



Issue Date	February 15, 2006
Audit Report Number	2006-PH-1007

TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing Commissioner, H

FROM:  John P. Buck, Regional Inspector General for Audit, Philadelphia Regional Office, 3AGA

SUBJECT: The Loan Origination Process and Quality Control Plan of American Mortgage, Inc., Cherry Hill, New Jersey, Did Not Comply with HUD Regulations and Requirements

## **HIGHLIGHTS**

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

We audited American Mortgage, Inc. (American), a nonsupervised lender approved to originate Federal Housing Administration single-family mortgage loans, because it had a high default rate and the Quality Assurance Division recommended we audit this lender. Our objectives were to determine whether American complied with the U.S. Department of Housing and Urban Development's (HUD) regulations, procedures, and instructions in the origination of Federal Housing Administration loans and whether American's quality control plan, as implemented, met HUD requirements.

### **What We Found**

American did not originate all Federal Housing Administration loans in accordance with HUD's loan origination requirements. Of the 23 loans we selected for review,<sup>1</sup>

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<sup>1</sup> Originally valued at \$2,598,937

American did not fully comply with Federal Housing Administration requirements for 15 of the loans originally valued at \$1,672,584 and could not locate three of the 23 case files. American did not exercise due diligence in the review of assets and liabilities; and did not resolve inconsistencies in calculations, signatures, and Social Security numbers. These deficiencies were caused by a lack of written procedures and a lack of due diligence by its employees, which contributed to an increased risk to the Federal Housing Administration insurance fund.

American charged ineligible fees totaling \$4,589 on nine loans. American charged these fees due to confusion over eligibility for document preparation, warehousing, commitment, expediting, and express mail fees.

Finally, American's quality control plan and the corresponding contractor agreement for quality control reviews did not contain requirements to identify patterns of early defaults and commonalities among loan origination participants. Also, the quality control plan required on-site branch reviews, but the contractor did not perform the on-site reviews. American was not aware of the requirement to identify patterns of early defaults and thought it was exempt from the on-site review requirement because it had recently established the branches.

## What We Recommend

We recommend that the assistant secretary for housing-federal housing commissioner

- Determine whether American's deficiencies in the loan origination process warrant administrative action, including indemnification from American on 15 Federal Housing Administration loans valued at \$1,632,468, which it issued contrary to HUD's loan origination procedures;
- Require American to develop written internal loan origination procedures to more closely monitor its loan origination process;
- Require American to refund ineligible fees collected totaling \$4,589; and
- Require American to revise its quality control plan to include reviews for patterns and commonalities among the loan origination participants and ensure the contractor performs on-site branch reviews.

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

## Auditee's Response

We requested American's response on December 15, 2005. We received American's written response, including comments on 14 of the 17 loans and 23 of the 40 issues, on January 25, 2006. American did not agree with specific issues concerning loan underwriting and did not address the recommendation to develop written policies and procedures. American generally agreed with the findings and recommendations concerning ineligible fees and its quality assurance plan. The text of American's written response, along with our evaluation of that response, can be found in appendix B of this report. With its response, American provided 18 exhibits, which we did not include in the report because they were too voluminous.

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## BACKGROUND AND OBJECTIVES

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The U.S. Department of Housing and Urban Development's (HUD) strategic plan states that part of its mission is to increase homeownership, support community development, and increase access to affordable housing free from discrimination.

The National Housing Act, as amended, established the Federal Housing Administration, an organizational unit within HUD. The Federal Housing Administration provides insurance for lenders against loss on single family home mortgages.

Beginning in 1983, HUD implemented the direct endorsement program, which authorized approved mortgagees to underwrite loans without HUD's prior review and approval. HUD can place them on credit watch status or terminate their approval if their rate of defaults and claims exceeds the normal rate for the area. Many sanctions are available for taking actions against lenders or others who abuse the program.

American Mortgage Inc.'s (American) main office is located in Cherry Hill, New Jersey. American operates nine branch offices in three states. American issued 856 Federal Housing Administration loans worth \$104,505,615 between January 1, 2003, and December 31, 2004. The main office issued 787 loans valued at \$95,493,574, of which 46 with a value of \$5,294,023 were in default. Of the 46 loans, we reviewed 23 loans worth \$2,598,937 that were in default status less than three years after closing.

Our audit objectives were to determine whether American originated Federal Housing Administration-insured loans in accordance with prudent lending practices and HUD requirements and whether American's quality control plan met HUD requirements. We reviewed case files from both the Homeownership Center and the lender and reviewed American's oversight of its branches.

## RESULTS OF AUDIT

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### Finding 1: American Did Not Fully Comply with HUD/Federal Housing Administration Requirements

American did not always originate Federal Housing Administration-insured loans in accordance with HUD requirements. It did not exercise due diligence in the review of assets and liabilities; and did not resolve inconsistencies in calculations, signatures, and Social Security numbers for 15 loans originally valued at \$1,672,584. Further, American could not locate three of the 23 case files we requested for review. These deficiencies stem from a lack of written policies and procedures and a lack of due diligence by its employees. The deficiencies contributed to an increased risk to the Federal Housing Administration insurance fund. Therefore, American should indemnify the 15 loans with remaining balances of \$1,632,468.

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#### **American Did Not Verify Borrowers' Assets**

American did not adequately verify the assets stated on the uniform residential loan application for 12 of the 23 cases reviewed. It did not verify the source of deposits for 10 cases. For example, American did not verify the source of deposits totaling \$5,516 for case 351-4462312 and \$15,000 for case 351-7188300. HUD requires the lender to verify savings and checking accounts. A verification of deposit, along with the most recent bank statement, may be used to accomplish this. If there is a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American did not obtain the required bank statements in support of assets for four cases. For case 351-4408689, American did not obtain a verification of deposit and provided only one bank statement. As an alternative to obtaining a verification of deposit, HUD requires the lender to obtain bank statements covering the most recent three-month period.

American did not adequately identify the source of gift funds for four cases. For cases 351-4555825 and 351-4477678, American did not verify the funds came from the donor's account. American did not obtain the check copy for case 351-4608117 and failed to investigate two deposits made to the donor's account on the day before and the day the borrower deposited the gift to his account for case 351-4626705. HUD requires that the donor provide a withdrawal document or cancelled check for the amount of the gift. The homebuyer's deposit slip and bank statement are also required. The lender must be able to determine that the gift funds were not provided from an unacceptable source.

American did not verify the source of earnest money for case 351-4462312. If the earnest money deposit exceeds 2 percent, the lender must verify the deposit amount and source of funds with documentation.

### **American Did Not Resolve Problems with Borrower Credit**

American did not verify that all delinquent accounts were adequately resolved (two cases). For example, for case 351-4316649, the credit report listed three delinquent accounts totaling \$1,042. There was no evidence American researched the debt. HUD requires that when delinquent accounts are revealed, the lender must determine whether late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

American did not obtain explanations for excessive inquiries on the credit reports (one case). For 351-4608117, American did not obtain an explanation for four inquiries on the credit report from March through May 2004. HUD requires written explanation from the borrower for all inquiries shown on the credit report in the last 90 days.

American did not verify the borrower's rental payment history for case 441-7188300. The loan application listed a rental amount of \$750, but there were inconsistencies in the borrower's addresses. There is no indication that American investigated this issue. The lender must include a determination of the borrower's payment history of housing obligations through the credit report, directly from a landlord, or through cancelled checks covering the most recent 12-month period.

### **American Issued Loans with Incorrect Calculations**

American issued two loans after making calculation errors. For case 351-4498468, American added the bank balance from two separate months for the same account to show funds to close. The second month's balance listed a different institution and the borrower's Social Security number on the loan application in place of the account number. Further, American calculated the mortgage payment-to-income and total fixed-payment-to-income ratios using overtime that was unlikely to continue. Without the overtime, the ratios were 41 and 58 percent, far exceeding HUD maximums of 29 and 51 percent. HUD allows use of overtime when the borrower has received overtime for the past two years and it is likely to continue.

American incorrectly calculated the loan-to-value ratio for case 351-4567347. Although, the borrower purchased the property from his employer, American used a loan-to-value ratio of 97.75 percent, instead of the 85 percent required by HUD. As a result, the mortgage was over-insured by \$14,428. HUD restricts identity-of-

interest transactions on principal residences to a maximum loan-to-value ratio of 85 percent.

### **American Issued Loans When Problems with Signatures and Social Security Numbers Existed**

American issued three loans in which required signatures did not match signatures on other documents. For case 351-4462312, the underwriter's signature on the Form HUD-92900-A, "Direct Endorsement Approval for a HUD/FHA-Insured Mortgage," did not match the signature on the mortgage credit analysis worksheet. The closing officer often signed the underwriter's name on the form when the underwriter was not available. The underwriter's signature certifies that the underwriter reviewed all pertinent documents, used due diligence in underwriting the loan, and approved the loan as eligible for HUD mortgage insurance under the direct endorsement program. HUD requires the uniform residential loan application and its addendum be signed and dated by all borrowers and the lender for mortgage credit analysis in all transactions.

American issued one loan (case 351-4487731) which had unresolved Social Security number issues. The credit report listed four Social Security numbers for the borrower. There was no evidence that American tried to resolve this issue. HUD requires the lender to resolve any inconsistencies or multiple Social Security numbers for individual borrowers.

### **American Did Not Retain Three Loan Case Files**

American could not locate case numbers 351-4381382, 351-4555825, and 441-7188300. It stated it was in the process of reboxing its files, which could have caused them to be misplaced. HUD requires originating lenders to retain the entire case file pertaining to the loan origination.

### **Conclusion**

The above discrepancies represent material deficiencies that require administrative action up to and including indemnification. The cases illustrate that HUD assumed unnecessarily high risk when insuring the loans originated by American. The deficiencies associated with American's loan origination activities stem from its lack of written procedures and the lack of due diligence by its employees. Therefore, American should indemnify the 15 loans with remaining balances of \$1,632,468.



Appendix C contains a table summarizing discrepancies for each of the 15 loans. Specific HUD regulations are contained in the narrative case presentations contained in appendix E.

## Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner

- 1A. Take appropriate administrative action up to and including indemnification for the 15 loans with unpaid balances of \$1,632,468 that did not comply with HUD requirements.
- 1B. Require American to develop and implement written internal control procedures that provide assurance that its employees follow proper procedures to satisfy HUD's requirements for loan origination.

## Finding 2: American Charged Ineligible Fees

American charged ineligible fees totaling \$4,589 on 9 of the 23 loans we reviewed. It charged these fees due to confusion over eligibility for document preparation, warehousing, commitment, expediting, and express mail fees. As a result, American overcharged borrowers and needs to refund these fees totaling \$4,589.

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### **American Charged Ineligible Document Preparation and Warehousing Fees**

American charged ineligible document preparation and warehouse fees payable to TLC, Inc., totaling \$1,800 on nine loans. As a result of a Quality Assurance Division review conducted the week of April 19, 2004, HUD determined that document preparation and warehouse fees paid to TLC, Inc. were unallowable. American refunded the fees for the loans identified in the Quality Assurance Division review. However, the Quality Assurance Division review did not include the 23 loans that we reviewed and American did not refund fees for the nine loans, totaling \$1,800. These fees are unallowable and should be refunded. American believed that the fees were allowable.

