

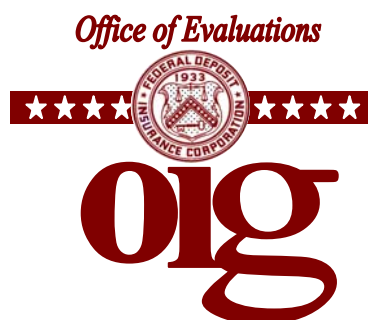


# Office of Inspector General

February 2010  
Report No. EVAL-10-001

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**The FDIC's Loan Modification Program**





## Why We Did This Evaluation

The recent financial crisis has resulted in dramatic increases in home mortgage defaults and foreclosures, and imposed significant costs on borrowers, lenders, mortgage investors, and neighborhoods. In response, the FDIC developed a loan modification program (LMP) at IndyMac Federal Bank, FSB (IndyMac), an FDIC conservatorship, to place borrowers into affordable mortgages while achieving an improved return for bankers and investors over foreclosure. Since November 2008, the FDIC has required institutions assuming FDIC failed bank assets to implement some form of loan modification program on single-family assets acquired under shared-loss agreements (SLAs). We performed this assignment as part of our efforts to evaluate the controls over, and operations of, new corporate programs.

The objectives of our evaluation were to assess the:

- Extent to which the FDIC has required LMP implementation at assuming institutions.
- Internal controls over the program and how those controls compare to the Department of the Treasury's (Treasury) Home Affordable Modification Program (HAMP), including controls established to detect and prevent program fraud.

## Background

In 2008, the FDIC initiated a systematic and streamlined approach to loan modifications at IndyMac, by turning troubled loans into performing loans and, thereby, avoiding unnecessary and costly foreclosures. The FDIC's LMP requires that a successful loan modification candidate result in a (1) positive net present value as opposed to a foreclosure option and (2) monthly payment representing no more than 31 percent of the borrower's gross monthly income. The FDIC's LMP process has to be straightforward and efficient in order to modify a large number of "at-risk" mortgages in a short period of time.

In February 2009, the Obama Administration announced The Homeowner Affordability and Stability Plan, a \$75 billion federal program designed to provide for a sweeping loan modification program targeted at borrowers who are at risk of foreclosure. The plan tasked Treasury with developing and implementing uniform guidance for the government's loan modification efforts. Treasury announced its HAMP in March 2009, which built on the work of Congressional leaders and the FDIC's LMP efforts.

## Evaluation Results

The FDIC frequently enters in SLAs with institutions that assume failed bank assets. These SLAs require the assuming institution to implement some form of LMP on the acquired single-family loans. Through December 31, 2009, the FDIC had entered into 86 SLAs for single-family loans totaling \$53.2 billion. The FDIC's LMP is the default program for SLAs; however, assuming institutions have the option of using HAMP or another loan modification program acceptable to the FDIC. Three large assuming institutions, representing 50 percent of total single-family SLA assets as of December 31, 2009, are implementing Treasury's HAMP.

We evaluated loan modification activity for the eight largest SLAs, representing 97 percent of the single-family assets under SLAs as of July 31, 2009. Through December 31, 2009, the assuming

institutions had completed 4,348 modifications and had 6,492 modifications in process. Collectively, the eight SLAs had a total of 24,853 single-family loans that had been delinquent longer than 60 days or were in foreclosure. FDIC officials noted that it is important to consider single-family portfolio characteristics when assessing the success of an assuming institution's loan modification program. Such characteristics include the type of loan portfolio (e.g., non-traditional or subprime); the number of second lien loans, non-owner occupied loans, or loans in bankruptcy; and the proportion of delinquent loans that are actually eligible for modification.

The FDIC may also enter into public-private partnerships with private sector investors, which require the purchasers to implement some form of LMP or retain single-family assets in FDIC receiverships. With respect to receivership assets, the FDIC encourages, but does not require, servicers to pursue loan modifications due to the temporary nature of the FDIC's ownership of those assets. The FDIC may issue guidance for pursuing loan modifications of receivership assets in the future.

President Obama's strategy for restructuring or refinancing millions of at-risk mortgages tasked Treasury with developing uniform guidance for loan modifications and required agencies such as the FDIC to seek to apply uniform guidance to loans that the agency owns or guarantees. We evaluated the FDIC's LMP program against Treasury's HAMP program. While certain important characteristics of the FDIC's LMP are consistent with HAMP, we identified other areas where the FDIC's LMP program attributes and controls could be strengthened, related to:

- The agreement with the assuming institution to follow the FDIC's LMP and LMP guidelines and program details;
- FDIC LMP loan underwriting, file documentation, and certain reporting requirements;
- Requirements for the assuming institution to develop an internal control program to monitor program compliance and to detect loan modification fraud; and
- The FDIC's plans for the independent monitoring of assuming institutions to ensure program compliance.

In comparing the FDIC's LMP to Treasury's HAMP, we acknowledge that HAMP is a much broader program aimed at modifying millions of mortgages. Accordingly, we are not suggesting that the FDIC's program should be identical to HAMP; rather, this report discusses certain program principles and attributes that could be strengthened in the FDIC LMP program to help ensure program success. We also acknowledge that the FDIC's LMP is a relatively new program and that the Division of Resolutions and Receiverships is still in the process of implementing program controls.

## **OIG Recommendations and Management Response**

We made five recommendations to enhance program controls related to: the LMP agreement with the assuming institution and LMP guidelines; underwriting and clarifying information collection requirements for fair housing purposes; assuming institution internal control programs; and FDIC compliance monitoring of assuming institutions. DRR concurred with each recommendation and proposed responsive actions to be completed by June 30, 2010.

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## ACRONYMS IN THE REPORT

DRR	Division of Resolutions and Receiverships
GAO	Government Accountability Office
HAMP	Home Affordable Modification Program
IRS	Internal Revenue Service
LMP	Loan Modification Program
NPV	Net present value
OIG	Office of Inspector General
P&A	Purchase & Assumption
PPP	Private-Public Partnership
SLA	Shared-Loss Agreement
SPA	Servicer Participation Agreement



**DATE:** February 4, 2010

**TO:** Mitchell L. Glassman, Director  
Division of Resolutions and Receiverships

**FROM:** E. Marshall Gentry  
Acting Assistant Inspector General for Evaluations

**SUBJECT:** *The FDIC's Loan Modification Program*  
(Report No. EVAL-10-001)

This report presents the results of our evaluation of the FDIC's Loan Modification Program (LMP). In 2008, the FDIC initiated a systematic and streamlined approach to loan modifications at IndyMac Federal Bank, FSB (IndyMac), in order to place borrowers into affordable, long-term mortgages while achieving an improved return for bankers and investors compared to the results of foreclosure. In February 2009, President Obama tasked the Department of the Treasury (Treasury) with program responsibility for developing and implementing uniform guidance for loan modifications across the mortgage industry based, in part, on the FDIC's work at IndyMac. Since November 2008, the FDIC has required most purchasers of failed bank assets to implement the FDIC's LMP, Treasury's Home Affordable Modification Program (HAMP), or some other loan modification program acceptable to the FDIC.

## **EVALUATION OBJECTIVES AND APPROACH**

The purpose of this evaluation was to assess FDIC LMP implementation at institutions that had acquired single-family loans from failed institutions. Our initial objectives were to

- Assess the FDIC's implementation of the loan modification program at IndyMac and
- Determine steps that the FDIC had taken to monitor implementation of its LMP at institutions that agreed to implement the program as part of transactions involving the FDIC and other financial regulatory agencies.

