA guidelines.

2. The Indemnification Clause Was Permissible

Finding 2 also alleges that the Branch Manager Agreement contained a prohibited indemnification clause, which provided:

> Manager shall indemnify GMC against any loss or damage incurred by GMC which has resulted from Manager's gross negligence or willful or wanton actions during the term of this agreement, including but not limited to fraudulent action known to Manager or participated in by Manager in connection with any loan originated at or brokered by the branch.

Guild understands and respects the prohibition in Mortgagee Letter 00-15 against certain types of indemnification by Branch Managers or other employees. The prohibition, however, states that an employment agreement may not "require the 'employee' (branch) to indemnify the HUD/FHA approved mortgagee if it incurs damages from any apparent, express, or implied agency representation by or through the 'employee's' (branch's) actions." Significantly, the indemnification provision in Guild's Branch Manager Agreement did not require this type of indemnification. In contrast, it required indemnification resulting only from the Branch Manager's "gross negligence or willful or wanton actions[,]" including fraud. This type of indemnification is not prohibited.

Moreover, we understand that the prohibition against indemnification in Mortgagee Letter 00-15 was aimed at ensuring that mortgagees pay for operating expenses and assume responsibility for harm caused to third parties resulting from the actions of the mortgagee's employees. We understand that HUD does not object to a mortgagee's requirement that employees indemnify it for their commission of fraud or violation of employment agreements, which, as previously noted, were the types of conduct covered by the indemnification clause at issue. In fact, the Department's Lender Approval and Recertification Division has acknowledged that a mortgagee may require a Branch Manager, loan officer, or branch office to pay for costs incurred in connection with repurchases due to the origination of loans that are fraudulent, contain material misrepresentations, or result in early payment defaults. This was precisely the nature of the indemnification provision at issue in this case. Guild is responsible for all operating expenses and assumes responsibility for any harm caused to third parties resulting from the actions of its employees. The indemnification provision in the Branch Manager Agreement was narrow and complied with FHA requirements.

3. Guild Exercised Proper Supervision and Control Over the Downey Branch Employees

Finally, Finding 2 alleges that Guild did not exercise adequate control and supervision over RMB employees insofar as RMB's former on-site underwriters both considered the RMB Branch Managers, rather than the corporate underwriting supervisor, to be their supervisors even though the Branch Manager Agreement provided that the managers would have no control over the underwriting process. Finding 2 also notes that the RMB Branch Managers rarely prepared performance appraisals for branch employees and that Guild's management indicated that Branch Managers could only be encouraged, not required, to perform personnel appraisals. The OIG stated its belief that such a practice is inconsistent with a traditional employer/employee relationship.

The Report fails to allege violation of any particular FHA requirement or to cite any authority for the allegations made in Finding 2. Nevertheless, contrary to the suggestion in the Report, Guild exercised proper supervision and control over the Downey Branch employees, including the underwriters.

With respect to supervision of the underwriters, the Branch Manager Agreement prohibited the Branch Managers from controlling the underwriting process in an effort to ensure that underwriting remained independent from loan origination and to shield the underwriters from any potential pressure to approve loans. For this reason, the two former underwriters reported directly to the Underwriting Coordinator in Guild's corporate office, not to the Branch Managers. Nevertheless, the underwriters were located on-site at the Downey Branch and the Branch Managers held positions senior to them in the Company and were in charge of the office. Thus, it is understandable that the underwriters would view the Branch Managers as their superiors. The underwriters,

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however, knew that they reported directly to the corporate Underwriting Coordinator located in the home office, who exercised responsible management controls over their work. Moreover, as previously noted, the underwriters were required to attend training at Guild's home office and perform well on live file test cases.

With respect to performance appraisals of branch employees, the Branch Managers were required to supervise branch personnel but were not required to perform formal written appraisals of employees' performance. Whether such appraisals are performed, however, is a matter of internal business strategy and is not governed by HUD or the FHA guidelines. The failure to perform such formal appraisals neither violates any FHA requirement nor suggests the absence of an employer/employee relationship. Furthermore, Guild did perform regular and ongoing reviews of employee performance through the Branch Managers' daily supervision of employees and the Company's formal Quality Control reviews. Loan officers were generally reviewed on their production and volume, as well as on any negative data available (e.g., Quality Control errors or deficiencies, underwriting concerns, etc. . . .), and all branch employees were included in Quality Control. More formal performance evaluations are uncommon in the lending industry, and Guild's procedures in this regard were consistent with typical employer/employee relationships in the mortgage lending context.