### **American Charged Ineligible Commitment Fees**

American charged ineligible commitment fees totaling \$2,624 on 9 of the 23 loans we reviewed. It believed commitment fees were chargeable as long as it included a letter stating that it committed to the loan and locked in the interest rate 10 days before closing. Of the nine loans, five, totaling \$1,500, lacked documentation to substantiate that the borrowers agreed to lock in their loans and four, totaling \$1,124, contained lock-in agreements signed by the borrowers, but the agreement stated that the borrower did not want to lock in the interest rate. HUD Handbook 4000.2, paragraph 1-9A, allows lenders to charge a commitment fee to guarantee, in writing, the interest rate and discount points for a specific period or to limit the extent to which they may change. The minimum time for lock-ins or rate locks is 15 days. The loan may close in less than 15 days at the convenience of the borrower, and the lock-in fees may still be earned. Lenders are expected to honor all such commitments.

### **American Charged Ineligible Expediting and Express Mail Fees**

American charged ineligible expediting and express mail fees, totaling \$165, on two loans. At the time it charged the fees, it believed they were allowable. However, HUD Handbook 4000.2, paragraph 5-2O, allows courier fees and wire fees to be charged only on refinances and only for delivery of the mortgage payoff statement to the lien holder and for closing documents to the settlement agent. The borrower must agree in writing to pay for the courier and wire fees before loan closing.

### **Recommendations**

We recommend that the assistant secretary for housing – federal housing commissioner

- 2A. Require American to refund the \$4,589 in ineligible fees collected.

### Finding 3: American's Quality Control Plan and Its Implementation Did Not Comply with HUD Requirements

American's quality control plan and its implementation did not fully comply with HUD requirements. Its quality control plan and its corresponding contractor agreement did not require American or the contractor to identify patterns in defaulted loans and commonalities among loan origination participants. Further, the plan required the contractor to visit the branch offices annually when performing on-site reviews, but the contractor did not do so, and American did not enforce the requirement. American was not aware of the requirement to identify early default patterns and thought it was exempt from the annual on-site visit requirement because it had established its branches recently. As a result, we have limited assurance that American adequately protected HUD from unacceptable risk.

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#### **American's Quality Control Plan Did Not Contain a Required Process to Identify Early Default Patterns**

American's quality control plan and its corresponding agreement with an independent contractor did not contain a requirement to identify patterns of early default and commonalities among the loan officers, processors, underwriters, appraisers, and realtors as required by HUD Handbook 4060.1, paragraph 6-5C. American stated that it was not aware of this requirement. However, American's president stated that during the audit, he informed the quality control officer to perform these reviews. Detection of patterns and commonalities among loan origination participants can identify personnel not complying with HUD requirements as well as possible fraudulent activities.

#### **American's Contractor Did Not Perform Required On-Site Quality Control Reviews**

American's quality control plan required on-site branch reviews, but American did not require the quality control contractor to perform the on-site branch reviews. It believed review of the case files, maintained at the corporate office, satisfied the on-site review requirement and thought it was exempt from the physical visit requirement as it had established its branches within the last 17 months. Further, we found that, in 2003, 2004, and 2005, American terminated 368 employees and hired 196 of its current staff of 227. With this much turnover and, as noted in Finding 1, no written policies and procedures, on-site branch

visits are that much more important. Although HUD Handbook 4060.1, paragraph 6-3G.2, allows electronic branch reviews, annual visits are mandatory for offices meeting certain higher risk criteria such as new branches and new key personnel. Therefore, American was not exempt from the annual on-site requirement.

Because American's quality control process did not comply with HUD requirements, we have limited assurance that HUD was protected from unacceptable risk and guarded against errors, omissions, and fraud; and that swift and appropriate corrective action would be taken when necessary in the origination and servicing of Federal Housing Administration loans.

## **Recommendations**

We recommend that the assistant secretary for housing – federal housing commissioner

- 3A. Require American to revise and implement its quality control plan to comply with HUD requirements.

## SCOPE AND METHODOLOGY

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To accomplish our objectives, we

- Reviewed Federal Housing Administration-insured loans (23 cases) originated by American's main office between January 1, 2003, and December 31, 2004, that had gone into default at least once. The 23 loans were part of a universe of 787 loans originated by American's main office during that time. The results of the detailed testing apply only to the 23 loans reviewed and cannot be projected to the universe of Federal Housing Administration-insured loans.
- Examined records and related documents of American.
- Reviewed applicable HUD handbooks and mortgagee letters.
- Conducted interviews with officials and employees of American and the HUD Quality Assurance Division.

In addition, we relied, in part, on data maintained by HUD in the Single Family Data Warehouse and Neighborhood Watch systems. We did not perform a detailed analysis of the reliability of these programs.

The audit generally covered the period from January 1, 2003, to December 31, 2004. We expanded this period to include the most current data while performing our audit. Therefore, when applicable, the audit period was expanded to include current data through November 30, 2005. We conducted our audit from March through December 2005.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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

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

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

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## Relevant Internal Controls

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

- Loan origination process – Policies and procedures that management has in place to reasonably ensure that the loan origination process complies with HUD program requirements.
- Quality control plan – Policies and procedures that management has in place to reasonably ensure implementation of HUD quality control requirements.

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

## Significant Weaknesses

Based on our review, we believe American did not operate in accordance with HUD requirements as they relate to loan issuance and quality control.

The deficiencies are discussed in detail in the Results of Audit section of this report.

## APPENDIXES

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### Appendix A

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

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Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A		\$1,632,468
2A	\$4,589	

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.



## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments



American Mortgage Inc.

January 23, 2006

**VIA FEDERAL EXPRESS**

Mr. John P. Buck  
Regional Inspector General for Audit  
U.S. Department of Housing  
and Urban Development  
Office of the Inspector General  
Philadelphia Regional Office, 3AGA  
Wanamaker Building, Suite 1005  
100 Penn Square East  
Philadelphia, PA 19107-3380

**RE: American Mortgage, Inc.  
HUD OIG Draft Audit Report**

Dear Mr. Buck:

American Mortgage, Inc. ("AMI" or "Company") is in receipt of the Draft Audit Report ("Report"), dated December 15, 2005, from the U.S. Department of Housing and Urban Development's ("HUD" or "Department") Office of the Inspector General ("OIG"). The Report is based on a review of AMI's procedures and practices in the origination of loans to the Department for Federal Housing Administration ("FHA") insurance endorsement. The review was conducted between November 2004 and June 2005, and it covers the period from March through December 2005.

The Report contains three findings, alleging that the Company: (1) did not originate 18 loans in accordance with HUD's loan origination requirements; (2) charged ineligible fees in 9 cases; and (3) maintained a Quality Control Plan and corresponding contractor agreement for quality control reviews that did not contain requirements to identify patterns of early defaults and commonalities among loan participants and did not ensure that on-site branch office reviews were conducted. Based on these findings, the Report recommends that HUD require the Company to: (1) consider appropriate action in connection with 18 loans; (2) refund the ineligible fees; and (3) revise its Quality Control Plan to include reviews for patterns and commonalities among loan origination participants and ensure its contractor performs on-site branch reviews.

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The OIG provided the Company with an opportunity to submit written comments for inclusion in the final report. We appreciate this opportunity to comment on the OIG's findings and recommendations.

**I. BACKGROUND**

AMI was incorporated in April of 1997. Headquartered in Cherry Hill, New Jersey, the Company employs approximately 200 individuals and does business in seven states: California, Connecticut, Delaware, Florida, Maryland, New Jersey, and Pennsylvania. AMI operates through its home office in Cherry Hill and 13 branch offices. In 1997, AMI received HUD/FHA approval as a loan correspondent. In January of 2002, we converted our status to a non-supervised mortgagee and Direct Endorsement Underwriter. AMI sells the loans it originates into the secondary market on a servicing-released basis. The Company's primary investors include [REDACTED]

FHA lending constitutes approximately thirty percent (30%) of AMI's business. As FHA-insured loans comprise a substantial portion of its business, the Company takes its relationship with the Department and its responsibilities under the FHA program seriously. We strive to comply with applicable rules and regulations and are committed to educating and training our employees on issues of FHA compliance. We never knowingly would violate FHA requirements or endanger the reputation of the Company or its employees. AMI is dedicated to working with HUD to extend credit to qualified FHA borrowers and looks forward to its continued relationship with the Department.

**II. RESPONSE TO THE FINDINGS**

As previously noted, the Report contains three findings with recommendations for action by HUD's Assistant Secretary – Federal Housing Commissioner ("Commissioner") in connection with 18 FHA-insured loan files and the Company's Quality Control Plan. Upon receipt of the draft report, the Company performed its own stringent analysis of the loans subject to the OIG's review. We also consulted applicable HUD Handbooks, Mortgagee Letters, and regulations, as well as examined Company policies and procedures, to provide pertinent information and documentation with this response.

AMI's diligent examination indicated that many of the Report's assertions are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of AMI, or do not affect the underlying loans' insurability. In addition, in one loan cited in the Report, [REDACTED] – FHA Case No. 351-4548348, the mortgage in question

**Comment 1**

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**Comment 2**

has been paid in full and was extinguished on October 13, 2005 (**Exhibit A**). As the loan is no longer FHA-insured, it poses no risk to the FHA Insurance Fund. Thus, we request that the OIG remove this loan from its final report of findings to HUD. Finally, please note that AMI has been unable to locate three of the files cited in the Report: (1) **FHA Case No. 351-4381382**; (2) **FHA Case No. 351-4555825**; and (3) **FHA Case No. 441-7188300**. We therefore cannot respond meaningfully to the allegations in these cases and hereby request that HUD provide us with copies of the insuring packages that we originally sent to the Department so that we can respond to the allegations in the Report. After receiving the files, we will submit a supplemental response concerning these cases.

**Comment 3**

**Comment 4**

While we recognize that there is always room for improvement, at no time did the Company intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. Where a deficiency existed, we have acknowledged it and strengthened our policies and procedures to assure compliance with HUD requirements. In addition, we have also refunded approximately \$4,500 in fees cited in the Report and amended our Quality Control procedures to fully comply with FHA guidelines. With regard to the remaining loans cited in the Report, however, this response and accompanying exhibits demonstrate AMI's general compliance with HUD/FHA requirements and adherence to prudent lending standards. Below we reply to the individual matters raised in the Report and evidence our adherence to FHA requirements in connection with several of the cited loans.

**A. FINDING 1 – LOAN ORIGATION AND UNDERWRITING REQUIREMENTS**

In Finding 1, the Report alleges that the Company did not originate 18 FHA-insured loans in accordance with HUD/FHA guidelines. Specifically, Finding 1 asserts that, in certain instances, AMI did not: (1) verify borrower's assets; (2) resolve borrower credit issues; (3) accurately calculate assets or maximum mortgage amounts; and/or (4) resolve file discrepancies prior to loan closing or submission for insurance endorsement. AMI disagrees with many of these allegations and addresses the individual assertions in turn below.