We tailored our objectives to address concerns communicated to us by Senator Charles Grassley that the IndyMac LMP include controls to prevent borrowers who fraudulently obtained an original mortgage from benefiting from an IndyMac loan modification. The FDIC subsequently sold IndyMac to OneWest Bank, FSB, on March 19, 2009. The FDIC also entered into a number of additional agreements with assuming institutions to implement the FDIC's LMP during 2009.

Accordingly, we revised our evaluation objectives to assess the:

- Extent to which the FDIC has required program implementation at assuming institutions.
- Internal controls over the program and how those controls compare to Treasury's HAMP, including controls established to detect and prevent program fraud.

Appendix I includes additional detail on our objectives, scope, and methodology. We performed our evaluation between April 2009 and October 2009 in accordance with the *Quality Standards for Inspections*.

## **BACKGROUND**

In 2008, the FDIC developed the LMP after taking over as conservator for IndyMac to achieve improved value for the IndyMac Federal conservatorship by turning troubled loans into performing loans and, thereby, avoiding unnecessary and costly foreclosures. The FDIC LMP requires that a successful candidate for loan modification result in a (1) positive net present value (NPV) as opposed to a foreclosure option and (2) monthly payment representing no more than 31 percent of the borrower's gross monthly income, known as the front-end debt-to-income ratio. The FDIC LMP utilizes a "waterfall" approach to reach the 31-percent ratio, by first lowering the borrower's interest rate, then extending the term of the loan not to exceed 40 years, and finally forbearing principal to the end of the loan period. FDIC officials have noted that a critical characteristic of the FDIC LMP process is that it has to be straightforward and efficient in order to modify a large number of "at-risk" mortgages in a short period of time.

In February 2009, the Obama Administration announced The Homeowner Affordability and Stability Plan, a \$75 billion federal program designed to provide for a sweeping loan modification program targeted at borrowers who are at risk of foreclosure. The plan tasked Treasury with developing and implementing uniform guidance for the government's loan modification efforts. Treasury announced its HAMP guidelines on March 4, 2009, which built on the work of Congressional leaders and the FDIC's LMP. Treasury's HAMP uses the FDIC LMP 31-percent "waterfall" process and the NPV test. However, HAMP also provides various incentive payments to the loan servicer and borrower for achieving sustainable loan modifications.

Under Treasury's HAMP, the Federal National Mortgage Association (Fannie Mae) serves as the financial agent and fulfills the role of administrator, record-keeper, and paying agent for the program. The Federal Home Loan Mortgage Corporation (Freddie Mac) is the compliance agent for the program and is responsible for ensuring that participating servicers comply with Treasury's guidelines.

As of August 2009, Treasury had signed Servicer Participation Agreements (SPA) with 38 servicers, who, along with 2,300 servicers of Fannie Mae and Freddie Mac loans, account for

more than 85 percent of the mortgage market.<sup>1</sup> In an August 2009 report, Treasury stated that more than 230,000 trial modifications had started and that the program was on pace to help 3 to 4 million homeowners over the next 3 years.

## **EVALUATION RESULTS**

### **Status of the FDIC's Loan Modification Program**

The FDIC generally requires entities that acquire failed bank residential assets through large, structured transactions to implement a loan modification program acceptable to the FDIC. These structured transactions include shared-loss agreements (SLA) and private-public partnerships (PPP). The FDIC encourages, but does not require, servicers of assets that remain in FDIC receiverships to pursue loan modifications of single-family receivership loans.

Single-Family Loans Under Shared-Loss Agreements: Since November 2008, the FDIC has been requiring purchasers (known as assuming institutions) of failed financial institutions to implement the FDIC's LMP or some other loan modification program acceptable to the FDIC, such as HAMP, on the single-family loans that the purchasers are acquiring. The FDIC enters into a purchase and assumption (P&A) agreement with the assuming institution, which explains the terms of the sale and assets and liabilities that transfer to the assuming institution. Most P&As also include an SLA wherein the assuming institution is responsible for managing and selling the failed bank assets, and the FDIC guarantees the bulk of any losses incurred in the disposition of the failed bank assets.<sup>2</sup> Each SLA requires the assuming institution to implement loan modification efforts, as follows:

For each single family shared-loss loan in default or for which a default is reasonably foreseeable, the assuming bank shall undertake reasonable and customary loss mitigation efforts, in accordance with any of the following programs selected by Assuming Bank in its sole discretion, Exhibit 5 (FDIC Mortgage Loan Modification Program), the United States Treasury's Home Affordable Modification Program Guidelines or any other modification program approved by the United States Treasury Department, the Corporation, the Board of Governors of the Federal Reserve System or any other governmental agency (it being understood that the Assuming Bank can select different programs for the various Single Family Shared-Loss Loans).

Through December 31, 2009, the FDIC had entered into 86 SLAs with single-family assets totaling \$53.2 billion.<sup>3</sup> FDIC officials indicated that the FDIC's loan modification program is the default program for SLAs. The assuming institution must notify the FDIC if it wishes to use another loan modification program, such as HAMP. An FDIC official indicated that larger institutions may prefer to implement HAMP, because of Treasury's incentive structure, while smaller institutions without a large infrastructure may prefer the FDIC's LMP. The FDIC

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<sup>1</sup> Fannie Mae and Freddie Mac loans automatically participate in the HAMP.

<sup>2</sup> The FDIC generally guarantees 80 percent of the loss up to a specified cumulative loss amount and 95 percent thereafter.

<sup>3</sup> The FDIC had also entered into 84 SLAs with commercial assets totaling \$65 billion.

official indicated that three large assuming banks were implementing HAMP. Collectively, these three SLAs represent 50 percent of the total single-family shared-loss assets through December 31, 2009. At this point, the assuming banks for the remaining 83 SLAs have not expressed an interest in implementing a program other than the FDIC's LMP.

FDIC officials indicated that one reason that assuming institutions may prefer the FDIC's LMP over HAMP involves the scope of the loan modification effort. The FDIC's LMP requires that the assuming institution apply the loan modification efforts only to the single-family loans acquired through the P&A transaction. Treasury requires HAMP participants to apply HAMP loan modification efforts to all of the single-family loans that the institution or servicer owns.

We compiled loan modification activity for eight SLAs, representing 97 percent of the total single-family assets under SLAs as of July 31, 2009.<sup>4</sup> Table 1 presents the results of our work.

**Table 1: Compilation of Loan Modification Activity of Selected SLAs**

Shared-Loss Agreement	Initial SF Loans (in millions)	Months under SLA	As of December 31, 2009 <sup>(4)</sup>				Cumulative Mods Completed
			Total loans	Loans Delinquent <sup>(1)</sup>	Loans in Foreclosure	Mods in Process	
1	\$12,755	9	45,211	11,111	5,650	1,278 <sup>(2)</sup>	1,384
2	\$11,069	13	21,685	3,864	2,393	1,079	2,821
3	\$10,280	7	37,294	9,186	6,426	4,013	1 <sup>(3)</sup>
4	\$1,329	13	4,023	314	136	65	118
5 <sup>(4)</sup>	\$223	11	1,033	96	0	54	24
6	\$299	6	2,460	184	70	0	0
7	\$217	5	2,628	86	34	3	0
8 <sup>(4)</sup>	\$111	5	1,316	12	1	0	0
Totals	\$36,283		115,650	24,853	14,710	6,492	4,348

Source: Office of Inspector General Review of Shared-Loss Certificates and other shared-loss reports.

<sup>(1)</sup> Loans delinquent 60 days or more, including loans in foreclosure.

<sup>(2)</sup> This SLA involves a mature loan modification program; as a result, fewer loans are eligible for modification.