C. FINDING 3 – GUILD DID NOT ALLOW THE FHA LOAN PROCESS TO BE MANIPULATED

In Finding 3, the Report alleges that Guild did not establish appropriate loan processing and underwriting controls to ensure HUD requirements were followed during the loan origination process. It alleges that, in several instances, the Downey Branch disregarded HUD underwriting requirements, did not identify and resolve questionable information and patterns in its loan origination files, and approved loans that did not meet FHA requirements. Finding 3 alleges that Guild's lack of effective controls and due care allowed the Downey Branch employees to manipulate the loan origination process and approve loans to unqualified borrowers. Specifically, Finding 3 alleges that loans were processed and approved with falsified information, contained documents faxed through interested third parties, were missing sales contracts, involved strawbuyers, indicated conflicts of interest, or were originated from space located inside a real estate company. Finding 3 recommends that Guild be required to indemnify HUD in connection with 27 loans.

Contrary to the allegations in Finding 3, Guild at no time allowed the FHA loan process to be manipulated and has continuously had controls in place to monitor loan origination, processing and underwriting. In fact, not only did Guild require corporate training for branch employees and satisfactory underwriter performance on live file test

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cases, but it was Guild that originally identified concerns in the Downey Branch files and took steps to terminate the potentially responsible individuals. As explained above, [redacted] a former Downey Branch loan officer employed between December 3, 1999 and July 3, 2001, originated 17 of the 40 loans cited in the Report,[8] 16 of which are included in the 29 loans that have resulted in claims to HUD. In addition, the same underwriter, [redacted] underwrote 35 of the 40 loans. Prior to the OIG audit, and as a result of routine Quality Control reviews, Guild identified concerns in these individuals' loans and took appropriate steps to investigate the Company's findings and terminate its relationship with the individuals involved. It fired [redacted] and both the underwriter and the Branch Managers resigned in response to increased scrutiny from the corporate office. Guild closed the Downey Branch and none of the employees who worked at the Downey Branch continue to work for the Company. Guild acted prudently and as swiftly as possible in connection with this matter.

Having said that, the Report fails to provide any specific information regarding the cited loans. In Appendix B, the Report includes a table of alleged loan origination deficiencies indicating false employment or other false information/documentation, but it does not identify the purportedly false documentation or explain how the OIG learned of the alleged falsehood. The lack of specific allegations in each case makes it impossible to address each individual loan separately, which therefore places Guild at a significant disadvantage in defending the loans. Nevertheless, our review of the files listed in Appendix B revealed that there was nothing in the file documentation to suggest that Downey Branch employees either knew or should have known of false information or other file deficiencies. While Finding 3 alleges that certain patterns in the files existed, such patterns could not necessarily have been identified by Guild given that the loans were originated several months apart. It is substantially easier to identify patterns when a handful of files are audited together. Absent evidence that Guild had actual or constructive knowledge of deficiencies in the loan files prior to submitting the loans for insurance endorsement, Guild cannot be held responsible for the alleged deficiencies and indemnifications are inappropriate. We address below the individual matters raised in Finding 3.

1. Guild Neither Knew Nor Should Have Known of False Information in the Files

Finding 3 alleges that, in 29 cases listed in Appendix B, the loans were approved based on false information, including false employment, fictitious identification and alternative credit, false gift fund and explanation letters, and invalid Social Security Numbers. As previously noted, the Report fails to provide any specific information regarding these 29 loans, thereby making it extremely difficult for Guild to defend them.

8 The remaining 23 loans were originated by 11 different loan officers.

Nevertheless, Guild's review of the loan files revealed no evidence to suggest that Downey Branch employees knowingly submitted loans with false information to HUD for insurance.