**1. Verification of Assets**

**Comment 5**

First, Finding 1 asserts that, in 17 cases, the Company did not verify the source of funds used to close the FHA loan. Of these 17 files, AMI has been unable to locate three: (1) **FHA Case No. 351-4381382**; (2) **FHA Case No. 351-4555825**; and (3) **FHA Case No. 441-7188300**. We therefore do not respond to the allegations in these cases and hereby request copies of the insuring packages we originally provided to HUD so

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**Comment 6**

that we may investigate and respond to the findings in the Report. In addition, as discussed above, in one loan cited in the Report, [REDACTED] – **FHA Case No. 351-4548348**, the mortgage in question has been paid in full and was extinguished on October 13, 2005 (**Exhibit A**). As the loan is no longer FHA-insured, indemnification would be inappropriate. Thus, we request that the OIG remove this loan from its final report of findings to HUD. With regard to the remaining 13 cases cited in Finding 1, AMI takes exception to a number of the draft Report's allegations. We discuss these objections below, as well as demonstrate AMI's adherence to FHA guidelines regarding asset documentation in these loans.

a. [REDACTED] – **FHA Case No. 441-7537281**

In the [REDACTED] loan, the Report alleges that AMI did not obtain explanations from the borrower regarding a deposit of \$1,412 into the borrower's bank account.

**Comment 7**

AMI understands and appreciates that, if a borrower's bank account reflects a large increase, or if the account was opened recently, it is obligated to obtain an explanation regarding the source of those funds. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B). Contrary to the allegation in this case, AMI did so in the [REDACTED] case. The bank statement contained in the loan file indicated that the borrower had made a \$1,412.01 on July 16, 2004 (**Exhibit B-1**). The loan file also contained a copy of the borrower's paycheck, dated July 2, 2004, in an amount of \$1,412.01 (**Exhibit B-2**). This document evidences that the source of the borrower's July 16, 2004 deposit was his paycheck that he received earlier that month. AMI complied with HUD requirements in this case. Therefore, this allegation should be removed from the Report.

b. [REDACTED] – **FHA Case No. 351-4462312**

In the [REDACTED] case, Finding 1 asserts that the loan file did not contain explanations for the source of eight deposits totaling \$5,516 or a \$5,750 earnest money deposit ("EMD") held by the borrowers' attorney.

**Comment 8**

With regard to the \$5,750 EMD, AMI understands and appreciates that, if the amount of the EMD exceeds two percent of the sales price or appears excessive based on the borrower's history of accumulating savings, it must verify the deposit amount and the source of funds by obtaining a copy of the borrower's canceled check or other appropriate documentation. See HUD Handbook 4155.1 REV-4, ¶ 2-10(A). It is AMI's policy and practice to obtain such documentation, and the Company did so in this instance. As indicated in the Report, the loan file contained a letter from the borrowers' attorney, dated July 14, 2003, stating that the borrowers had made a \$5,750 EMD (**Exhibit C-1**). To verify the source of the EMD, the loan file also contained a HUD-1

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Settlement Statement ("HUD-1"), evidencing the sale of the borrowers' prior property, which resulted in \$10,109.73 in proceeds to the borrowers on June 27, 2003 (**Exhibit C-2**). These proceeds were more than sufficient to cover the \$5,750 EMD made with their attorney the following month.

**Comment 8**

With regard to the bank account deposits, as discussed above, AMI understands and appreciates its obligation to document large increases in a borrower's bank account. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B); see also HUD Handbook 4155.1 REV-4, ¶ 2-10(B). It has consistently been the Company's policy and practice to do so. In this instance, none of the eight deposits constituted large increases to the borrowers' account, based on the activity indicated on the two months' bank statements contained in the loan file. The bank statements evidenced that the borrower periodically made regular cash deposits into the checking account (**Exhibit C-3**) and the borrowers' average balance over the two-month period reflected in the loan file was consistent (**Exhibit C-3**). Moreover, based on the borrower's Verification of Employment ("VOE") and pay stubs from his employment with [REDACTED] (**Exhibit C-4**), several of the deposits questioned in the Report constituted deposits of the borrowers' pay checks (**Exhibit C-3**). Finally, these regular deposits were made in March and April of 2003 (**Exhibit C-3**), more than three months prior to closing on July 23, 2003 (**Exhibit C-5**). The HUD-1 demonstrates that the borrower did not need any of these eight deposits to produce the \$110.48 to close. The borrowers easily could have met this closing obligation with their regular earnings or the approximately \$5,000 in remaining proceeds from their prior home sale after accounting for the EMD discussed above (**Exhibit C-2**). As the deposits reflected on the borrowers' bank statements did not constitute large increases in their monthly balances and were not used to close the loan, AMI was not required to obtain explanations regarding the source of these funds.

**Comment 8**

In summary, AMI complied with HUD requirements in the [REDACTED] loan. The Company properly documented the source of the borrowers' EMD and complied with FHA guidelines in connection with the borrower's assets. Thus, AMI requests that these allegations be removed from the final Report.

**c. [REDACTED] – FHA Case No. 351-4408689**

In this case, the Report alleges that the loan file did not include a verification of deposit ("VOD") and contained only one bank statement.

AMI understands and appreciates that, as an alternative to obtaining a VOD, a lender must obtain bank statements covering the two most recent consecutive statements, provided the statement shows the previous month's balance. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1(F). AMI complied with this requirement in this

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instance. The loan file contained a bank statement that covered the period from March 31, 2003 through May 27, 2003 (**Exhibit D**). While the statement did not reflect any activity from May 1 through May 27, 2003, the statement clearly evidences that it is a "detailed report of the transactions that have been posted to [the] account as of May 27, 2003" (**Exhibit D**). Thus, this document covered the two most recent consecutive months in accordance with HUD requirements. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1(F). Moreover, this statement indicated the borrower's daily balance as of March 31, 2003, which reflected the borrower's previous month's balance in accordance with FHA guidelines. AMI fully complied with HUD requirements in documenting the borrower's assets in this case.

**d. ██████ – FHA Case No. 351-4316649**

In the ██████ case, Finding 1 asserts that the source of eight deposits totaling \$2,738 in the borrower's bank account were not verified.

**Comment 10**

With regard to bank account deposits, as discussed above, AMI understands and appreciates its obligation to document large increases in a borrower's bank account. See HUD Handbook 4155.1 REV-4, ¶ 2-10(B). AMI complied with this requirement in the ██████ loan. The loan file contained bank statements reflecting four months of activity in the borrower's ██████ account (**Exhibit E-1**). Each bank statement evidences that all of the deposits, with the exception of one small \$200 deposit made on September 18, 2002, reflected either deposits of the borrower's income from his employment with ██████ (**Exhibit E-2**) or regular transfers of small amounts from his savings account into his checking account. None of the four bank statements included in the loan file demonstrate large or unusual deposits, and AMI had no reason to question the source of any of the deposits into the borrower's bank account prior to closing. AMI complied with HUD requirements regarding asset documentation and was not obligated to provide any further documentation regarding the source of the borrower's assets in this case. Therefore, we respectfully request that this allegation be removed from the Report.

**e. ██████ – FHA Case No. 351-4525586**

In the ██████ loan, AMI takes issue with the allegation in Finding 1 that the loan file did not contain verification that the \$3,000 in gift funds were deposited into the borrower's account prior to closing.

As you know, with regard to gift funds obtained by a relative, as in this case, HUD guidelines in place when this loan closed required a lender to obtain the following documents when the gift funds are in the homebuyer's account prior to closing: (1) a

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gift letter specifying, among other items, the dollar amount given, the donor's name, address, telephone number, and relationship to the borrower, and stating that no repayment is required; (2) a copy of the canceled check or other withdrawal document showing the withdrawal from the donor's personal account; and (3) the homebuyer's deposit slip or bank statement that shows the deposit of the gift funds. See HUD Handbook 4155.1, REV-4, CHG-1, ¶2-10 (C); Mortgagee Letter 00-28.

Comment 11

In compliance with these requirements, AMI documented the \$3,000 gift in this case by obtaining a gift letter in an amount of \$3,000 from the borrower's mother (**Exhibit F-1**), a printout of the donor's checking account evidencing the withdrawal of \$3,000 on October 6, 2003 (**Exhibit F-2**), and a cashier's check made payable to the borrower in an amount of \$3,000 listing the donor as the remitter also dated October 6, 2003 (**Exhibit F-3**). In addition, contrary to the Report's allegation, the loan file contained a deposit slip evidencing that the borrower in fact deposited the \$3,000 check into his [REDACTED] account on October 7, 2003 (**Exhibit F-4**), two days before closing on October 9, 2003 (**Exhibit F-5**). This information evidences that AMI fully complied with HUD requirements regarding gift fund documentation. Therefore, this allegation should be removed from the Report.

f. [REDACTED] - FHA Case No. 351-4345198

In the [REDACTED] case, Finding 1 alleges that the loan file did not document the source of two deposits totaling \$2,052 prior to closing.

Comment 12

As discussed above, AMI understands and appreciates its obligation to document large increases in a borrower's bank account. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B); see also HUD Handbook 4155.1 REV-4, ¶ 2-10(B). It has consistently been the Company's policy and practice to do so. In this instance, AMI obtained bank statements reflecting over six months of activity in the borrower's bank account (**Exhibit G-1**). During that time, other than regular payroll deposits and occasional small deposits reflecting store credits, only two deposits were made into the account. These deposits included a \$750 deposit on October 16, 2002 (**Exhibit G-1**), and a \$1,074 deposit on February 18, 2003 (**Exhibit G-1**). AMI reviewed all six months of bank statements and determined that these two deposits did not constitute large increases in the borrower's average balance. Moreover, both deposits occurred several months prior to closing on April 30, 2003 (**Exhibit G-2**), and were not used to close the loan, as the borrowers in fact were not required to bring any funds to closing (**Exhibit G-2**). As these deposits were not large or unusual based on the borrower's pattern of assets, as these funds were used to close, and as there was no evidence to suggest that any of these funds came from an impermissible source, AMI properly determined that verifying the source of these aged deposits was unnecessary. The Company

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adhered to HUD guidelines in documenting the borrowers' assets in this case and, therefore, we request that this allegation be removed from the final Report.

g. [REDACTED] – FHA Case No. 351-4477678

In this case, the Report asserts that the Company did not adequately identify the source of gift funds, as the loan file did not contain verification that the borrower's sister-in-law provided the cash gift of \$1,300 to satisfy one of the borrower's debts.

Comment 13

As discussed above, with regard to gift funds obtained by a relative, as in this case, HUD guidelines in place when this loan closed required a lender to obtain a gift letter and a copy of the canceled check or other withdrawal document showing the withdrawal from the donor's personal account to document the provision of gift funds. See HUD Handbook 4155.1, REV-4, CHG-1, ¶2-10(C); Mortgagee Letter 00-28. In this case, the loan file contained a gift letter from the borrower's sister-in-law in an amount of \$1,300 dated July 28, 2003 (Exhibit H-1). In addition, the file also contained a notarized letter from the donor, dated August 2, 2003, in which she stated that she had provided the borrower with a \$1,300 gift to repay her account with [REDACTED] (Exhibit H-2). Finally, the loan file contained two receipts from this company indicating that the borrower had in fact used the \$1,300 gift to repay her account on July 29, 2003 (Exhibit H-3). While we recognize that documentation evidencing the withdrawal of the funds from the donor's bank account should have been obtained to evidence that the gift was given to the borrower, please note that the omission in this instance does not reflect Company policy or practice and was an anomaly. AMI has advised Company personnel of the findings in this case and reminded them of the documentation requirements for gifts set forth in HUD guidelines. We are confident that any oversight in connection with this matter has been resolved and will not recur.