<sup>(3)</sup> This assuming institution is participating in HAMP, which requires a 3-month trial period before modified loans are considered completed.

<sup>(4)</sup> Activity is shown through October 31, 2009 and September 30, 2009 for 5 and 8, respectively. This was the most recent data available to our office.

As shown, through December 31, 2009, assuming institutions for the eight SLAs had completed 4,348 modifications and had 6,492 modifications in process. Collectively, the eight SLAs had a total of 24,853 single-family loans that had been delinquent longer than 60 days or were in foreclosure.

FDIC officials noted that in gauging the success of an assuming institution's loan modification program, one must also consider single-family portfolio characteristics such as (1) the loan product type distribution—for example, Option ARM (adjustable rate mortgage) products are

<sup>4</sup> We selected all SLAs with initial single-family loans in excess of \$100 million, as of July 31, 2009. Loan modification activity information was not available for one SLA with initial single-family loans of \$128 million. For this analysis, we did not select SLA transactions after July 31, 2009, because sufficient time would not have elapsed for the assuming institutions to report meaningful loan modification activity.

difficult to successfully modify because the modified loan often does not meet the NPV test; (2) the population of second-lien loans, non-owner occupied or second homes, and loans in bankruptcy; and (3) the proportion of delinquent loans that are actually eligible for modification. The maturity and type of loan modification program (e.g., HAMP or FDIC LMP) can also be a factor in gauging an assuming institution's loan modification program success.

Public-Private Partnership Transactions: The FDIC has also entered into several joint venture agreements with private sector investors to manage pools of assets drawn from one or more receiverships. In a PPP transaction, the FDIC sells a managing joint venture interest in a pool of receivership assets. The buyer manages the assets, and the FDIC and the buyer share in any net asset collections. Through October 19, 2009, the FDIC had entered into six PPP transactions with residential and commercial assets totaling \$4.91 billion. Under the PPP, the FDIC requires the private-sector investor to implement a loan modification program acceptable to the FDIC. Due to evaluation time constraints, we did not evaluate loan modification activity for PPP transaction purchasers.

Single-Family Assets Retained in FDIC Receiverships: The FDIC retains failed financial institution single-family assets that are not acquired by assuming institutions, or otherwise sold, in failed bank receiverships. The FDIC may manage receivership assets internally or hire external vendors to service the assets. As of October 2009, DRR officials indicated that the FDIC had approximately 5,500 single-family loans valued at \$950 million in receiverships.<sup>5</sup>

DRR officials told us that the FDIC provides resolution assistance contractors and external servicers of receivership assets with LMP documentation and encourages servicers to implement loan modification efforts; however, the FDIC does not require servicers to pursue loan modification efforts for single-family assets in receivership. The FDIC is working to package receivership assets into structured sales transactions, and an FDIC official cited the temporary nature of the FDIC's ownership of receivership assets as a reason that the FDIC does not always pursue loan modification efforts for receivership assets. The official also indicated that DRR is developing guidance related to performing loan modifications for receivership assets.

## **Controls Over the FDIC's Loan Modification Program**

President Obama's Homeowner Affordability and Stability Plan required Treasury to develop uniform guidance for loan modifications and federal agencies to seek to apply uniform guidance to loans that they own or guarantee. Both the FDIC's LMP and HAMP possess similar key controls related to income verification and owner-occupancy that are important in ensuring that the modification effort is valid and sustainable, and these controls help to prevent or detect loan modification fraud. However, we identified differences between the FDIC's LMP and HAMP where the FDIC's program controls could be strengthened to be more consistent with HAMP program principles.

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<sup>5</sup> The FDIC also had approximately 20,600 single-family loans valued at almost \$3.3 billion in receivership from two failed banks for which the ownership of the loans was in question, and the FDIC was investigating these loans at the time we issued our draft report. This ownership uncertainty had made it difficult for the FDIC to take action with respect to those loans.

In February 2009, the Obama Administration announced the Homeowner Affordability and Stability Plan as a comprehensive strategy to restructure or refinance millions of at-risk mortgages. Among other things, the Plan provided that:

Treasury will develop uniform guidance for loan modifications across the mortgage industry, working closely with the bank agencies and building on the FDIC's pioneering work. The Guidelines will be used for the Administration's new foreclosure prevention plan. Moreover, all financial institutions receiving Financial Stability Plan financial assistance going forward will be required to implement loan modification plans consistent with Treasury Guidance. Fannie Mae and Freddie Mac will use these guidelines for loans that they own or guarantee, and the Administration will work with regulators and other federal and state agencies to implement these guidelines across the entire mortgage market. The agencies will seek to apply these guidelines when permissible and appropriate to all loans owned or guaranteed by the federal government, including those owned or guaranteed by Ginnie Mae, the Federal Housing Administration, Treasury, the Federal Reserve, the FDIC, Veterans' Affairs and the Department of Agriculture.

An FDIC official noted that the FDIC's LPM is consistent with Treasury's HAMP because both programs utilize the "waterfall" approach and NPV test. We also note that both the FDIC's LMP and HAMP possess some similar key controls, such as requirements for income verification, that the loan modification involve the borrower's primary residence, and that the property subject to the loan modification be owner-occupied. Each of these controls are important in ensuring that the modification effort is valid and sustainable, and these controls help to prevent or detect fraudulent loan modification attempts.

The remaining sections of this report compare the FDIC's LMP to Treasury's HAMP and, where appropriate, identify areas where the FDIC's program could be strengthened.

### ***Agreement with Assuming Institution to Follow the FDIC's Loan Modification Program***

**FDIC's LMP:** The P&A agreement is the governing document for the FDIC's LMP and requires the assuming institution to implement some form of loan modification program acceptable to the FDIC on the single-family loans subject to the SLA. Exhibit 4.15A, Single Family Shared-Loss Agreement, requires the assuming institution to manage and administer each single-family shared-loss loan in accordance with the assuming bank's usual and prudent business and banking practices and customary servicing procedures and to comply with the terms of the modification guidelines with the objective of (1) minimizing the loss to the assuming institution and the FDIC and (2) maximizing the opportunity for qualified homeowners to remain in their homes.

The P&A also requires loan-specific monthly reporting for shared-loss claims and recoveries and losses resulting from loan restructuring (loan modification); monthly submission of the servicing file for each outstanding shared-loss loan; record retention requirements for the term of the agreement; and an annual report signed by the assuming institution's independent public accountant. In the annual report, the auditors must indicate that they have reviewed the terms of

the single-family SLA and in the course of their annual audit of the assuming institution's books and records, nothing came to their attention to suggest that any required computations on the part of the assuming institution during such calendar year were not made. The P&A agreement also provides the receiver or the FDIC in its corporate capacity the right to perform audits to determine the assuming institution's compliance with the provisions of the SLA. While these P&A provisions are important, we note that most of the provisions focus on reporting information about loss amounts as opposed to information about loan modification efforts. Opportunities exist to strengthen the SLA, by incorporating, by reference, expanded program guidance and other program requirements discussed in this report.

Treasury's HAMP: Treasury's program requires participants to sign an SPA and Financial Instrument requiring the servicer to, among other things, follow program guidelines and procedures and to maintain complete and accurate records. The Financial Instrument includes requirements for audits, reporting, data retention, and a servicer internal control program.

The Financial Instrument provides that Freddie Mac, the Federal Housing Finance Agency, and other parties designated by the Treasury or applicable law shall have the right to conduct unannounced, informal onsite visits and to conduct formal onsite and offsite physical, personnel, and information technology testing; security reviews; and audits of the servicer; and to examine all books, records, and data related to the services provided and purchase price received in connection with the program.