As you may know, the incontestability clause of the National Housing Act ("NHA") restricts the circumstances under which the Department may terminate its contract of insurance with a mortgagee to those where the mortgagee had actual or constructive knowledge of fraud or misrepresentation. Specifically, the NHA provides that:

> Any contract of insurance heretofore or hereafter executed by the Secretary under this title shall be conclusive evidence of the eligibility of the loan or mortgage for insurance, and <u>the validity of any contract of insurance so executed shall be incontestable in the hands of an approved financial institution or approved mortgagee from the date of the execution of such contract, except for fraud or misrepresentation on the part of such approved financial institution or approved mortgagee.</u>

12 U.S.C. § 1709(e) (emphasis added). Those courts that have considered the NHA's incontestability clause generally agree that the Department may not challenge the validity of an FHA insurance policy or deny insurance unless the mortgagee engaged in fraud or misrepresentation. <u>See, e.g.</u>, <u>Ashton Acres Apartments, Ltd. v. The United States of America</u>, No. 84-6395, 1985 U.S. Dist. LEXIS 20810, *13 (E.D. Pa. April 12, 1985) ("Although there are few cases on the issue, it is apparent that the clearly expressed purpose of § 203(e) is to prevent HUD from denying the validity of an insurance contract; once the guarantee has been issued, the Secretary cannot claim that the mortgage was ineligible in order to defeat the claim of the lender, in the absence of fraud by the latter. . . . [The] decision that the mortgage was eligible . . . is now immutable.") (citing <u>Jay F. Zook, Inc. v. Brownstein</u>, 237 F. Supp. 800 (N.D. Ohio 1965)). In fact, the Department traditionally has not held a lender responsible for fraud committed by the borrower, seller, real estate agent, or others absent actual or constructive knowledge on the part of the lender.

Here, the Downey Branch obtained the required documentation to approve the loans and the borrowers certified on the initial and final loan applications that the information contained therein was accurate and complete. The Downey Branch had no reason to question the borrowers' veracity, and there is no evidence that Downey Branch employees knowingly submitted false information to the Department. To the extent the borrowers or others may have furnished false information or documentation or falsely certified employment or other information, it appears that the borrowers and/or others may have perpetrated a fraud against both Guild and the Department.

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a. Employment Verifications

Finding 3 alleges that, in 18 cases listed in Appendix B, RMB employees falsely claimed that employment information had been verified and re-verified prior to closing. It provides one example, stating that, for one transaction, the Verification of Employment ("VOE") form indicated that the owner of a beauty salon and supply business in Huntington Park, California had signed the VOE form in February 2000 and verified that the borrower had worked as a receptionist since 1996, but that the owner informed the OIG that the signature did not belong to him and that the borrower had never worked there. Finding 3 references a document in the file indicating that the loan closer "reverified" the borrower's employment by telephone prior to closing, and that although the telephone number shown on the reverification belonged to the employer, the reverification could not have been performed given the owner's statement that the borrower had never worked there.

There is no evidence in the files that Downey Branch employees falsified employment verifications. In compliance with FHA requirements, see HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-6, the Downey Branch verified the borrowers' employment for the most recent two years based on factual data received from the borrowers and their employers. Each loan file contains all required employment documentation (e.g., a VOE form and most recent pay stub, or a verbal certification of employment, 30 days' pay stubs, two years' W-2 forms, and an IRS form 4506 or 8821), and nothing on the face of the file documentation is suspicious. Each borrower also certified on the loan application that the employment information was correct. Guild reasonably relied on both the documentation it received and the borrowers' certifications.

The example cited in the Report refers to the [redacted] case, FHA Case No. 197-1596389. Here, there is nothing in the loan file that would have alerted the underwriter to the fact that the borrower may not have worked for the employer. The mere fact that the employer denied signing the VOE form or employing the borrower does not evidence that a Guild employee falsified the VOE form or re-verification. For example, it is possible that a telephone bank had been established by the borrower and/or others to receive the re-verification calls and make the employment appear legitimate. Even if HUD confirmed an employee's signature as valid on a re-verification form, one cannot conclude from that alone that the employee was involved in fraud. Absent specific allegations in the remaining cases referenced in the Report, Guild cannot respond in greater detail to any of the cases.