Comment 13

Having said that, the donor did in fact provide the gift funds in this case. Both the gift letter and notarized letter evidence that the borrower's sister-in-law provided the funds used to satisfy the debt in question. Furthermore, the Report offers no evidence to suggest that these funds came from an impermissible source. Thus, any deficiency regarding documentation in this case constituted, at worst, harmless error. The donor provided the gift funds, which the borrower used to satisfy the outstanding debt, and the borrower qualified for FHA financing in this case. Therefore, we believe that indemnification would be inappropriate and respectfully request that this recommendation should not be included in the Report.



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h. [REDACTED] – FHA Case No. 351-4602931

In the [REDACTED] loan, Finding 1 asserts that the loan file did not document the source of four deposits totaling \$8,450.

As discussed above, AMI understands and appreciates its obligation to document large increases in a borrower's bank account. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B); see also HUD Handbook 4155.1 REV-4, ¶ 2-10(B). In this case, contrary to the allegation in the draft Report, other than regular payroll deposits, the bank account statement included in the loan file reflected only two deposits, in the amounts of \$12,000 and \$7,000 (Exhibit I-1). To document the \$12,000, which was used to close the loan on April 23, 2004 (Exhibit I-2), AMI obtained a gift letter from the borrower's cousin (Exhibit I-3), evidence of the donor's ability to provide the \$12,000 gift (Exhibit I-4), and documentation that the donor in fact withdrew the funds that were deposited into the borrower's account (Exhibits I-1, I-5). These attachments indicate that AMI properly documented the source of this deposit. With regard to the remaining \$7,000 deposit, the borrower informed AMI that these funds were a gift from another relative; however, the Company was unable to obtain evidence of the source of these funds. Therefore, in qualifying this borrower for FHA financing, AMI disregarded these funds and did not include the \$7,000 in the borrower's assets and the MCAW (Exhibit I-6). Moreover, as indicated above, the borrower used the \$12,000 gift to close the loan, and did not need the \$7,000 to do so (Exhibit I-2). As these funds were not used to qualify the borrower for FHA financing or to close the FHA transaction, AMI was not required to document the source of this deposit. Therefore, AMI complied with HUD guidelines in documenting the borrower's assets and verified the source of funds used to close this loan. As a result, this allegation should be removed from the Report.

i. [REDACTED] – FHA Case No. 351-4608117

In this loan, the Report alleges that the Company did not document five deposits totaling \$1,891 reflected on the borrower's bank statements and did not adequately identify the source of the gift funds, as inconsistencies in the gift process were noted. Specifically, Finding 1 asserts that the gift letter is dated May 25, 2004; however, the donor's bank statement shows a withdrawal of funds on April 30, 2004 and then again on May 25, 2004. In addition, the Report alleges that, although the borrower's account statement indicated receipt of the \$2,700 in gift funds on May 25, 2004, the loan file did not include a copy of a check or deposit slip.

With regard to verification of the source of the deposits into the borrower's bank account, AMI respectfully disagrees with the assertion that it did not comply with HUD guidelines in this case. Here, the loan file contained bank statements evidencing four

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months of activity in the borrower's accounts. Absent the above-referenced gift and a tax return, both of which were verified, all deposits into the borrower's account reflect either payroll credits or routine, small deposits made by the borrowers (**Exhibit J-1**). As you know, while HUD guidelines require lenders to document the source of large or unusual deposits, such verification is not mandated for routine deposit activity into a borrower's account. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B); see also HUD Handbook 4155.1 REV-4, ¶ 2-10(B). In these case, as none of the remaining deposits were large, and as there was no evidence to suggest that any of these deposits originated from an impermissible party (**Exhibit J-1**), AMI was not obligated to document the source of the remaining deposits reflected in the four months of bank statements included in the loan file. The Company complied with HUD requirements in documenting the borrowers' assets in this case.

**Comment 15**

With regard to the gift funds, contrary to the allegation in Finding 1, AMI properly documented the receipt of these funds by the borrower prior to closing. With regard to gift funds obtained by a relative, as in this case, HUD guidelines in place when this loan closed required a lender to obtain: (1) a gift letter; (2) a copy of the canceled check or other withdrawal document showing the withdrawal from the donor's personal account; and (3) the borrower's deposit slip and bank statement showing the deposit of gift funds. See HUD Handbook 4155.1, REV-5, ¶2-10(C). To satisfy these requirements, AMI obtained a gift letter dated May 25, 2004 from the borrower's grandfather indicating a \$2,700 gift (**Exhibit J-2**). The loan file also contains a copy of the donor's bank statement evidencing his ability to provide these gift funds (**Exhibit J-3**), as well as a withdrawal slip dated May 25, 2004 indicating a withdrawal of the funds (**Exhibit J-4**). While the Report questions the fact that the donor's bank statement reflects a similar withdrawal of funds in April of 2004, AMI was not required to document the donor's reasons for making such a withdrawal. HUD guidelines merely required the Company to evidence the actual withdrawal of gift funds, which AMI did in this case by obtaining the May 25, 2004 withdrawal slip. Finally, to evidence the borrower's receipt of these gift funds, the loan file contained the borrower's bank statement, reflecting a \$2,700 deposit on May 25, 2004 (**Exhibit J-1**). While the Company acknowledges that it should have also retained a copy of the borrower's deposit slip, any oversight in this case was harmless. The bank statement clearly demonstrates that the borrower in fact received the \$2,700 gift from his relative on the same day as it was withdrawn from the donor's account (**Exhibit J-4**).

**Comment 15**

In summary, AMI complied with HUD requirements in documenting the borrower's assets and all gift funds in this loan. As the Company acted in accordance with FHA guidelines in this instance, we respectfully request that these allegations be removed from the final Report.

j. [REDACTED] - FHA Case No. 351-4626705

In the [REDACTED] loan, Finding 1 asserts that AMI did not adequately identify the source of gift funds. Specifically, the Report alleges that: (1) although the borrower's wife provided a gift of \$4,500 on June 4, 2004, the source of deposits into her account on June 3 and 4, 2004 were not explained; and (2) the loan file did not contain the borrower's deposit slip reflecting the \$4,500 gift.

Comment 16

As you know, with regard to gift funds obtained by a relative, as in this case, HUD guidelines in place when this loan closed required a lender to obtain: (1) a gift letter; (2) a copy of the canceled check or other withdrawal document showing the withdrawal from the donor's personal account; and (3) the borrower's deposit slip and bank statement showing the deposit of gift funds. See HUD Handbook 4155.1, REV-5, ¶2-10(C). As stated in the Report, the borrower received a \$4,500 gift from the non-purchasing spouse prior to closing. To evidence that the donor in fact provided the gift, AMI obtained a gift letter in the amount of \$4,500 from the non-purchasing spouse (Exhibit K-1), a copy of the personal check made payable to the borrower from the donor in an amount of \$4,500 (Exhibit K-2), and a printout of the donor's bank statement evidencing that the gift check was cashed on June 8, 2004 (Exhibit K-3).

Comment 16

The Report acknowledges this documentation, but takes issue with two deposits reflected on the donor's bank statement. While we recognize that lenders are responsible for determining that the donor actually provided the gift funds in each case, there was no evidence to suggest that the funds in the donor's account were derived from an impermissible source. While these two deposits were rather large, the bank statement obtained covered only 8 days and does not present a full picture of the individual's regular deposit activity (Exhibit K-3), nor was AMI required to obtain a more complete picture of the donor's deposit activity to document the transfer of gift funds in this case. Without reviewing the donor's full account history to determine an average balance, the deposits in question did not appear to be unreasonable or suspect. Furthermore, HUD guidelines expressly state that "[a]s a rule, we are not concerned with how the donor obtains the gift funds provided they are not derived in any manner from a party to the sales transaction." HUD Handbook 4155.1 REV-5, ¶ 2-10(C). Thus, absent any indication that such funds are derived from such source, which was not present here, AMI had no obligation to document the source of the funds in the donor's account in this case. Nevertheless, the Company appreciates the Department's concern with ensuring that donor funds are not derived from an impermissible source. Therefore, we have reminded our employees to ensure that the donor actually provides gift funds in each and every case, and to document the source of those funds when questions arise as to their origin. We are confident that this action will resolve any

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outstanding concerns. Having said that, the loan file in this case contained all required documentation to evidence the provision of gift funds by the donor.

**Comment 16**

Finally, to document the borrower's receipt of the gift funds, the loan file contained the borrower's bank statement, reflecting a \$4,500 deposit on June 8, 2004 (**Exhibit K-4**). While the Company acknowledges that it should have also retained a copy of the borrower's deposit slip, any oversight in this case was harmless. The bank statement clearly demonstrates that the borrower in fact received the \$4,500 gift from his relative on the same day that the check posted as being cashed in the donor's account (**Exhibit K-3**).

**Comment 16**

In summary, AMI substantially complied with HUD guidelines in documenting the transfer of gift funds in this case. Therefore, indemnification is unwarranted and we believe that this allegation should be removed from the final Report.

## **2. Borrower Creditworthiness**

Second, Finding 1 alleges that, in 6 cases, AMI did not resolve issues with borrower credit prior to closing. Specifically, the Report asserts that the Company did not: (1) verify that all delinquent accounts were adequately resolved or explained; (2) obtain explanations for excessive credit report inquiries; or (3) verify the borrower's rental payment history.

**Comment 17**

Of these 6 files, AMI has been unable to locate one, **FHA Case No. 441-7188300**. We therefore do not respond to the allegations in this case and hereby request a copy of the insuring package we originally provided to HUD so that we may investigate and respond to the finding in the Report. With regard to the remaining cases cited, AMI takes exception to several of the draft Report's allegations. We discuss these objections below, as well as demonstrate AMI's adherence to FHA guidelines regarding evaluating the borrowers' credit history in these loans.

As an initial matter, AMI respects the importance of analyzing a borrower's credit performance and examining his or her attitude towards credit obligations. It is AMI's policy, with respect to every FHA applicant, to scrutinize the applicant's credit record and reasonably determine the applicant's creditworthiness. Given the potential risks not only to the Department, but to the Company, of making a poor credit decision, the Company's management has endeavored to monitor underwriting performance and provide ongoing training to employees on the issue of credit analysis. AMI's employees take their underwriting responsibilities seriously and understand that they will face severe consequences for unsatisfactory analysis of borrower credit. AMI never would knowingly jeopardize the Company's stability or its relationship with the Department.