Under HAMP, the servicer is also required to certify annually that, among other things, the servicer is complying with all program guidance; applicable federal, state, and local laws; and has implemented an internal control program to monitor and detect loan modification fraud and to monitor compliance with applicable consumer protection and fair lending laws. The financial instrument acknowledges that the provision of false or misleading information to Fannie Mae or Freddie Mac in connection with the program or pursuant to the agreement may constitute a violation of: (a) Federal criminal law involving fraud, conflicts of interest, bribery, or gratuity violations found in title 18 of the United States Code or (b) the civil False Claims Act (31 U.S.C. Part 3729-3733).

### ***Loan Modification Program Guidelines***

FDIC LMP: The P&A agreement includes Exhibit 5, which is a 2-page document, entitled, *FDIC Mortgage Loan Modification Program*. The exhibit provides detailed guidance for the waterfall process and NPV test. However, as discussed in more detail later, the exhibit provides limited underwriting guidance or servicer internal control/quality control requirements.

During the pilot LMP at IndyMac, the FDIC published on its public Web site FDIC Loan Modification Program guidance, example marketing material, and FDIC Workout Program Guidelines. These documents provide much more implementing guidance than the 2-page exhibit. At a minimum, the FDIC should provide assuming institutions with LMP information similar in detail to the IndyMac LMP guidance published on the FDIC's Web site. As discussed later, the FDIC has communicated extensive reporting requirements in the SLAs and through a Data Reporting Package provided to each assuming institution.

Treasury's HAMP: Treasury has issued extensive guidance and frequently asked question documents related to HAMP. Key Treasury HAMP guidance includes:

- Supplemental Directive 09-01, *Introduction of the Home Affordable Modification Program*, dated April 6, 2009, which provides detailed guidance to servicers about HAMP eligibility, underwriting requirements, the modification process, fees and compensation, and servicer quality assurance program and program compliance requirements.
- Supplemental Directive 09-02, *Fair Housing Obligations Under the Home Affordable Modification Program*, dated April 21, 2009, which requires servicers to collect Government Monitoring Data and report to Fannie Mae to monitor compliance with the Fair Housing Act (42 U.S.C. 3601 *et seq.*) and other applicable fair lending and consumer protection laws.
- *Home Affordable Modification Program (HAMP) Servicer Reporting Requirements*, updated July 23, 2009, which requires servicers to provide detailed, loan-level data monthly to Fannie Mae.

### ***Loan Underwriting and File Documentation Requirements***

FDIC LMP: P&A agreement Exhibit 5 provides limited underwriting guidance, stating that “the borrower’s monthly income shall be the amount of the borrower’s (along with any co-borrowers’) documented and verified gross monthly income...” FDIC officials told us the FDIC LMP includes other program practices to promote strong underwriting practices that are not specifically reflected in the program guidance. For example, DRR representatives always meet with the assuming institution within a month of the SLA transaction date to review the assuming institution’s policies for underwriting. These would include policies and practices related to requiring property appraisals and reviewing borrower credit reports associated with a loan modification. A DRR official provided a Questionnaire for Assuming Institutions that is used to gather such information. In addition, assuming institutions are required to manage SLA assets consistent with their management of non-SLA assets and customary servicing procedures. Finally, assuming institutions verify or determine certain underwriting factors, such as owner occupancy and the property’s appraised value, as part of the loan modification process. Notwithstanding, we believe that opportunities exist to clarify and strengthen program guidance provided to assuming institutions for underwriting loan modifications. At a minimum, the FDIC could strengthen controls by providing LMP program guidance to assuming institutions similar to the written materials for the FDIC’s IndyMac LMP, as presented on the FDIC Web site. Doing so would also promote program consistency among the assuming institutions.

Treasury’s HAMP: Treasury’s Supplemental Directive 09-02 includes detailed underwriting guidance for verifying information such as borrower income, debts, and owner occupancy. Table 2 compares loan underwriting and file documentation practices for the FDIC’s LMP and Treasury’s HAMP.

**Table 2: Comparison of FDIC LMP and Treasury HAMP Underwriting and File Documentation Retention Practices**

	<b>FDIC’s IndyMac LMP (Web site) and SLA Documents</b>	<b>Treasury’s HAMP</b>
Income Verification	Either IRS Form 4506-T, <i>Request for Transcript of Tax Return</i> , or pay stub.	Both 4506-T and pay stubs are required.
Self-Employment Income Documentation	FDIC and Treasury programs require additional documentation, including a signed tax return and year-to-date profit and loss statement. Treasury also allows other reliable third-party documentation, such as a financial statement certified by an accountant, business bank statements, or business tax returns prepared by an accountant.	
Documentation for Other Sources of Income	FDIC and Treasury programs require bank statements for confirming certain sources of income (i.e., social security, disability, death benefits, alimony, child support).	
Debts	FDIC reviews assuming institutions’ underwriting practices during an initial SLA meeting with the assuming institution. The assuming institution is also required to manage and administer SLA loans consistent with the assuming institution’s usual and prudent business and banking practices and customary servicing procedures.	Treasury’s program requires servicers to obtain a credit report to validate installment debt and other liens and to obtain documentation to support payments on an installment debt not listed on the credit report.
Owner Occupancy	Owner occupancy is required for participation in the FDIC LMP. FDIC reviews the assuming institutions’ underwriting practices during an initial SLA meeting with the assuming institution. Owner occupancy may also be verifiable from income verification source documents.	Treasury’s program requires servicers to verify owner occupancy using a credit report.
Appraisal	FDIC reviews the assuming institution’s underwriting practices during an initial SLA meeting with the assuming institution. Further, the assuming institution must include the current property value, determined by an appraisal method such as an automated valuation model or broker price opinion, in conducting the NPV test.	Treasury’s program requires servicers to use an automated valuation model or broker price opinion.
Suspicion of Fraud	The assuming institution must certify that monthly shared-loss certificates are true, complete, and correct.	Servicers are not required to complete the modification if they suspect fraud.
Documentation Retention	The SLA requires the assuming institution to maintain books and records during the term of the SLA sufficient to ensure and document compliance with the terms of the agreement, including documentation of alternatives considered with respect to defaulted loans or loans for which default is reasonably foreseeable.	Treasury’s program requires servicers to maintain records and retain documents for 7 years and make records available for audit or review.

Source: FDIC LPM guidance and HAMP Web site guidance.

In developing underwriting guidance for the FDIC LMP, we recommend clarifying that borrowers should be reporting all sources of income, and that servicers should be verifying material sources of borrower income.<sup>6</sup> LMP guidance should also clarify whether borrowers are required to report alimony, separation maintenance, or child support income to qualify for the LMP and to what extent rental income should be included as borrower income.<sup>7</sup>

Fraud Prevention Steps Pertaining to the Original Underlying Mortgage: As referenced earlier, Senator Charles Grassley expressed concerns to our office about borrowers who fraudulently obtained an original mortgage benefiting from a government-sponsored loan modification. The Senator inquired about preliminary indicators of fraud that could be used to identify potentially fraudulent loans. The FDIC Chairman has stated that if an LMP is to have a significant impact in reducing mortgage foreclosures, it is essential to streamline the modification process while providing effective protections against fraud. An FDIC official indicated that in order to reach large numbers of at-risk borrowers in a short amount of time, it may not be feasible to implement the same degree of verification and controls in approving a loan modification that one would expect during an approval of an initial loan. For this reason, the FDIC's LMP and HAMP employ a streamlined mortgage approval process. Of note, in October 2009, Treasury relaxed servicer loan documentation requirements to improve servicer efficiency and encourage borrowers to complete trial modifications.<sup>8</sup>

***Possible Antifraud Procedures***

1. To the extent that the original Uniform Residential Loan Application (Fannie Mae Form 1003) is available, compare reported income amounts to IRS Form 4506-T information for the appropriate tax year for reasonableness.
2. Review servicer system history for fraud characteristics or red flags, such as:
  - Payments made by someone other than the borrower;
  - Questions about the validity of the home address, mail returned, or servicer unable to contact borrower;
  - Indications of confusion over property ownership;
  - Unusual changes in borrower information (address, social security number).