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b. Borrower Identities

Finding 3 alleges that, in five cases listed in Appendix B, the borrowers used fictitious identifications, sometimes to obtain more than one FHA loan under different names. For example, Finding 3 references a case where a man and woman who represented themselves as a couple living together obtained two FHA loans from the same Downey Branch loan officer under different names using driver's licenses with the same picture but different license numbers. Finding 3 also references a case where two brothers obtained an FHA loan using false resident alien cards and allegedly informed the OIG that the loan officer, one of the Branch Managers, was aware the cards were falsified.

There is no evidence in the loan files that Downey Branch employees knew that some borrowers may have used fictitious identifications. The files contain all required documentation to verify the borrowers' identities and the file documentation is consistent in this regard. The borrowers also certified as truthful the information contained in their loan applications, and Guild had no reason to question the borrowers' veracity.

With respect to the example used where a couple obtained two FHA loans from the same loan officer under different names using driver's licenses with the same pictures but different license numbers, this case refers to the [redacted] and [redacted] transactions, FHA Case Nos. 197-1689422 and 197-1920162, respectively. There is no evidence in these cases, however, that the loan officer knew of the borrowers' wrongdoing, and the Report offers no such evidence. Nothing on the face of any file documentation for either transaction was cause for suspicion, and if the loan officer did not have a face-to-face interview with the applicants in one of the transactions, then he likely would not have recognized the borrowers from the other transaction given that they were using different names. In addition, the loans closed six months apart, and neither the loan officer nor the underwriter could have been expected to recognize the photographs in the driver's licenses in the second transaction. With respect to the case where two brothers used false resident alien cards and allegedly claim that the loan officer knew they were false, this case refers to the [redacted] transaction, FHA Case No. 197-1527570. Again, the documents in the file appear legitimate. The borrowers therefore may be mistaken in their accusation. Absent an opportunity to interview both the borrowers and the loan officer, Guild cannot adequately respond to this allegation. Again, absent specific allegations in the remaining cases allegedly involving fictitious borrower identities, Guild cannot respond in greater detail.

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c. Other Documents

Finding 3 also alleges that 15 loans referenced in Appendix B contained other false documents, including invalid or questionable Social Security Numbers ("SSN"), false gift, credit, explanation and relationship letters, an altered police report, and a falsified tax return. Specifically, it alleges that, in eight cases, the borrowers/co-borrowers had questionable or invalid SSNs insofar as borrowers used SSNs prior to their purported date of issuance, SSNs were shown as issued prior to the borrowers' year of birth, an SSN was shown as unissued, the borrowers admitted the SSNs were false, and a borrower used more than one SSN. Finding 3 further alleges that there were false gift letters in five cases. Finding 3 states that the OIG interviewed the purported donors, who stated that they had not furnished any gift funds. Finally, Finding 3 alleges that relationship letters had been misrepresented insofar as one borrower stated that the co-borrower shown as his girlfriend was actually a friend of his mother's and had been added to the loan to help him qualify but did not help make the mortgage payments or live in the property.

As explained above, there is no evidence that Guild employees knew or should have known of the false information or documentation referenced in the Report. The files contain all required documentation and the borrowers certified that their applications were accurate and complete. Guild reasonably relied on the borrowers' certifications.

With respect to the borrowers' SSNs, the Downey Branch properly obtained evidence of each borrower's SSN in compliance with FHA guidelines. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-2(C). All file documentation is consistent in this regard insofar as the SSNs are the same on all items contained in the files, and there is no evidence that the borrowers' credit reports or other file documentation should have alerted Company employees to the potential that borrowers were using false SSNs. With respect to gift funds, each loan file contained sufficient documentation to evidence the transfer of gift funds and there is no evidence that Company employees knew or should have known that the gifts were false. The borrowers certified in the gift letters and loan applications that the gift funds were received, and Guild had no reason to question the borrowers' veracity. Finally, with respect to the example provided in which a relationship letter purportedly was misrepresented, please note that Guild has been unable to identify the referenced transaction. In Appendix B, however, the Report alleges that there was a false relationship letter in the [redacted] case (FHA Case No. 197-1612259). In this case, Guild has been unable to find any relationship letter in its files for this borrower. Furthermore, a relationship letter would have been unnecessary given that there was only one borrower in this case. With respect to the remaining transactions referenced in the Report, as stated above, absent specific allegations in each individual case, Guild cannot respond in detail to the findings.