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**Comment 17**

That being said, in evaluating the cases cited in Finding 1, we hope the Department will consider that HUD delegated to FHA lenders the responsibility for analyzing borrower credit and determining an individual's creditworthiness. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. While HUD has established specific guidelines, credit analysis remains largely subjective. Underwriting is an art, not a science, and requires careful weighing of the circumstances. See Mortgagee Letters 00-24 and 95-07. Where derogatory items are present, lenders have discretion to consider the borrower's unique circumstances and determine whether financing is appropriate. As HUD directed, in the cases discussed below, AMI examined the overall pattern of credit behavior and determined whether financial difficulties in the past reflected an unacceptable risk or failed to reflect the borrower's current situation. The Company properly considered each borrower's previous housing obligations, recent and/or undisclosed debts, collections, judgments, and bankruptcies. In all of these cases, AMI reasonably determined that late payments were not due to the borrower's disregard for financial obligations and at times resulted from factors beyond the borrower's control. As discussed below, the borrowers were generally hard-working individuals who took responsibility for their financial obligations. AMI adhered to FHA requirements in these cases and reasonably determined that the borrowers qualified for FHA loans. Our individual responses follow.

a. [REDACTED] - FHA Case No. 351-4316649

In the [REDACTED] loan, Finding 1 alleges that all of the borrower's credit problems were not adequately resolved, as the credit report listed three delinquent accounts totaling \$1,042; however, there was no evidence that the Company obtained explanations regarding these credit issues from the borrower.

**Comment 18**

It is AMI's policy to carefully scrutinize a borrower's credit history and to obtain any documentation or explanations necessary to assess a borrower's credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. AMI did so in this case. AMI obtained the borrower's credit report, which indicated a few collection accounts. Therefore, contrary to the allegation in the Report, AMI obtained two letters from the borrower explaining these accounts and his credit history (**Exhibits L-1, L-2**). One hand-written letter from the borrower specifically explains the outstanding debts on his credit report (**Exhibit L-1**), and both letters provide an explanation regarding the reasons for the borrower's past credit problems (**Exhibit L-2**). As indicated in the draft Report, when delinquent accounts are present, HUD guidelines require a lender to determine whether late payments were due to a disregard for, or an inability to manage, financial obligations, or to factors beyond the control of the borrower. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. AMI evaluated the borrower's credit history in this case

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and, contrary to the allegations in Finding 1, the loan file contains sufficient explanations of the borrower's past credit issues. In both explanation letters, the borrower indicated that all of his debts occurred during his previous marriage, and his credit issues derived from his divorce and a temporary period of unemployment (**Exhibits L-1, L-2**). The borrower indicated that, since that time, he had been able to obtain steady employment and satisfy the debts incurred during his marriage, and also demonstrated both a conservative use of credit and greater responsibility for debt repayment (**Exhibits L-1, L-2**).

**Comment 18**

AMI carefully analyzed these explanations in light of the borrower's credit report, and included this analysis on the Mortgage Credit Analysis Worksheet ("MCAW") (**Exhibit L-3**). The underwriter noted that, while the credit report reflected some delinquent credit references, the borrower had sufficiently explained that these problems occurred during a previous difficult marriage and notes that the Company received letters from the borrower's attorney indicating that he had no further obligations (**Exhibit L-3**). Based on this information, the underwriter reasonably concluded that "the credit difficulties are caused by circumstances beyond the control of the borrower" and determined that the borrower was a limited user of credit (**Exhibit L-3**). Thus, the underwriter reasonably determined that the "credit risk is acceptable" in this case" (**Exhibit L-3**).

**Comment 18**

In summary, contrary to the allegation in Finding 1, the underwriter in this case properly obtained explanations regarding the borrower's delinquent credit, examined all of the information in the loan file, and, within the discretion provided to AMI by HUD, reasonably determined that the borrower had made a concerted effort to reestablish credit after his divorce and demonstrated a conservative use of credit in recent years. AMI complied with HUD requirements in analyzing the borrower's creditworthiness in this case and, therefore, this allegation should be removed from the final Report.

**b. [REDACTED] - FHA Case No. 351-4525586**

In this case, AMI takes issue with certain allegations in Finding 1 regarding AMI's documentation of the borrower's credit and rental history. Specifically, the draft Report asserts that the loan file did not contain an explanation for 12 inquiries on the credit report or verification of the borrower's rental payment history.

AMI understands and appreciates the Department's requirement that a lender must obtain a written explanation regarding all inquiries shown on the credit report, as well as determine the borrower's payment history of housing obligations. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3(A) and (B). In connection with loans originated by automated underwriting systems, however, FHA guidelines state that the lender is

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accountable for documentation aspects not addressed in the user's guides provided by the automated underwriting system's creator. See Mortgage Letter 99-26. The [REDACTED] loan was underwritten using Fannie Mae's Desktop Underwriter ("DU") (Exhibit M). In such cases, the Fannie Mae Underwriting Findings report provides verification messages requiring the specific credit and liabilities documentation required in each case. Based on these directives, AMI obtained the documentation indicated in the verification messages provided in the Underwriting Findings reports and the [REDACTED] loan file contained all the necessary credit documentation for the borrower. With regard to credit inquiries, Finding 18 of the DU report expressly stated that "no explanation of these [credit] inquiries is required" (Exhibit M). Moreover, with regard to the borrower's rental history, Finding 16 of the DU report indicated that "no verification of rental history is required" (Exhibit M). Based on these directives, the exclusion of this information from the loan file did not violate FHA requirements. The loan file contained all necessary credit and liability documentation in accordance with FHA and DU requirements and, therefore, we believe that these allegations should be removed from Finding 1.

c. [REDACTED] - FHA Case No. 351-4345198

In this loan, the Report asserts that the loan file did not contain evidence that all credit problems were resolved prior to closing. Specifically, Finding 1 alleges that, the credit report included two credit accounts with past delinquencies and four paid collection accounts, which indicated that the borrower had a difficult time paying bills on time; however, the file did not contain an explanation regarding the past credit issues.

Comment 20

As discussed above, it is AMI's policy to carefully scrutinize a borrower's credit history and to obtain any documentation or explanations necessary to assess a borrower's credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. As you know, when analyzing the borrower's credit record, a period of financial difficulty in the past does not necessarily equate to an unacceptable credit risk. *Id.* When delinquent accounts are present, a lender must determine whether late payments were due to a disregard for, or an inability to manage, financial obligations, or to factors beyond the control of the borrower. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. In this case, contrary to the allegations in Finding 1, the loan file contains sufficient explanations of the borrowers' past late payments and collection accounts. The loan file contains a detailed explanation from the borrower for each of the credit accounts that appear on the credit report (Exhibit N-1), as well as a signed statement from the borrowers stating that their recent credit inquiries have not resulted in new debt (Exhibit N-2). In the explanation letter, the borrowers indicated that their past credit issues

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occurred more than a few years before the date of loan application and resulted from multiple relocations and resulting address changes (**Exhibit N-1**).

**Comment 20**

AMI took the borrowers' credit history and explanations into consideration when analyzing this case. The underwriter noted the reasons for the borrowers' past credit issues on the MCAW and indicated that their past mortgage payment history was excellent and the past mortgage amount was reasonably related to the current mortgage payment (**Exhibit N-3**). As you know, HUD guidelines dictate that the payment history of a borrower's housing obligations is of significant importance in evaluating credit. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3(A). Based on HUD requirements, the underwriter analyzed the borrowers' written explanation regarding their credit accounts, and reasonably determined that these borrowers were eligible for FHA financing. AMI complied with HUD guidelines in this case and, therefore, we do not believe that a recommendation for indemnification is appropriate.

d. [REDACTED] - FHA Case No. 351-4608117

In the [REDACTED] case, Finding 1 alleges that the loan file did not contain an explanation from the borrower regarding four inquiries on the credit report between March and May of 2004.

**Comment 21**

It is AMI's policy to carefully scrutinize a borrower's credit history and to obtain any documentation or explanations necessary to assess a borrower's credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. AMI did so in this case. The credit report AMI obtained indicated a few recent inquiries, all of which had been made by financial institutions or entities that provided mortgage financing (**Exhibit O**). AMI thus determined that the inquiries had occurred as a result of the borrower's attempts to obtain mortgage financing and did not evidence an overuse of credit by the borrower. Therefore, the Company did not require the borrower to provide an explanation regarding the inquiries. Finally, the MCAW documents that the underwriter considered the borrower's credit history in this case (**Exhibit O-2**). The MCAW indicates that, while the borrower had past credit issues, he had good payment records on his housing obligations and noted that the borrower qualified for this loan using less effective income than was reflected in employment documentation included in the loan file (**Exhibit O-2**). Therefore, the underwriter reasonably determined that this borrower was eligible for FHA financing. As a result, this allegation should be removed from the final Report.



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**3. Loan File Accuracy**

Finally, AMI takes issue with the allegations and recommendations for three loans in connection with signatures on the Addendum to the Uniform Residential Loan Application ("Addendum"), HUD Form 92900-A. These loans are as follows: (1) [REDACTED] - FHA Case No. 351-4462312; (2) [REDACTED] - FHA Case No. 351-4408689; and (3) [REDACTED] - FHA Case No. 351-4471386. Specifically, Finding 1 alleges that, in these cases, an individual other than the underwriter signed the underwriter's certification section of the Addendum.

**Comment 22**

AMI understands and appreciates its responsibility to ensure that each loan file contains complete and accurate versions of all documentation supporting its decision to approve the mortgage loan, including the Addendum. See HUD Handbook 4155.1, REV-5, ¶ 3-1. It has consistently been AMI's policy and practice to do so. With regard to the underwriter's certification on Page 3 of the Addendum, HUD guidelines require the lender to certify that an underwriter reviewed all documentation necessary to support loan approval and included such documentation in the file, used due diligence in underwriting the loan, and approved the loan as eligible for HUD insurance endorsement. See HUD Form 92900-A, Page 3. When a loan is manually underwritten, HUD requires the underwriter to sign this form; however, if the loan received an "accept" or "approve" rating from an FHA-approved automated underwriting system, the Department permits a representative of the mortgagee, who may or may not be an underwriter, to execute Page 3 of the Addendum.

**Comment 22**

Pursuant to these guidelines, AMI's policy has been to require its underwriters to sign the Addendum in cases that the underwriter manually underwrote the loan, and to permit its post-closing staff to sign Page 3 of the Addendum only if the loan had received an "accept" rating from an automated underwriting system and the underwriter had not otherwise signed Page 3 of this form. Under these circumstances, Company policy requires the post-closing employee to sign his or her own name as a representative of AMI and does not permit these individuals to sign the name of a Company underwriter or other employee. At no time did AMI permit any employee to sign the name of another individual to any document. In the three isolated cases cited in Finding 1; however, it appears that post-closing personnel signed the underwriter's name instead of their own name on this form. This action was against Company policy and we have provided training to all personnel regarding the importance of signing one's own name on all documents at all times. We have also reminded our post-closing staff to sign Page 3 of the Addendum only in loans that have received an "accept" rating from an automated underwriting system.