We note that the owner occupancy requirement and most of the underwriting steps in the FDIC IndyMac LMP and Treasury HAMP are effective controls in preventing a fraudulent loan from benefiting from a loan modification. Beyond this, and consistent with the FDIC's view that there is a trade-off between preventing fraud and achieving sustainable loan modifications on a large scale, we would suggest that that any antifraud measures related to the original mortgage be: (1) carefully weighed with respect to timeliness and effectiveness of the additional antifraud techniques and (2) limited to information readily available in the servicer loan file, servicer

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<sup>6</sup> Treasury issued Supplemental Directive 09-07, *Home Affordable Modification Program—Streamlined Borrower Evaluation Process*, dated October 8, 2009, to streamline HAMP program documentation requirements and standardize the servicer evaluation process. This guidance stated that borrowers do not have to provide documentation for passive and non-wage income constituting less than 20 percent of the borrower's total income.

<sup>7</sup> Under HAMP, borrowers are not required to use alimony, separation maintenance, or child support income to qualify for a loan modification. With respect to rental income, for rental of a portion of the borrower's principal residence, rental income should be calculated at 75 percent of the monthly gross rental income to account for vacancy loss and maintenance expense. For non-principal residence rentals, the 75-percent income amount should be further reduced by the monthly debt service on the property.

<sup>8</sup> Participants in Treasury's HAMP must successfully complete a 3-month trial period.

system history, or an IRS Form 4506-T related to the tax year of the mortgage in question. We also note that such procedures may be impractical given the condition of servicer files or granularity of servicer system histories.

Implementation of antifraud procedures pertaining to the original mortgage may also be more appropriate outside of the loan modification process. For example, a servicer may want to review a sample of original mortgages from a common source before processing modifications to determine if the mortgages exhibit fraud characteristics or review a sample of re-defaulted loans for fraud characteristics.

We note that Treasury's HAMP includes controls designed to prevent or detect fraudulent modifications, including:

- HAMP trial period plan documents require the borrower to certify in writing that "Under penalty of perjury, all documents and information...including the documents and information regarding my eligibility for the program, are true and correct."
- Special Inspector General for the Troubled Asset Relief Program Notice to Borrowers advising that any misstatement of material fact would subject the borrower to potential criminal investigation and prosecution and including contact information for a hotline number to report fraud, waste, abuse, mismanagement, or misrepresentation.
- As discussed later in this report, Freddie Mac will be conducting periodic reviews of servicers that will include fraud-related procedures. Freddie Mac will also be performing separate Loan File Reviews that will include procedures designed to detect fraud.

### ***Reporting Requirements***

FDIC LMP: The FDIC's standard SLA requires assuming institutions to provide a monthly certificate consisting of:

- A schedule of loans for which a loss amount is being claimed;
- A schedule of loans for which a recovery amount was received;
- A schedule showing the calculation of the loss amount for each loan for which a loss is being claimed as a result of foreclosure, short sale, or loan restructuring (i.e., such as through a loan modification);
- A schedule showing the calculation of the gain or loss realized from a sale of each restructured loan; and
- A portfolio performance report and summary schedule.

The SLA also requires the assuming institution to submit the servicing file for single-family assets under the SLA with specific fields of information.

An FDIC official provided a data reporting package that the FDIC provides to each assuming institution. The data reporting package contains detailed guidance and templates for monthly or quarterly reporting. Several required reports include information fields that will enable DRR officials to monitor loan modification activity for larger institutions.

Specifically, assuming institutions that purchased single-family loan pools with an initial value greater than \$100 million must submit monthly a loss certificate report that includes a summary of the performance of the single-family shared loss portfolio. The FDIC official indicated that assuming institutions must also provide supplemental information related to call center and mailing campaigns designed to reach eligible borrowers. Assuming institutions that purchase single-family loan pools with an initial value less than \$100 million must report quarterly but are not required to report performance information related to loan modifications.

We acknowledge that the Data Reporting Package requirements are extensive and should provide the FDIC with comprehensive information to support shared-loss claims. The Data Reporting Package will also provide useful information for the reporting period about loan modifications completed or in process from the larger assuming institutions. However, it is not clear that the required reports will readily provide the FDIC with cumulative information necessary to monitor LMP success without some level of DRR compilation or analysis. Ideally, assuming institution LMP reporting should address basic areas related to loan modification activity such as:

- The number of single-family loans eligible for loan modification;
- The number of borrowers that the assuming institution has solicited for loan modification;
- The number of loan modification requests that have been declined;
- The extent to which modifications resulted in interest rate reductions, loan term extensions, and/or payment reductions; and
- Loan re-default rates following loan modification.

We note that the FDIC collected such information under the IndyMac LMP and that OneWest Bank, which acquired IndyMac, continues to produce monthly reports for its investors containing much of the abovementioned information. Appendix II presents excerpts from IndyMac loan modification reporting information from OneWest Bank's Web site. Because DRR is already requiring extensive reporting from assuming institutions, we are not making a formal recommendation. However, we would encourage DRR to collect current period information about the number of loans eligible for modification and cumulative information about denied modification requests, completed modifications, and re-defaulted modifications. Doing so would provide DRR with information necessary to assess assuming institutions' success in implementing the LMP.

Collection and Reporting of Fair Housing Act Information: Treasury and the Department of Housing and Urban Development have determined that loan modifications under HAMP are subject to the protections of the Fair Housing Act.<sup>9</sup> Treasury is requiring servicers participating in HAMP to collect government monitoring data on the race, ethnicity, and sex of borrowers participating in loan modifications and to report such information to Fannie Mae.

The FDIC is not requiring assuming institutions to collect or report such government monitoring data under the FDIC LMP. DRR officials noted that while HAMP may require servicers to collect such data, providing information is voluntary and up to the applicant. Because applicants

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<sup>9</sup> 42 U.S.C. 3604(a), 3604(b), and 3604(f).

may elect not to provide such data, it may be difficult to draw meaningful conclusions about servicer modification practices. Notwithstanding, we believe that DRR should consult with the FDIC's Legal Division to determine whether the FDIC should require assuming institutions to request such information from loan modification applicants.

Treasury's HAMP: Treasury has issued extensive reporting requirements for servicers participating in HAMP. Supplemental Directive 09-06, *Home Affordable Modification Program-Data Collection and Reporting Requirements Guidance*, dated September 11, 2009, requires that servicers provide monthly HAMP loan-level data to Fannie Mae, including:

- Borrower and property information;
- Government monitoring data for Home Mortgage Disclosure Act purposes;
- NPV Model input information; and
- Reason codes for loans that are not approved for, or that withdraw from, HAMP.

Treasury also requires servicers to report on a loan-by-loan basis:

- Information about why loans that the servicer evaluated for a modification were not modified, or why a trial modification was not completed;
- The status and disposition of eligible loans not modified, including trial modifications not completed; and
- The status and disposition of loans that were modified but failed to remain in good standing because they became 90 or more days delinquent.