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2. Documents Did Not Improperly Pass Through the Hands of Interested Third Parties

The Report alleges that, in 15 cases listed in Appendix B, documents relating to borrower credit, employment or income were faxed from real estate companies, and that many of the pay stubs, W-2 forms and other items had been falsified. The Report suggests that these items should not have been submitted for endorsement until documents that had not passed through the hands of interested third parties had been obtained and re-verified.

In many cases where the Report suggests that documentation was faxed, the items contained in Guild's loan files fail to reflect any evidence that they were faxed. These items do not contain facsimile banners and are not attached to facsimile cover sheets. We therefore are uncertain of the basis for the allegations.

In addition, contrary to the suggestion in the Report, FHA guidelines in force at the time the cited loans were originated and closed permitted items other than credit reports and verification forms to come from the borrower, and there was no prohibition against the use of an interested third party's facsimile machine to transmit the items. As you may know, borrowers often meet with loan officers outside of a lender's office in order to accommodate a borrower's work schedule or use facsimile machines made available by real estate agents, attorneys and others, to which the borrowers otherwise would not have access, in order to deliver documents to the lender. Guild understands and appreciates that, under the guidelines in force at the time, "credit reports" and "[v]erification forms must pass directly between lender and provider without being handled by any third party" and that faxed documents should be verified. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1; Mortgagee Letter 2001-01. Thus, it was Guild's policy and practice to obtain credit reports and verification forms directly from the providers and to ensure that faxed documentation was accurate and complete. There was no prohibition, however, against obtaining other items, such as pay stubs, W-2 forms, bank statements, alternative credit references and tax returns, from borrowers. Such items are not "credit reports" or "verification forms." Moreover, FHA guidelines expressly stated that the "applicant must provide a copy of his/her most recent pay stub" and that a lender may obtain pay stubs, W-2 forms, and bank statements "from the borrower." HUD Handbook 4000.2 REV-2, ¶ 3-6(B)(2) (emphasis added); HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1(E), (F) (emphasis added). Thus, borrowers were permitted to fax the referenced items to Guild, and there was no prohibition against a borrower's use of a third party's facsimile machine to do so.

While Guild adhered to FHA requirements in the cases referenced in Finding 3, please note that the Company has since modified its policies and procedures. In

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compliance with the requirements set forth in the new Mortgage Credit Analysis Handbook, effective for all initial FHA loan applications taken on or after January 1, 2004, Guild no longer accepts or uses documents relating to the credit, employment or income of borrowers that are handled by or transmitted from or through interested third parties or by using their equipment. See HUD Handbook 4155.1 REV-5, ¶ 3-1. Again, however, these requirements were not effective at the time the loans cited in the Report were originated and closed.

3. The Files Contained Required Sales Documents and Guild Neither Knew Nor Should Have Known that Some Transactions May Have Involved Strawbuyers

Finding 3 alleges that 13 loan files cited in Appendix B did not contain a sales agreement in the file submitted to HUD for endorsement. It acknowledges that these loans were "for sale by owner" transactions, but it notes the FHA requirement that sales contracts, and any amendments or other agreements and certifications, are typically required in all FHA transactions other than certain streamline refinances. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1. Finding 3 further alleges that, in all 13 cases, the seller was an investor or strawbuyer. It states that strawbuyers generally do not occupy the properties and are often used to conceal the actual buyer or investor. Finding 3 indicates that the OIG reviewed public records and determined that some of the investors had business connections with at least one RMB employee, including working for the same real estate company or jointly investing in real estate. It notes that one investor, who was a partner in at least one property investment with an RMB loan officer, was involved in six of the 13 loans; he was the seller in three cases and received large unexplained payouts at closing in three cases.