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**Comment 22**

Having said that, any oversight with regard to the signatures in these three cases constituted, at worst, harmless error. In all three of the referenced loans, prior to closing, the underwriter reviewed all relevant documentation required to underwrite the loan, fully analyzed the borrower's eligibility for FHA financing, and made a determination to approve the loan. In each of these cases, the underwriter signed an internal underwriting approval sheet evidencing his review of all loan file documentation (**Exhibit P**). These loans were originated during a period of high volume for the Company. During that time, loan files forwarded to the Company's post-closing department were sometimes missing certain forms or signatures. In these cases, it appears that, rather than return the incomplete Addendum to the underwriter, the post-closing staff relied on the underwriter's review of the loan file indicated on the internal underwriting approval sheet and signed Page 3 on the underwriter's behalf. As discussed above, although this action did not conform to AMI's procedures, the underwriter in each of these cases in fact reviewed the loan file documents with due diligence and determined that the borrower was eligible for FHA financing, as evidenced on the internal approval sheet (**Exhibit P**). Thus, the certification made on Page 3 was accurate in each of these three loans and did not result in any harm to the borrower or the Department. As any oversight in these cases did not affect the loans' insurability or place the FHA Insurance Fund at risk, we respectfully request that the indemnification recommendation for these three cases be removed from the final Report.

**B. FINDING 2 – FEES**

In Finding 2, the Report alleges that, in 9 cases, the borrowers paid unallowable fees totaling \$4,589.

**Comment 23**

AMI's policy consistently has been to charge only those fees permitted by HUD requirements. See HUD Handbook 4000.2 REV-2, ¶ 5-2. Nevertheless, the Company recognizes that the fees cited in the Report should not have been charged to the borrowers. Therefore, AMI has refunded each of the fees cited in the Report to the borrower or loan servicer, depending on the status of the loan. Evidence of these refunds is attached as **Exhibit Q**. The Company currently scrutinizes all fees charged to borrowers to ensure that it charges only those fees permissible under HUD guidelines in FHA-insured transactions. Moreover, AMI has reminded its staff that only those fees permitted by FHA guidelines may be passed on to the borrower in FHA loans. We are confident that the any impermissible fees identified in the Report are not currently charged to borrowers in FHA transactions originated by the Company and that all commitment fees the Company charges strictly comply with HUD guidelines. We trust that these actions effectively resolve any concerns raised in the Report.

**C. FINDING 3 – QUALITY CONTROL PLAN AND PROCEDURES**

Finally, in Finding 3, the Report alleges that AMI's Quality Control Plan and its implementation did not fully comply with HUD/FHA requirements. Specifically, the Report states that the Quality Control Plan and its corresponding agreement with its independent Quality Control contractor did not contain a requirement to identify patterns of early default and commonalities among the loan participants, including loan officers, processors, underwriters, etc. Furthermore, the Report asserts that, although the Quality Control Plan required the contractor to visit AMI's branch offices annually when performing on-site reviews, the contractor did not do so.

**Comment 24**

AMI understands and appreciates that all FHA-approved mortgages must implement and continuously have in place a Quality Control Plan for the origination of insured mortgages as a condition of maintaining FHA approval. See HUD Handbook 4060.1, REV-1, ¶ 6-1. While AMI has consistently had in place a Quality Control Plan to monitor the Company's origination procedures and practices, AMI recognizes that, in the past, its Quality Control Plan had omitted certain items regarding identifying patterns and commonalities during its reviews. In an effort to improve the Company's Quality Control efforts, AMI has amended its Quality Control Plan to include these requirements. A copy of our amended Plan is attached as **Exhibit R**. AMI has fully implemented the amended plan, as well as notified all Company employees of the new plan and instructed them to adhere strictly to it. In addition, the Company acknowledges that, in the past, we did not stringently enforce our requirement that our Quality Control contractor perform annual on-site reviews of branch offices that were new or experienced recent personnel changes. To remedy this oversight, we are in the process of amending our Quality Control procedures to include regular on-site reviews of AMI's branch offices. Senior management will monitor this process to ensure that these reviews are routinely completed. AMI will continue to practice stringent quality control and trust that our response to this finding fully addresses the Report's concerns.

**III. CONCLUSION**

**Comment 25**

AMI takes the matters raised in the draft Report very seriously. Because FHA lending comprises a significant portion of AMI's overall business operations, the Company is committed to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, AMI generally complied with FHA underwriting requirements and made loans to qualified FHA borrowers. AMI's thorough review of the findings set forth in the Report indicated that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of AMI, or do not affect the underlying loans' insurability. AMI at no time misrepresented information it submitted to

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the Department. Moreover, AMI refunded over \$4,500 to borrowers and made amendments to its Quality Control procedures.

We believe that this response and accompanying exhibits demonstrate that certain of the Report's recommendations in connection with the cited loans are unwarranted. We respectfully request that the OIG revise its recommendations to fit the facts of this case and remove allegations from the Report in those instances in which AMI has demonstrated its compliance with HUD requirements.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Phillip L. Schulman, at (202) 778-9027. Thank you for your kind consideration.

Sincerely,



Mr. Phillip Valianti  
President

cc: Phillip L. Schulman, Esq.

## OIG Evaluation of Auditee Comments

- Comment 1** American's assertions that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect loan insurability are incorrect. We identified 40 issues with 17 of the 23 loans that we reviewed, of which 15 cases remain in the report. American only addressed 23 of the 40 issues noted, which involved 14 of the 17 cases in Finding 1. We removed two cases and five other issues from the report based on subsequent information that American provided. The other 32 issues remain discrepancies. For the 17 issues that American did not address, we assume American concurred with our conclusions. Further, American agreed with the facts in Findings 2 and 3 and is taking corrective action or already has taken action. Finally, in its comments, American repeatedly stated its policies and procedures conformed to HUD regulations, and it had directed its personnel to adhere to its policies and procedures. However, we stated in the report that one of the main causes of the problems noted was that American did not have written policies and procedures. To date, American has not addressed this issue.
- Comment 2** As discussed at the exit conference, we removed case 351-4548348 from the report prior to receiving American's comments. We found problems with 17 other loans of the 23 loans that we reviewed, of which 15 remain in the report.
- Comment 3** American acknowledged it was not able to locate three case files. As noted in the report, HUD regulations require that the originating lender retain the entire case file pertaining to loan origination. The fact that American could not locate the case files does not absolve it of the responsibility to properly underwrite its loans or relieve it of indemnification liability.
- Comment 4** Although American stated it has strengthened its policies and procedures where deficiencies existed, it has not addressed our recommendation to develop written policies and procedures. Further, American stated it refunded approximately \$4,500 in fees, but has not provided sufficient documentation to support this statement. In addition, American stated it amended its quality control procedures to comply with FHA guidelines, but American only provided documentation that pertained to identifying early default patterns. American stated later in its comments that it is in the process of amending procedures for performing on-site quality control reviews. As noted below, although American generally complied with HUD's requirements, there are several areas that need correction.
- Comment 5** See Comment 3 concerning missing case files.
- Comment 6** See Comment 2 concerning the case removed prior to receiving American's comments.
- Comment 7** Based on the information that American provided, we removed this case from the report.

**Comment 8** American noted that the earnest money deposit of \$10,110 came from the sale of a prior property on June 27, 2003. However, we noted that the borrower had debts to pay including a \$10,894 auto loan, which he paid off on July 18, 2003, five days before closing on the subject property. The source of the earnest money remains in question.

We reviewed the only available bank statements, which covered the months of March and April 2003. Payroll deposits were clearly indicated on the bank statements. However, as American noted, the borrower often made cash deposits, but there was no documentation as to the source of these deposits. The eight deposits in question, totaling \$5,516, ranged in amounts from \$300 to \$1,200. During the audit, American stated that it generally does not investigate deposits under \$1,000, but it agreed it should have investigated the two deposits of \$1,200 and \$1,132. HUD Handbook 4155.1 does not define “large deposits”. However, discussion with the Philadelphia Quality Assurance Division disclosed that \$1,000 was a high threshold and large aggregate amounts should be verified as well as large individual deposits. As a result, it is not apparent that the borrower had the funds to close.

In summary, American did not comply with HUD requirements in underwriting the loan. It did not properly document the source of the borrower’s earnest money deposit and did not comply with FHA guidelines concerning the borrower’s assets.

Based on the above, the case remains in the report.

**Comment 9** The statement provided appeared to be a typed report listing account activity between March 31 and May 1, 2003, rather than a normal bank statement. The document stated it was a report of transactions posted to the account as of May 27, 2003, although there was no activity listed for May 2003. Further, the financial institution was not indicated and the statement was not certified or signed by a bank official. During the audit, American agreed that it should have had the statement certified and obtained an additional bank statement.

Based on the above and another issue discussed below (Comment 22), the case remains in the report.

**Comment 10** The deposits in question, totaling \$2,738, were in amounts from \$100 to \$708 and all but one were transferred from the borrower’s savings account. Savings account bank statements were not provided, so the source of funds remained in question. However, due to the fact the deposits occurred early in the process and there were no questionable deposits in the last two months, we removed this issue from the report.

Based on another issue discussed below (Comment 18), the case remains in the report.

**Comment 11** American noted that HUD Handbook 4155.1, REV-4, CHG-1 and Mortgagee Letter 00-28 require the borrower's deposit slip or bank statement to document the gift deposit. On October 20, 2003, HUD revised this requirement to read the borrower's deposit slip and bank statement. However, the revision occurred after the closing date of October 9, 2003, so the revision did not apply in this case.

Based on the above, this issue was removed from the report. However, based on two other issues American did not address, the case remains in the report.

**Comment 12** According to the settlement document, cash required from the borrower at closing totaled \$5,400, which is contrary to American's assertion that the borrowers were not required to bring any funds to closing. As noted, there were two deposits of \$950 and \$1,075, totaling \$2,025, which American did not investigate. However, based on the fact that there was no questionable activity within the two months prior to settlement, this issue was removed from the report.

Based on another issue discussed below (Comment 20), the case remains in the report.

**Comment 13** American acknowledged that it did not obtain the required documentation of a cancelled check or withdrawal document. The receipt, indicating payment of the borrower's debt, noted payment received from the borrower, but does not prove the gift funds were used for this purpose. Based on the findings in our report, American's assertion that this was an anomaly appears to be unsupported.

Further, the gift letter and notarized letter do not prove the donor provided the gift from her own funds. Without the required cancelled check or withdrawal document, the source of funds remains in question. As a result, American did not perform due diligence to determine that the funds came from a legitimate source.

Based on the above, the case remains in the report.

**Comment 14** American incorrectly stated that the only deposits other than payroll deposits were two gift deposits. Payroll deposits were clearly indicated on the bank statements. However, we noted three deposits of \$200, \$500, and \$750, totaling \$1,450, as well as a \$7,000 deposit, which were not payroll deposits and were not investigated.

Since the deposits were not needed to close, the case was removed from the report.

**Comment 15** The five deposits ranged in amount from \$291 to \$500, totaling \$1,891. HUD Handbook 4155.1 does not define "large deposits". However, discussion with the Philadelphia Quality Assurance Division disclosed that \$1,000 was a high threshold and large aggregate amounts should be verified as well as large individual deposits.

During the audit and in its comments, American agreed it should have obtained a deposit slip to properly document the gift. Further, as noted in the report, although American provided a withdrawal slip for \$2,700 in May 2004, there was also a withdrawal for the same amount in April 2004, which American did not investigate. In its response, American agreed it did not provide the deposit slip or a copy of the check for the gift funds.

In summary, American did not comply with HUD requirements. It failed to obtain explanations for deposits totaling \$1,891 and failed to obtain a copy of the deposit slip for the gift funds.

Based on the above, the case remains in the report as American did not comply with HUD documentation requirements.