***Assuming Institution Internal Control Programs to Monitor Program Compliance and to Detect Loan Modification Fraud***

FDIC LMP: As discussed earlier, the SLA requires the servicer's annual audit report to include a negative assurance statement with respect to the accuracy of computations required under the SLA. With the exception of the annual audit statement, we did not identify any specific requirements for the assuming institution to maintain an internal control program or monitoring program associated with the SLA.

Treasury's HAMP: Within the Financial Instrument agreement between Fannie Mae and the Servicer, Section 4, Internal Control Program, states the servicer shall develop, enforce, and review on a quarterly basis for effectiveness an internal control program designed to: (1) ensure effective delivery of services in connection with the program and compliance with the program documentation, (2) effectively monitor and detect loan modification fraud, and (3) effectively monitor compliance with applicable consumer protection and fair lending laws. The internal control program must include documentation of the control objectives for program activities, the associated control techniques, and mechanisms for testing and validating the controls.

Moreover, the agreement requires the servicer to provide Freddie Mac with access to all internal control reviews and reports that relate to services under the program performed by the servicer and its independent auditing firm to enable Freddie Mac to fulfill its duties as compliance agent.

Supplemental Directive 09-01 includes a section on program compliance stating that servicers must comply with the HAMP requirements and must document the execution of loan evaluation, loan modification, and accounting processes. Servicers must also develop and execute a quality assurance program that includes either a statistically based (with a 95-percent confidence level) or a 10-percent stratified sample of loans modified drawn within 30-45 days of final modification and reported on within 30-45 days of review. In addition, a trending analysis must be performed on a rolling 12-month basis.

### ***Independent Monitoring of Assuming Institutions to Ensure Program Compliance***

**FDIC LMP:** The FDIC has entered into basic ordering agreements with seven contractors to provide surveillance, oversight, and compliance monitoring of single-family shared-loss loans under SLAs.<sup>10</sup> The FDIC will award task orders to the contractors to monitor individual assuming institutions. As of January 20, 2010, contractors had completed visitations at 5 assuming institutions and had 4 additional visitations in progress. The scope of work requires the contractor to:

- Review and comment on the assuming bank's internal audit program for auditing compliance with the single-family SLA.
- Review and process monthly certificates and review certificates to determine whether the related loss amounts appear reasonable and that loss mitigation efforts are adequately documented on the certificate.
- Ensure compliance with agreement reporting and asset management requirements.
- Plan and conduct compliance visitations, exit meetings, and prepare compliance visitation reports. Visitations will be on-site, semi-annually or annually, based on the risk and size of the shared-loss asset portfolio.
- Evaluate and document the adequacy of corrective actions taken in response to visitation reports.

We concluded that most of the compliance steps listed above are related to shared-loss compliance as opposed to loan modification program compliance. We noted that an earlier version of the scope of work included the following step under compliance visitations:

Selecting a sample of loan modifications [and] verifying that the loan modifications and respective calculations meet the terms of Qualifying Mortgage Loans and the objective of the FDIC Modification Program and/or Home Affordability Modification Program.

However, we did not see this step in the final executed contract. DRR officials indicated that they expected the SLA compliance contractors to include LMP monitoring and compliance procedures in their SLA compliance reviews. We also spoke with a representative from one of the contractors who indicated that it was his understanding that his firm would be monitoring the assuming institution's compliance with the FDIC's LMP. Still, we recommend that the FDIC

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<sup>10</sup> The FDIC has also entered into surveillance, oversight, and compliance monitoring contracts for the FDIC's commercial asset SLAs.

explicitly include in the surveillance and monitoring contract the FDIC's expectation that the contractor's efforts should include assessing the assuming institution's compliance with the LMP.<sup>11</sup>

Additionally, the FDIC Office of Inspector General (OIG) will be periodically performing reviews of assuming institutions' compliance with SLAs, and such reviews will include procedures pertaining to LMP compliance. The OIG conducted the first of such reviews in October 2009.

Treasury's HAMP: Treasury has selected Freddie Mac to serve as its compliance agent for the HAMP. In this role, Freddie Mac employees and contractors will conduct independent compliance assessments of mortgage servicers and review loan-level data for evidence of appropriate eligibility consideration, solicitation, cessation of foreclosure sales during HAMP consideration, and overall compliance with HAMP guidelines.

The scope of these assessments will include, among other things, an evaluation of documented evidence to confirm adherence to HAMP requirements with respect to the following:

- Evaluation of borrower and property eligibility;
- Compliance with underwriting guidelines;
- Execution of NPV/waterfall processes;
- Accurate processing of borrower, investor, and incentive payments; and
- Data integrity

Freddie Mac will also evaluate the effectiveness of the servicer's quality assurance program, to include: the timing and size of the servicer's sample selection, the scope of the servicer's quality assurance reviews, and the servicer's reporting and remediation process. Freddie Mac will also evaluate the servicer's fraud prevention controls as part of the on-site audits.

According to a July 2009 GAO report,<sup>12</sup> Freddie Mac compliance reviews will take three approaches:

- Announced reviews (remote and on-site), which will provide a structured and consistent process to assess servicer compliance;
- Unannounced reviews (remote and on-site), which will provide the ability to review any loan at any time; and
- Data analysis, including third-party data verification, which will provide ongoing analyses of servicers to identify patterns or trends that require investigation.

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<sup>11</sup> With respect to assuming institutions that elect to implement HAMP, an FDIC official noted that HAMP pays servicers incentive fees for completing and sustaining individual loan modifications and that assuming institutions should be including received incentives to offset loss claims under the SLA. The official stated that the surveillance, oversight, and compliance monitoring contractors should perform procedures to ensure that assuming institutions are accurately considering HAMP incentive payments received in their shared-loss calculations.

<sup>12</sup> *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, GAO-09-837, dated July 2009.

The GAO report noted that Freddie Mac conducted trial period reviews, which are on-site audits and file reviews targeting larger servicers and are intended to assess the strength of the servicer's control environment, systems, and staffing. Freddie Mac will also develop a "second look" process to review non-performing loans not offered a HAMP modification, to assess whether servicers appropriately evaluate loans for HAMP eligibility.

We visited Freddie Mac's Office of Compliance to understand more about its planned monitoring efforts. We reviewed oversight program documentation and determined that Freddie Mac's program will include the following elements:

- Data Analytics—Freddie Mac will analyze servicer HAMP performance information to identify trends, outliers, and anomalies for further review.
- Risk Assessment Framework—Freddie Mac will perform risk assessments of participating servicers to identify servicers presenting greater risk to HAMP and to target servicers requiring additional review.
- Management Compliance Reviews—Freddie Mac will perform periodic on-site reviews of servicers' internal control programs and compliance with HAMP.
- Loan File Compliance Reviews—Freddie Mac will remotely review a sample of imaged loan files from participating servicers to assess program compliance.

We verified that Freddie Mac will not be performing compliance reviews of loan modification efforts outside of the HAMP (such as the FDIC's LMP).

## **CONCLUSION AND RECOMMENDATIONS**

The FDIC's pioneering loan modification work at IndyMac Bank became the basis for Treasury's comprehensive, industry-wide HAMP. Still, from November 2008 through December 2009, the FDIC entered into 86 SLAs with single-family assets totaling \$53.2 billion. While some of the larger assuming institutions may elect to implement Treasury's HAMP, the FDIC's LPM is the default loan modification program, and most assuming institutions are electing to follow the FDIC's program.