With respect to sales contracts, no such contracts existed in the referenced cases because the properties were sold by the owners and listing real estate brokers/agents were not involved. Guild was not required to compel the parties to execute sales contracts in order to make the loans. There were, however, escrow instructions containing all pertinent information and stating that there were no separate purchase agreements. For example, in one case (FHA Case No. 197-1596389), the escrow instructions stated: "Buyer and Seller hereby certify that these escrow instructions are the only contract between them; that there are NO Real Estate Brokers involved in this transaction and therefore NO Purchase Agreement and Receipt for Deposit has been written, and NO commissions will be paid through this escrow." Note that Guild also has a requirement in its Loan Settlement Instructions to the closing agent that "All escrow amendments must be provided to Guild Mortgage prior to closing." Such documentation is acceptable evidence in a "for sale by owner" transaction, and the escrow instructions represented the terms of the sale and satisfied the FHA requirement that all agreements or certifications in existence be provided.

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With respect to the allegation that some cases involved strawbuyers, Guild neither knew nor should have known that there may have been strawbuyers in these transactions. We understand the OIG has determined that, based on public records, there were connections between some of the investors/sellers and a Downey Branch employee, including working for the same real estate company or jointly investing in real estate, and that one investor, who was a partner in at least one property investment with a Downey Branch loan officer, was involved in six transactions insofar as he was either the seller or received payouts. There was nothing in the files, however, that would have alerted the underwriter who approved the loans to the possibility of transactions occurring outside of escrow that involved both the investors and a Downey Branch employee. Significantly, the OIG learned of possible connections by reviewing public records, which Guild was not required to do at the time. Furthermore, when Guild reviewed the HUD-1s prior to closing, the HUD-1s likely included only the buyers' information and did not reflect the seller payouts. Moreover, the loans were underwritten over a two and a half year period. Thus, given the large number of loans underwritten each month, the underwriter could not have been expected to identify the number of times a particular seller was involved in Downey Branch transactions or to conduct an investigation outside the scope of her responsibilities. While a pattern regarding the sellers may have become apparent when reviewing all of the loans at the same time, there was no reason to detect any such pattern over the long period of time during which the loans were approved.

In connection with Finding 1, the Report cites three transactions allegedly involving strawbuyers in Appendix D. The Report states that, in each case, the non-profit resold the property for significantly more than it purchased it and that the non-profit received a discount on the property when purchasing it from HUD and either deeded it to an investor prior to sale or acted as a strawbuyer. The first transaction is the [redacted] case, FHA Case No. 197-1645648. In this case, the seller was a HUD-approved non-profit, Shelter First, Inc. ("Shelter"). Shelter acquired the property in December 1999, five months prior to the closing of the Guild loan. While the OIG Report states that the non-profit's acquisition price was $70,000, the appraisal report indicates a purchase price of $100,000 and the preliminary title report indicates that a deed noting $120,000 was recorded. The appraisal report in this case indicates that the subject property was "gutted and remodeled" with new stucco, new roof, new windows, and new flooring throughout, new trim, new ceramic in the bathrooms, and new heating. In this regard, the HUD-1 reflects payments to several contractors. The comparable properties used in the appraisal report bracket the subject in sales price and square footage and support the final estimate of value. There was nothing in the file that would have alerted the underwriter to the possibility that the borrowers might be strawbuyers.

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The second transaction cited in Appendix D refers to the [redacted] case, FHA Case No. 197-1689422. In this case, the seller was [redacted], a California Public Benefit Corporation, and the file contains a written approval from HUD for this entity to participate in HUD's REO program. According to the appraisal report, the seller acquired the property in April 2000, two months prior to the closing of the Guild loan, for $116,000, though the Report indicates an acquisition price of only $81,200 and the preliminary title information notes that a deed for $105,000 was recorded on April 26, 2000. The appraiser commented that the property had been "completely rehabilitated and upgraded," and it noted new flooring, wainscot, heater, and stucco/paint. In addition, the comparables used in the appraisal report all supported the appraiser's final estimate of value. There was nothing in the file that would have alerted the underwriter to the possibility that the borrowers might be strawbuyers.