**Comment 16** As American stated, we did not question the documentation provided to show the funds came from the donor's account.

However, as noted in the report, there were two deposits in the amounts of \$1,900 on June 3, 2004, and \$2,595 on June 4, 2004. American stated it was not required to investigate the source of these funds. However, the donor's bank balance was \$9.20 prior to these deposits and was \$4.20 on June 4, 2004, after the gift withdrawal was made. As American noted, HUD Handbook 4155.1, paragraph 2-10C states that as a rule HUD is not concerned with how the donor obtains the gift funds provided they are not derived from a party to the sales transaction. Considering the dates of the deposits to the donor account, the donor account balances before and after the transaction, and the fact that the total of the deposits was \$5 less than the amount of the gift, American should have investigated the source of the deposits to the donor's account.

Further, American did not adequately document the gift, as it did not provide a deposit slip to the borrower's account.

In summary, American did not comply with HUD requirements.

Based on the above, the case remains in the report.

**Comment 17** See Comment 3 concerning missing files. Further, as shown below and contrary to American's assertions, it did not reasonably determine or document that late payments were not due to borrower's disregard for financial obligations.

**Comment 18** We acknowledge that American obtained two letters from the borrower. However, in the letter dated December 13, 2002, he stated that the accounts in question do not pertain to his social security number. There was no evidence that American investigated this situation.

Further, the note on the MCAW stated that the borrower's attorney provided statements that showed no further obligations by the borrower. Although



American documented the attorney's letter, it did not provide copies of the supporting statements.

Based on the above, this case remains in the report.

**Comment 19** Based on the information American provided, we agree that explanations for credit inquiries and verifications of rental history were not required and we removed the issues from the report.

Based on two other issues that American did not address, the case remains in the report.

**Comment 20** Contrary to American's statement, the file did not contain an explanation for every credit account on the credit report. It appeared the borrowers selectively addressed specific delinquent accounts from 1999 through 2003 and did not address the accounts we noted in the report. American admitted it did not pursue the matter further.

Based on the above, this case remains in the report.

**Comment 21** There was no documentation in the file that American, as stated in its response, had determined that the recent inquiries were a result of the borrower's attempts to obtain mortgage financing. The inquiries were not addressed at all. As noted in the report, HUD Handbook 4155.1, paragraph 2-3B requires that the borrower explain in writing all inquiries on the credit report in the last 90 days.

Based on the above and two other issues discussed previously (Comment 15), this case remains in the report.

**Comment 22** American cites its policy for automated underwriting, allowing the post-closing staff to sign for the underwriter if it is an accept or approve rating, noting the staff must sign their own name, not the underwriter's name. Although, case 351-4471386 was rated accept/approve, the post-closer apparently signed the underwriter's name, which American, in its response, admitted was not permitted. Further, the automated underwriting software rated cases 351-4462312 and 351-4408689 as refer/caution, so the above procedure does not apply to them. In both instances, the post-closer signed the underwriter's name, although, according to American, the underwriter was required to sign for these cases. Although American stated these are isolated cases, it should be noted that the three cases noted comprise 13 percent of the 23 cases reviewed. Further, American noted that the underwriter signed an internal approval sheet. We believe that since the underwriter was able to sign the internal approval sheet and both the underwriter and the post-closing staff are located in the same building, the underwriter should have signed the Direct Endorsement Approval form.

Based on the above, other issues discussed previously (Comments 8 and 9), and another issue that American did not address, these cases remain in the report.

- Comment 23** American provided copies of letters and the front of checks written to the servicers or borrower for the ineligible fees. However, the recommendation remains open, pending documentation that the funds were removed from American's account.
- Comment 24** American provided a copy of an excerpt from its revised quality control plan, which included a process to identify patterns of early default and commonalities among loan origination participants. Because American is in the process of amending the quality control procedures to include regular on-site reviews of branch offices, the recommendation remains open.
- Comment 25** American's assertions that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect loan insurability are incorrect. First, only two cases and five other issues were removed from the report based on subsequent information that American provided. The other 32 issues remain discrepancies. Further, American only addressed 23 of the 40 issues noted, which involved 14 of the 17 cases in Finding 1. For the 17 issues that American did not address, we assume American agreed with our conclusions. Finally, in its comments, American constantly stated its policies and procedures conform to HUD regulations, and it had directed its personnel to adhere to its policies and procedures. However, we stated in the report, and American agreed at the exit conference, that one of the main causes of the problems noted was that American did not have written policies and procedures. To date, American has not addressed this issue.
- Comment 26** We removed 2 cases and 5 other issues of the 23 issues that American addressed in its comments from the report. The remaining 32 issues of the 40 reported remain in question.

## Appendix C

### SCHEDULE OF CASE FILE DISCREPANCIES

Case Number	Mortgage Amount	Unpaid Principle Balance	Claim Paid	Assets	Credit	Calculations	Signatures and Social Security Numbers
351-4462312	\$187,064	\$182,356	\$1,175	X			X
351-4498468	\$123,068	\$120,297		X		X	
351-4567347	\$110,625	\$108,629				X	
351-4381382	\$98,455	\$95,430	\$7,495	X			
351-4555825	\$64,488	\$63,260	\$200	X			
351-4408689	\$94,613	\$91,914	\$7,456	X			X
351-4487731	\$92,547	\$90,314		X			X
351-4316649	\$98,223	\$95,234			X		
351-4525586	\$142,871	\$139,717	\$200	X	X		
351-4345198	\$177,219	\$172,203			X		
351-4471386	\$79,540	\$77,791		X			X
351-4477678	\$96,485	\$93,694	\$950	X			
351-4608117	\$93,821	\$92,499		X	X		
351-4626705	\$130,224	\$128,390		X			
441-7188300	\$83,341	\$80,740		X	X		
	\$1,672,584	\$1,632,468	\$17,476	12	5	2	4

## Appendix D

### SCHEDULE OF INELIGIBLE FEES

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Case Number	Ineligible Fees	Breakdown of Ineligible Fees		
		Doc Prep/Warehouse Fee	Commitment Fee	Express Mail/Rush Fee
351-4516295	\$525.00	\$200	\$325	
351-4498468	\$675.00	\$200	\$325	\$150
351-4527751	\$540.00	\$200	\$325	\$15
351-4567347	\$349.00	\$200	\$149	
351-4391163	\$400.00	\$200	\$200	
351-4438622	\$525.00	\$200	\$325	
351-4471386	\$525.00	\$200	\$325	
351-4548348	\$525.00	\$200	\$325	
351-4602931	\$525.00	\$200	\$325	
	\$4,589	\$1,800	\$2,624	\$165

## Appendix E

### NARRATIVE CASE PRESENTATIONS

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Case number: 351-4462312

Mortgage amount: \$187,064

Date of loan closing: July 23, 2003

Status: Reinstated by mortgagor who retains ownership

Payments before first default reported: Three

Claims paid: \$1,175

Unpaid principal balance: \$182,356

Summary:

American did not (1) properly verify the borrower's funds to close and (2) obtain required signatures.

Pertinent Details:

American Did Not Properly Verify Funds to Close

American failed to verify the source of the borrower's funds to close. It failed to obtain explanations for eight deposits totaling \$5,516. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American failed to determine the source of \$5,750 in earnest money held by the borrower's attorney. HUD Handbook 4155.1, paragraph 2-10A, requires that if the earnest money deposit exceeds 2 percent of the sale price, the lender must verify with documentation the deposit amount and source of funds.

American Did Not Obtain Required Signatures

The underwriter's signature on the Form HUD-92900-A, "Direct Endorsement Approval for a HUD/FHA-Insured Mortgage," was not his. The underwriter stated that the closing officer will sign his name for him if he is not available. The underwriter's signature

certifies that the underwriter reviewed all pertinent documents, used due diligence in underwriting the loan, and approved the loan as eligible for HUD mortgage insurance under the direct endorsement program. HUD Handbook 4155.1, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. The uniform residential loan application and the addendum, signed and dated by all borrowers and the lender, are required for mortgage credit analysis in all transactions.

Case number: 351-4498468

Mortgage amount: \$123,068

Date of loan closing: August 28, 2003

Status: Reinstated by mortgagor who retains ownership

Payments before first default reported: Six

Unpaid principal balance: \$120,297

Summary:

American did not (1) properly verify the borrower's funds to close and (2) correctly calculate assets available and mortgage payment-to-income and total fixed-payment-to-income ratios.

Pertinent Details:

American Did Not Properly Verify Funds to Close

American failed to obtain explanations for four deposits totaling \$1,910. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American Incorrectly Calculated Available Assets and Mortgage Payment-to-Income and Total Fixed-Payment-to-Income Ratios

American added the bank balance of \$1,002 as of June 12, 2003, to the bank balance of \$5,050 as of August 13, 2003 (same account), to show assets available of \$6,052. On the loan application, American showed the proper bank and account number for the \$1,002 balance, but showed a different institution and the borrower's Social Security number for the \$5,050 balance. Without the \$1,002, the borrower only had \$5,050 of the \$6,568 funds required on the loan application.

American calculated the mortgage payment-to-income and total fixed-payment-to-income ratios using overtime that was unlikely to continue. The verbal verification of employment indicated overtime was unlikely to continue, but American used overtime in the calculation with no explanation. Without the overtime, the mortgage payment-to-income ratio changed from 28 to 41 percent and the total fixed-payment-to-income ratio changed from 39 to 58 percent, both of which significantly exceed HUD's allowable ratios of 29 and 51 percent, respectively. HUD Handbook 4155.1, paragraph 2-7A, states that HUD allows the use of overtime when the borrower has received such income for the past two years and it is likely to continue.

Case number: 351-4567347

Mortgage amount: \$110,625

Date of loan closing: February 17, 2004

Status: Reinstated by mortgagor who retains ownership

Payments before first default reported: Six

Unpaid principal balance: \$108,629

Summary:

American incorrectly calculated the loan-to-value ratio.

Pertinent Details:

American Incorrectly Calculated the Loan-to-Value Ratio

Although the borrower was purchasing the property from his employer, American calculated the loan-to-value ratio at 97.75 percent, rather than the required 85 percent. As a result, the mortgage amount was over-insured by \$14,428. HUD Handbook 4155.1, paragraph 1-8, states identity-of-interest transactions on principal residences are restricted to a maximum loan-to-value ratio of 85 percent. "Identity-of-interest" is defined as a sales transaction between parties with family relationships or business relationships.



Case number: 351-4381382

Mortgage amount: \$98,455

Date of loan closing: March 31, 2003

Status: Default – First Legal Action to Commence Foreclosure

Payments before first default reported: Seven

Claims paid: \$7,494.58

Unpaid principal balance: \$95,430

Summary:

American did not (1) retain the case file and (2) properly verify the borrower's funds to close.

Pertinent Details:

American Did Not Retain the Case File

American could not locate this case file and no longer employs the underwriter for this case. HUD Handbook 4000.2, paragraph 5-8, stipulates that the originating lender must retain the entire case file pertaining to loan origination.