President Obama's strategy for restructuring or refinancing millions of at-risk mortgages tasked Treasury with developing uniform guidance for loan modifications and required agencies such as the FDIC to seek to apply uniform guidance to loans that the agency owns or guarantees. We evaluated the FDIC's LMP program against Treasury's HAMP program. While certain characteristics of the FDIC's LMP, such as the use of an NPV test, waterfall process, and owner occupancy requirements, are consistent with Treasury's HAMP, we identified other areas where the FDIC's LMP program attributes and controls could be strengthened or better documented. Doing so will promote program consistency among assuming institutions and help to ensure FDIC LMP success.

Accordingly, we recommend that the Director, DRR:

1. Review the standard SLA and LMP guidance documents to ensure they contain sufficient information about the FDIC LMP and the assuming institution's responsibilities under the program. We would suggest program guidance in similar detail to the IndyMac Loan Modification Program guidelines on the FDIC's public Web site.
2. Document within FDIC LMP guidance, loan modification underwriting requirements discussed in Table 2 of this report to be more consistent with Treasury's HAMP underwriting requirements, in particular, pertaining to verification of borrower debts and material sources of borrower income.
3. Research with the FDIC's Legal Division whether assuming institutions should request borrowers being considered for loan modification to provide demographic information similar to that requested for the HAMP related to consumer protection and fair lending laws.
4. Require assuming institutions to maintain an internal control program for monitoring compliance with the FDIC's LMP and for detecting loan modification fraud.
5. Modify the scope of work for the SLA surveillance, oversight, and compliance monitoring contractors to explicitly reflect the FDIC's expectations with respect to LMP contractor monitoring and compliance efforts.

## **CORPORATION COMMENTS AND OIG EVALUATION**

DRR management provided a written response, dated January 15, 2010, to a draft of this report. The response is presented in its entirety in Appendix III. Management concurred with our five recommendations and proposed responsive actions to be completed by June 30, 2010. A summary of management's responses to our recommendations is presented in Appendix IV.

## OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of this evaluation was to assess the FDIC's implementation of the FDIC LMP at institutions that had acquired single-family loan assets from failed banks. Initially our objectives were to

- Assess the FDIC's implementation of the loan modification program at IndyMac, including determining the:
  - Extent to which the program had been implemented in terms of number and dollar value of loans;
  - Types of measures and mechanisms that the FDIC has established to evaluate the success of the program and how they compare to those used by other federal regulators;
  - Reasonableness of steps taken, including the program's qualifying criteria, to ensure that modification of loans maximizes their value; and
  - Internal controls established to detect and prevent participation in the program by those who fraudulently obtained mortgages.
- Determine steps that the FDIC has taken to monitor implementation of its Loan Modification Program at institutions that agreed to implement the program as part of transactions involving the FDIC and other financial regulatory agencies.

Following the issuance of our February 2009 evaluation engagement letter for this assignment, on March 19, 2009, the FDIC sold IndyMac to OneWest Bank, FSB. During 2009, the FDIC also entered into a number of additional agreements with assuming institutions to implement the FDIC's LMP. Accordingly, we revised our objectives to assess the:

- Extent to which the FDIC has required program implementation at assuming institutions.
- Internal controls over the program and how those controls compare to Treasury's HAMP, including controls established to detect and prevent program fraud.

To accomplish our objectives, we:

- Interviewed DRR officials and other FDIC officials responsible for implementing and overseeing the FDIC's LMP;
- Reviewed SLA agreements and reporting requirements;
- Compiled loan modification activity for eight SLAs, representing 97 percent of the total single-family assets under SLAs as of July 31, 2009.
- Reviewed monthly loss certificates submitted by selected assuming institutions;
- Reviewed IndyMac LMP program guidance from the FDIC's Web site;
- Reviewed Treasury HAMP guidance, including the SPA and Financial Instrument;
- Researched mortgage fraud prevention and detection techniques, including mortgage fraud prevention literature from Freddie Mac and Fannie Mae;
- Reviewed the FDIC's oversight, surveillance, and compliance monitoring contract scope of work; and

- Interviewed Freddie Mac officials and reviewed Freddie Mac documents and audit programs for monitoring HAMP servicers.

With respect to our original evaluation objectives, Appendix II provides information about the extent to which the loan modification program has been implemented at IndyMac through August 31, 2009.

We performed our evaluation between April 2009 and October 2009 in accordance with the *Quality Standards for Inspections*.

## ONEWEST LOAN MODIFICATION REPORTING FOR INDYMAC BANK

Excerpts from OneWest Bank Report Entitled: **FDIC Loan Modification Program Summary Report for Indymac MBS [Mortgage-Backed Securities] and ABS [Asset-Backed Securities] Investors—Data as of August 31, 2009 (Dollars in Millions)**

Original Information at Settlement			Current Period Information				Total FDIC Modifications Completed Since Program Inception					
	Original Loan Count	Original Unpaid Principal Balance (UPB)	Current Loan Count	Current UPB	60+ Days Delinquent Loan Count	60+ Days Delinquent Loan UPB	Total Mod Offers Mailed and Awaiting Borrower Response	Type I Interest Rate Reduction Only	Type II Interest Rate Reduction + Amortization Extension	Type III: Interest Rate Red. +Amort Ext. + Principal Forbearance	Total: All Mods Completed (Count)	Total: All Mods Completed (UPB)
IndyMac MBS	500,392	\$125,376	219,785	\$59,959	53,504	\$16,716	71,523	8,319	2,994	3,951	15,264	\$4,595
Grand Total	<i>Information not Presented in Investor Summary Report</i>						101,587	12,230	4,362	5,470	22,062	\$6,593

Performing/Current Loan Modifications			Delinquent/Re-Defaulted FDIC Loan Modifications (60+ Days Delinquent)					Estimated Economics of Modification			
	Total Performing Loan Mods	Total Performing Loan Mod (UPB)	Type I Interest Rate Red. Only	Type II Interest Rate Red.+ Amort. Ext.	Type III: Interest Rate Red. +Amort. Ext. + Principal Forbearance	Total Re-Defaulted Mods (including 26 liquidated mods) (Count)	Total Re-Defaulted Mods (UPB)	Re-default Mod Percentage	Estimated NPV Cost of Foreclosure Avoided at the Time of Mod	Estimated NPB Cost of Mod Incurred at Time of Mod	Net Estimated Benefit of Mod
IndyMac MBS	12,162	\$3,672	2,244	469	363	3,102	\$926	20.3%	\$2,277	\$1,714	\$564
Grand Total	17,216	\$5,186	3,578	726	516	4,846	\$1,410	22.0%	\$3,270	\$2,469	\$801

Source: OneWest Bank Web Site.

## Corporation Comments



550 17th Street NW, Washington, D.C. 20429-9990

Division of Resolution and Receiverships

DATE: January 15, 2010

TO: E. Marshall Gentry  
Acting Assistant Inspector General for Evaluations

FROM: Mitchell L. Glassman, Director  
Division of Resolutions and Receiverships

SUBJECT: Response to Draft Audit Report Entitled, *The FDIC's Loan Modification Program (Assignment No. 2009-018)*

This memorandum is in response to the recommendations in the subject draft audit report dated November 20, 2009.

**OIG Audit Recommendation 1:** Review the standard SLA and LMP guidance documents to ensure they contain sufficient information about the FDIC LMP and the assuming institution's responsibilities under the program. We would suggest program guidance in similar detail to the IndyMac Loan Modification Program guidelines on the FDIC's public Web site.