Finally, Appendix D notes the [redacted] case, FHA Case No. 197-1754867. As in the [redacted] case above, the seller was [redacted], a California Public Benefit Corporation, but the loan closed over a month after the [redacted] loan closed. The seller acquired the property in July 2000 from HUD's REO. While the Report indicates a purchase price of $66,000 in May 2000, the appraisal reports a purchase in July 2000 and a deed for $75,500 was recorded. The appraiser also commented that the property was "being upgraded and rehabilitated" and that new flooring was being installed. While the Report states that the property was then resold for $134,794 on July 27, 2000, note that it in fact was resold for $125,000 on July 26, 2000. Moreover, the comparables used in the appraisal report bracket the subject property in size and sales price and supported the final estimate of value. Moreover, note that HUD concurred with the underwriter's decision in this case. The [redacted] transaction was one of many suspended by the HUD Santa Ana HOC for insuring purposes pending a field review appraisal. Significantly, HUD ultimately determined that the property was properly valued and issued an MIC. As in the two aforementioned cases, there was nothing in the file that would have alerted the underwriter to the possibility that the borrowers might be strawbuyers.

4. <u>Guild Requires Exclusive Employment</u>

The Report alleges that there were conflicts of interest in a handful of cases cited in Appendix B. Specifically, it alleges that Guild allowed RMB to hire a licensed real estate agent as a loan officer, who was married to another Guild loan officer and worked for the Company between December 16, 2000 and December 14, 2001. The Report alleges that, in one case, this individual was the listing real estate broker and agent while his wife originated the loan, and that, in a second case, this individual received a real estate commission though not identified as the real estate broker/agent in the file. The Report further alleges that another Guild loan officer operated a development

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company out of the RMB office (i.e., the addresses for the two entities were the same) and originated two FHA loans where the seller was a non-profit organization but his development company received the sales proceeds. The Report concludes that the non-profit was acting as a strawbuyer on the loan officer's behalf in these cases.

Since its inception, in compliance with FHA requirements, Guild has required that loan officers and other personnel work exclusively for the Company during normal business hours and maintain no other employment for a real estate related entity. To this end, both its employment agreements and its Employee Handbook expressly prohibit dual employment. Each employee, including the employees referenced in the Report, are required to certify their understanding of this requirement. To the extent any employees may have worked for any other entities during normal business hours or otherwise worked for another real estate related entity, such employees violated their agreements with Guild and deliberately withheld information from the Company.

Having said that, with respect to the loan officer who also worked as a real estate agent, this individual was [redacted]. While [redacted] technically was employed by Guild for about one year, he did not operate as a full time loan officer of the Company insofar as he originated only one loan during that time. Guild is not even certain that [redacted] was considered an employee when the loans cited in the Report were originated. Nevertheless, while we recognize that his violation of Guild's and FHA's requirements should have been detected and resolved, note that there was no conflict of interest in the cases cited in the Report. In no case did this individual act as both the real estate agent and the loan officer in the same transaction. The Report cites two examples of cases in which [redacted] allegedly was involved. First, in the [redacted] case, FHA Case No. 197-2141053, the Report states that [redacted] was the listing real estate broker and agent while his wife, [redacted], originated the loan. Again, while [redacted] employment as a real estate agent should have been detected, he did not originate the [redacted] loan and did not receive dual payments in connection with the transaction. Second, in the [redacted] case, FHA Case No. 197-2341820, the Report alleges that [redacted] received a real estate commission though not identified as the real estate broker/agent in the file. In this case, [redacted] was the loan officer and the purchase contract reflects [redacted], not [redacted] as the real estate agent. The HUD-1 also indicated that the commission was paid to Remax Teamwork. We therefore are uncertain of the basis for the allegations in this case.

With respect to the two cases where the loan officer's development company received loan proceeds, please note that we were not aware of the loan officer's association with the development company until after Guild had closed the Downey Branch and hired a private investigator who identified the relationship between [redacted] and [redacted] and discovered the existence of the development company.