American Failed to Verify the Source of the Borrower's Funds to Close

American failed to obtain explanations for nine deposits totaling \$3,373. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American did not obtain any bank statements from the borrower and only obtained one bank statement from the co-borrower, rather than the required two statements showing balances for three months. HUD Handbook 4155.1, paragraph 3-1F, states the verification of deposit and most recent bank statements are to be provided. "Most recent" means at the time the initial loan application is made. As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower original bank statements covering the most recent three-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements.

Case number: 351-4555825

Mortgage amount: \$64,488

Date of loan closing: January 16, 2004

Status: Delinquent

Payments before first default reported: Seven

Claims paid: \$200

Unpaid principal balance: \$63,260

Summary:

American did not (1) retain the case file and (2) properly verify the borrower's funds to close.

Pertinent Details:

American Did Not Retain the Case File

American could not locate this case file and no longer employs the underwriter for this case. HUD Handbook 4000.2, paragraph 5-8, stipulates that the originating lender must retain the entire case file pertaining to loan origination.

American Failed to Verify the Source of the Borrower's Funds to Close

American did not obtain verifications of deposit, but provided two bank statements, dated December 16, 2003, and January 7, 2004. The borrower's account balance was \$487 as of January 7, 2004, which was not enough to close. In addition, the loan application listed the borrower's father's account balance of \$3,579 but listed the borrower's account number. HUD Handbook 4155.1, paragraph 2-10, states the cash investment in the property must equal the difference between the amount of the insured mortgage, excluding any upfront MIP, and the total cost to acquire the property including prepaid expenses and closing costs. All funds for the borrower's investment in the property must be verified and documented.

American did not adequately identify the source of gift funds. The borrower's father signed a gift letter for \$2,300, and American included in the file an undated cashier's check, made out to the borrower. However, there was no documentation confirming that the funds were provided by the donor. HUD Handbook 4155-1, paragraph 2-10C, states that if the donor purchased a cashier's check, money order, official check, or any other type of bank check as a means of transferring the gift funds, the donor must provide a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account.

Case number: 351-4408689

Mortgage amount: \$94,613

Date of loan closing: May 30, 2003

Status: Repayment

Payments before first default reported: Eight

Claims paid: \$7,455.51

Unpaid principal balance: \$91,914

Summary:

American did not (1) properly verify the borrower's funds to close and (2) obtain required signatures.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American did not obtain a verification of deposit and provided only one bank statement. HUD Handbook 4155.1, paragraph 3-1F, states the verification of deposit and most recent bank statements are to be provided. As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower original bank statements covering the most recent three-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements.

American Did Not Obtain Required Signatures

The underwriter's signature on the Form HUD-92900-A, "Direct Endorsement Approval for a HUD/FHA-Insured Mortgage," was not his. The underwriter stated that the closing officer will sign his name for him if he is not available. The underwriter's signature certifies that the underwriter reviewed all pertinent documents, used due diligence in underwriting the loan, and approved the loan as eligible for HUD mortgage insurance under the direct endorsement program. HUD Handbook 4155.1, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. The uniform residential loan application and the addendum, signed and dated by all borrowers and the lender, are required for mortgage credit analysis in all transactions.

Case number: 351-4487731

Mortgage amount: \$92,547

Date of loan closing: August 29, 2003

Status: Repayment

Payments before first default reported: Eight

Unpaid principal balance: \$90,314

Summary:

American did not (1) properly verify the borrower's funds to close and (2) investigate multiple Social Security numbers.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American failed to obtain explanations for six deposits in two accounts totaling \$4,276. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American Did Not Investigate Multiple Social Security Numbers

The credit report listed four Social Security numbers for the borrower. There was no documentation in the file confirming that American tried to resolve the multiple Social Security number issue. HUD Handbook 4155.1, paragraph 3-1C, requires the lender to resolve any inconsistencies or multiple Social Security numbers for individual borrowers.

Case number: 351-4316649

Mortgage amount: \$98,223

Date of loan closing: February 6, 2003

Status: First Legal Action to Commence Foreclosure

Payments before first default reported: Nine

Unpaid principal balance: \$95,234

Summary:

American did not evaluate credit history or explain negative credit information.

Pertinent Details:

American Did Not Evaluate Credit History or Explain Negative Credit Information

American did not ensure that all credit problems were adequately resolved. The credit report listed three delinquent accounts totaling \$1,042. There was no evidence that American researched the debt. The underwriter stated that American, according to HUD regulations, does not require clearing collection accounts. HUD Handbook 4155.1, paragraph 2-3, states when delinquent accounts are revealed, the lender must determine whether late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

Case number: 351-4525586

Mortgage amount: \$142,871

Date of loan closing: October 9, 2003

Status: Partial reinstatement

Payments before first default reported: 10

Claims paid: \$200

Unpaid principal balance: \$139,717

Summary:

American did not (1) properly verify the borrower's funds to close and (2) evaluate credit history or explain negative credit information.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American failed to obtain explanations for six deposits totaling \$3,403. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American Did Not Evaluate Credit History or Explain Negative Credit Information

American did not obtain an explanation for derogatory credit. The credit report listed two collection accounts totaling \$1,031. One account for \$729 was not listed on the loan application or mortgage credit analysis worksheet, and there is no evidence that American researched this debt. HUD Handbook 4155.1, paragraph 2-3, states when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. While minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit (including judgments, collections, and any other recent credit problems) require sufficient written explanation from the borrower. The borrower must provide a satisfactory explanation for any significant debt that is shown on the credit report but not listed on the loan application.

Case number: 351-4345198

Mortgage amount: \$177,219

Date of loan closing: April 30, 2003

Status: Reinstated by mortgagor who retains ownership

Payments before first default reported: N/A

Unpaid principal balance: \$172,203

Summary:

American did not evaluate credit history or explain negative credit information.

Pertinent Details:

American Did Not Evaluate Credit History or Explain Negative Credit Information

American did not ensure that all credit problems were resolved. The credit report listed two credit accounts in March and April 2003 that were up to 90 days delinquent, between two and six times, and four collection accounts from February 2002 through March 2003, all of which were paid off. Although the delinquencies and collection accounts indicated the borrowers had a difficult time paying bills on time, there was no explanation for the delinquencies. HUD Handbook 4155.1, paragraph 2-3, states when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. While minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit (including judgments, collections, and any other recent credit problems) require sufficient written explanation from the borrower.

Case number: 351-4471386

Mortgage amount: \$79,540

Date of loan closing: August 5, 2003

Status: Repayment

Payments before first default reported: N/A

Unpaid principal balance: \$77,791

Summary:

American did not (1) properly verify the borrower's funds to close and (2) obtain required signatures.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American failed to obtain an explanation for one deposit totaling \$2,200. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American Did Not Obtain Required Signatures

The underwriter's signature on the Form HUD-92900-A, "Direct Endorsement Approval for a HUD/FHA-Insured Mortgage," was not his. The underwriter stated that the closing officer will sign his name for him if he is not available. The underwriter's signature certifies that the underwriter reviewed all pertinent documents, used due diligence in underwriting the loan, and approved the loan as eligible for HUD mortgage insurance under the direct endorsement program. HUD Handbook 4155.1, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. The uniform residential loan application and the addendum, signed and dated by all borrowers and the lender, are required for mortgage credit analysis in all transactions.



Case number: 351-4477678

Mortgage amount: \$96,485

Date of loan closing: August 20, 2003

Status: Reinstated by mortgagor who retains ownership

Payments before first default reported: N/A

Claims paid: \$950

Unpaid principal balance: \$93,694

Summary:

American did not properly verify the borrower's funds to close.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American did not adequately identify the source of gift funds. It did not determine that the borrower's sister-in-law provided the cash gift of \$1,300 to pay off one of the borrower's debts. HUD Handbook 4155-1, paragraph 2-10C, states if the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit are also required. Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were the donor's own funds.

Case number: 351-4608117

Mortgage amount: \$93,821

Date of loan closing: June 2, 2004

Status: Repayment

Payments before first default reported: N/A

Unpaid principal balance: \$92,499

Summary:

American did not (1) properly verify borrower's funds to close and (2) evaluate credit history or explain negative credit information.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American failed to obtain an explanation for five deposits totaling \$1,891. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American did not adequately identify the source of gift funds. We noted some inconsistencies in the gift process. The gift letter for \$2,700 is dated May 25, 2004, but the donor's bank statement shows a withdrawal for that amount on April 30, 2004, and again on May 25, 2004. The borrower's account shows a deposit of \$2,700 on May 25, 2004, but American did not include a copy of a check or deposit slip. HUD Handbook 4155-1, paragraph 2-10C, states if the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit are also required. Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were the donor's own funds.

American Did Not Evaluate Credit History or Explain Negative Credit Information

American did not obtain an explanation for four inquiries on the credit report from March through May 2004. There was no indication that American investigated this issue. HUD Handbook 4155.1, paragraph 2-3B, states the borrower must explain in writing all inquiries shown on the credit report in the last 90 days.

Case number: 351-4626705

Mortgage amount: \$130,224

Date of loan closing: June 15, 2004

Status: Modification

Payments before first default reported: Three

Unpaid principal balance: \$128,390

Summary:

American did not properly verify the borrower's funds to close.

Pertinent Details:

American Failed to Verify the Source of the Borrower's Funds to Close

American did not adequately identify the source of gift funds. We noted some inconsistencies in the gift process. The borrower's wife provided a gift of \$4,500 via a check, dated June 4, 2003. We noted deposits to the wife's account on June 3, 2004 for \$1,900 and June 4, 2004, for \$2,595. American did not investigate the source of these funds. Further, American did not document the borrower's deposit slip for the \$4,500 gift. HUD Handbook 4155-1, paragraph 2-10C, states if the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit are also required. Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were the donor's own funds.

Case number: 441-7188300

Mortgage amount: \$83,341

Date of loan closing: May 22, 2003

Status: Repayment

Payments before first default reported: N/A

Unpaid principal balance: \$80,740

Summary:

American did not (1) retain the case file, (2) properly verify the borrower's funds to close, and (3) evaluate credit history or explain negative credit information.

Pertinent Details:

American Did Not Retain the Case File

American could not locate this case file. HUD Handbook 4000.2, paragraph 5-8, stipulates that the originating lender must retain the entire case file pertaining to loan origination.

American Failed to Verify the Source of the Borrower's Funds to Close

American failed to obtain an explanation for one deposit totaling \$15,000. HUD Handbook 4155.1, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in the account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

American only obtained one checking account statement inquiry, which was missing two pages, rather than the required two statements showing balances for three months. HUD Handbook 4155.1, paragraph 3-1F, states the verification of deposit and most recent bank statements are to be provided. "Most recent" means at the time the initial loan application is made. As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower original bank statements covering the most recent three-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements.

American Did Not Evaluate Credit History or Explain Negative Credit Information

American did not verify the borrower's rental payment history. The loan application shows a monthly rental of \$750. We noted inconsistencies in the borrower's address on various documents. The borrower's driver's license, earnings statements, and W-2 forms

show an address other than the subject property. However, the loan application and credit report list the subject property as the borrower's address. There is no indication that American investigated this issue or verified the borrower's rental payment history. HUD Handbook 4155.1, paragraph 2-3A, requires that the lender include in its loan origination file or case binder a determination of the borrower's payment history of housing obligations through the credit report, directly from the landlord or mortgage servicer, or through canceled checks covering the most recent 12-month period.