**DRR Response:** DRR agrees with the recommendation. Exhibit 5 provided in the standard Single Family Shared-Loss agreement outlines the broad documentation requirements; however, DRR agrees with the OIG's recommendation that more detailed guidelines should be provided to Loss Share institutions. On or before February 26, 2010, DRR will finalize a guidebook on Loss Share Loan Modification requirements. This will include detail on the appropriate documentation expected in order to verify the assuming institution is fulfilling its contractual duties. DRR is currently documenting, analyzing, and updating processes for the Loss Share Loan Modification Program (LMP). DRR will review HAMP materials and adapt them to Loss Share policies and procedures as appropriate. We expect to complete documentation of the accompanying procedures by February 26, 2010. Additionally, DRR plans to include a more detailed discussion of loan modification documentation requirements and NPV modeling expectations in the initial kickoff meeting with new Shared-Loss institutions, which is usually held within 30 days of an institution's failure. To date, the kickoff meeting includes a discussion of Exhibit 5, participation in HAMP, the restructure loss calculation, and loan level reporting on restructured loans.

**OIG Audit Recommendation 2:** Document within FDIC LMP guidance, loan modification underwriting requirements discussed in Table 2 of this report to be more consistent with Treasury's HAMP underwriting requirements, in particular, pertaining to verification of borrower debts and material sources of borrower income.

**DRR Response:** DRR agrees with the recommendation. Exhibit 5 provided in the standard Single Family Shared-Loss Agreement requires: "(1) the borrower's monthly income shall be the amount of the borrower's (along with any co-borrowers')

documented and verified gross monthly income”. DRR will expand upon this statement in the detailed guidelines under development. These guidelines are expected to be completed on or before February 26, 2010. However, these guidelines will not be as restrictive or prescriptive as the income documentation and verification standards required under HAMP. These HAMP standards may have contributed to the low conversion rate under HAMP for trial modifications and have led to HAMP revisions. The guidance DRR is working on will contain the same income verification requirements instituted in the FDIC modification program piloted at IndyMac. Shared-Loss institutions will be expected to have recent pay stub information and a signed 4506T on file for all modified borrowers (additional documentation will be required for self-employed borrowers or borrowers whose primary source of income is benefits such as social security or pension income).

**OIG Audit Recommendation 3:** Research with the FDIC’s Legal Division whether assuming institutions should request borrowers being considered for loan modification to provide demographic information similar to that requested for the HAMP related to consumer protection and fair lending laws.

DRR Response: DRR agrees with the recommendation. We will work with the Legal Division to determine whether collection of this information is permitted. We will also assess operational considerations and the reliability of data to be collected. We plan to provide the results of our research by June 30, 2010.

**OIG Audit Recommendation 4:** Require assuming institutions to maintain an internal control program for monitoring compliance with the FDIC’s LMP and for detecting loan modification fraud.

DRR Response: DRR agrees that the assuming institutions should be required to maintain an internal control program for monitoring compliance with the FDIC’s LMP and for detecting loan modification fraud. Section 3.2, “Duties of the Assuming Bank,” of the standard Single Family Shared-Loss Agreement establishes standards for performance of duties which are the basis for internal controls under each acquiring institution’s corporate governance provisions. Compliance Review Contractors are responsible for reviewing the retained documentation and verifying contract compliance. This review includes the performance of the Assuming Bank with regard to Section 3.2.

Furthermore, DRR will communicate during the initial meeting, the FDIC's expectation that assuming banks should maintain an internal control program to include control techniques to help ensure the success of the institution's loan modification efforts. DRR will also amend future Single-Family Shared-Loss Agreements to include a provision similar to Section 2.3 in the Commercial Shared-Loss Agreement which explicitly requires the Assuming Bank to perform on an annual basis an internal audit of its compliance with the provisions of the Shared-Loss Agreement. DRR plans to have this provision in place by February 26, 2010, for future agreements.

In addition, Section 2.2, Auditor Report; Right to Audit, provides “Within ninety (90) days after the end of each fiscal year during which the Receiver makes any payment to the Assuming Bank under this Single Family Shared-Loss Agreement, the Assuming Bank shall deliver to the Corporation and to the Receiver a report signed by its independent public accountants stating that they have reviewed the terms of this Single Family Shared-Loss Agreement and that, in the course of their annual audit of the Assuming Bank’s books and records, nothing has come to their attention suggesting that any computations required to be made by the Assuming Bank during such year pursuant to this Article II were not made by the Assuming Bank in accordance herewith.” DRR is in consultations with large accounting firms on the interpretation of the above section of the agreement and to clarify the responsibilities of the independent public accountant.

Additionally, the Assuming Bank is required to retain records at all times during the term of the Single Family Shared-Loss Agreement which are sufficient to document compliance including: “(a) documentation of alternatives considered with respect to defaulted loans or loans for which default is reasonably foreseeable, (b) documentation showing the calculation of loss for claims submitted to the Receiver, (c) retention of documents that support each line item on the loss claim forms, and (d) documentation with respect to the Recovery Amount on loans for which the Receiver has made a loss-share payment”.

**OIG Audit Recommendation 5:** Modify the scope of work for the SLA surveillance, oversight, and compliance monitoring contractors to explicitly reflect the FDIC’s expectations with respect to LMP contractor monitoring and compliance efforts.

**DRR Response:** DRR agrees with the recommendation. DRR reviews in detail with all Compliance Review Contractors the FDIC modification program and HAMP. On or before February 26, 2010, DRR will also develop standardized checklists for Compliance Review Contractors.

cc: Michael Krimminger, Special Advisor for Policy  
Jim Wigand, DRR  
Herb Held, DRR  
Richard Fischman, DRR  
Clare Rowley, DIR  
James Angel, OERM  
Steven Trout, DRR  
Howard Cope, DRR

## MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendations in our report and the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
1	DRR will finalize a guidebook on loss share loan modification requirements to include detail on the appropriate documentation expected in order to verify the assuming institution is fulfilling its contractual duties. DRR will review HAMP materials and adapt them to loss share policies and procedures as appropriate. Additionally, DRR plans to include a more detailed discussion of loan modification documentation requirements and NPV modeling expectations in the initial kickoff meeting with new shared-loss institutions.	February 26, 2010	\$0	Yes	Open
2	DRR is developing guidance to include the same income verification requirements instituted in the FDIC modification program piloted at IndyMac.	February 26, 2010	\$0	Yes	Open
3	DRR will work with the Legal Division to determine whether collection of demographic information for consumer protection and fair lending laws is permitted. DRR will also assess operational considerations and the reliability of data to be collected.	June 30, 2010	\$0	Yes	Open
4	<p>DRR will communicate, during the initial meeting, the FDIC's expectation that assuming banks should maintain an internal control program to include control techniques to help ensure the success of the institution's loan modification efforts.</p> <p>DRR will also amend future single-family SLAs to require the assuming bank to perform an annual internal audit of its compliance with SLA provisions.</p> <p>DRR is also in consultations with large accounting firms on the interpretation of SLA Section 2.2, Auditor Report: Right to Audit, to clarify the responsibilities of the independent public accountant.</p>	February 26, 2010	\$0	Yes	Open

**Appendix IV**

<b>Rec. Number</b>	<b>Corrective Action: Taken or Planned/Status</b>	<b>Expected Completion Date</b>	<b>Monetary Benefits</b>	<b>Resolved:<sup>a</sup> Yes or No</b>	<b>Open or Closed<sup>b</sup></b>
5	DRR noted that it reviews the FDIC loan modification program and HAMP in detail with all compliance review contractors and that DRR will develop standardized checklists for the compliance review contractors.	February 26, 2010	\$0	Yes	Open

<sup>a</sup> Resolved - (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.  
 (2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.  
 (3) Management agrees to the OIG monetary benefits, or a different amount, or no (\$0) amount. Monetary benefits are considered resolved as long as management provides an amount.

<sup>b</sup> Once the OIG determines that the agreed-upon corrective actions have been completed and are responsive, the recommendation can be closed.