Prior to this investigation, Guild had no reason to suspect that these employees had a development company that was profiting from any Downey Branch loans. Such conduct was prohibited by Guild. Had Guild known of the matter, it would have terminated all employees involved.

5. Loan Officers Worked from Company Office Space

Finally, Finding 3 alleges that Guild approved a lease for workspace for one loan officer within a real estate company, where the space was categorized as a workstation in the real estate office. It notes that the lease shows that there was a telephone answered by the real estate office receptionist, and alleges that such a provision violated HUD requirements.

In compliance with FHA guidelines, see HUD Handbook 4060.1 REV-1, ¶ 2-16(A)(5), Guild ensures that each of its branch locations has its own telephones. A mortgagee, however, is permitted to share office space, including a receptionist. See, e.g., HUD Handbook 4060.1 REV-1, ¶ 2-16(A)(3) ("A mortgagee may share general reception-type entrances or lobbies with another business entity."); HUD Handbook 4060.1 REV-1, ¶ 2-14 ("All employees of the mortgagee except receptionists, whether full-time or part-time, must be employed exclusively by the mortgagee at all times, and conduct only the business affairs of the mortgagee during normal business hours.") (emphasis added); Mortgagee Letter 96-18 ("With the exception of receptionists, . . . lender employees may not work for more than one company engaged in the real estate finance business at the same time.") (emphasis added). Thus, the mere fact that the loan officer referenced in the Report shared a receptionist with the real estate company does not constitute a violation of FHA requirements. Moreover, please note that this office was closed on January 1, 2002.

IV. CONCLUSION

The Report portrays Guild as a predatory lender that has not implemented satisfactory controls. This is not the case, however, and the Report fails to support its allegations.

All of the loans cited in the Report were originated by the Downey Branch, a former branch office of the Company, and they are not representative of Guild's policies and procedures. Guild identified concerns with the Downey Branch loans and closed the branch prior to the OIG audit. None of the employees who worked at the Downey Branch continue to work for the Company. Guild maintains 51 other branch offices, none of which have experienced the problems faced at the Downey Branch. Having been in business for over 40 years, the Company has continuously strived to adhere to applicable rules and regulations and provide high quality service in the best interest of

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borrowers. It has stringent controls in place to ensure that branch personnel comply with Company policy, and it consistently engages in Quality Control to evaluate branch performance. To this end, Guild complied with applicable requirements in the cases cited in the Report and at no time permitted predatory lending practices.

In sum, the loans cited in Finding 1 of the Report were not "predatory." While the interest rates were high due to the nature of the borrowers' credit histories, they were only slightly above par and all closing costs, points and fees were paid by the sellers. The loans were not even considered high-cost loans under either federal or state law. Thus, by nature, these FHA loans could not be "predatory." Moreover, Guild was not required to reduce the interest rates by the amounts of discount points charged to the sellers, there was no premium pricing involved in these cases, and the appraisal reports justified the property values, which HUD confirmed through its own review appraisals in many cases. In connection with Finding 2, although the office space leases were in the name of the Branch Manager's company, there was a sublease agreement with Guild and Guild paid all operating expenses for the Downey Branch. The Downey Branch was a legitimate branch office, and there was no separation between the Downey Branch and Guild. Finally, in connection with Finding 3, the Report makes unsupported allegations and offers no evidence that any Guild employee knew or should have known of deficiencies in the loan files. Given Guild's adherence to FHA requirements in the loans cited in the Report, as well as the facts and circumstances surrounding the Downey Branch's operation, the recommended penalties in the Report are inappropriate.

Throughout this proceeding, we hope the OIG will consider this response and Guild's good faith efforts to address the conduct of the Downey Branch. We trust that, after reading this response, you will agree that Guild substantially complied with FHA requirements and that the penalties recommended in the Report are disproportionate to any deficiencies that may have occurred in the cited loan files. If you have any questions concerning the Downey Branch or the matters discussed herein, please contact me at (858) 627-3670, or Guild's Washington counsel, Phillip L. Schulman, at (202) 778-9027.

Thank you for your consideration.

Sincerely,

Linda Maguire
Senior Vice President

cc: Phillip L. Schulman, Esq.