FEDERAL HOUSING FINANCE AGENCY
OFFICE OF INSPECTOR GENERAL

Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements

AUDIT REPORT: AUD-2013-007

March 21, 2013

FEDERAL HOUSING FINANCE AGENCY
OFFICE OF INSPECTOR GENERAL

AT A GLANCE

Enhanced FHFA Oversight Is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements

Why OIG Did This Audit

By the end of 2012, Freddie Mac owned or guaranteed over 10.6 million residential mortgages with a combined unpaid principal balance of $1.6 trillion. It pays mortgage servicers to collect payments from and interact with the borrowers (hereinafter "consumers") associated with its residential mortgages. Such interaction includes handling complaints.

Serious complaints, known as escalated cases, may allege servicing fraud or regulatory violations. Freddie Mac and its eight largest servicers together received over 34,000 escalated cases between October 2011 and November 2012.

In accordance with FHFA's Servicing Alignment Initiative (SAI), servicers are required to report on the escalated cases they receive and resolve those cases within 30 days. Additionally, Freddie Mac's Servicing Guide specifically requires servicers to report monthly on the escalated cases they receive.

The objective of this performance audit was to assess FHFA's oversight of Freddie Mac's controls over servicers' handling of escalated cases.

What OIG Found

Mortgage servicers, Freddie Mac, and FHFA have not adequately fulfilled their respective responsibilities to address and resolve escalated cases. First, evidence suggests that most of Freddie Mac's servicers are not complying with reporting requirements for escalated cases. As of December 2012, 1,179 or 98% of Freddie Mac's servicers had not reported on any escalated cases even though they managed 6.6 million mortgages for Freddie Mac. Of Freddie Mac's eight largest servicers—which serviced nearly 70% of its loans—four did not report any information about escalated cases despite handling more than 20,000 such cases during the 14-month period between October 2011 and November 2012. Further, of the 25,528 escalated cases resolved by the eight largest servicers during the 14-month period between October 2011 and November 2012, 5,372 or 21% were not timely resolved within 30 days.

Second, Freddie Mac's oversight of servicer compliance has been inadequate. It has not implemented procedures for testing servicer compliance. As a result, it had findings related to escalated cases in only 1 of 38 reviews of its largest national and regional servicers that it conducted in 2012. Freddie Mac has also neglected to establish penalties (such as fines) for servicers that do not report escalated cases.

Third, FHFA did not identify the foregoing problems through its own examination of Freddie Mac's implementation of the SAI. Rather than independently testing servicers' compliance with complaint reporting requirements, the FHFA examination team relied exclusively on Freddie Mac's onsite operational review reports, which did not mention problems with servicer reporting. Additionally, FHFA lacks guidance for examination teams to use when testing the implementation of directives, such as its SAI. Further, without reports on escalated cases from servicers, FHFA will be unable to monitor servicer compliance and take appropriate action to ensure that escalated cases are timely resolved. Strengthened oversight—through actions aimed specifically at improving servicer compliance with escalated case requirements—can benefit homeowners, Freddie Mac, and taxpayers.

What OIG Recommends

We recommend, first, that FHFA ensure that Freddie Mac requires its servicers to report, timely resolve, and accurately categorize escalated cases; second, that FHFA ensure that Freddie Mac enhances its oversight of its servicers through testing servicer performance and establishing fines for noncompliance; and third, that FHFA improve its oversight of Freddie Mac by developing and implementing examination guidance related to testing the implementation of directives.

FHFA provided comments agreeing with the recommendations in this report. Overall, FHFA concurs with the importance of ensuring timely and responsive resolution of consumer complaints, particularly the more serious escalated cases. FHFA plans to implement the audit recommendations by working with Freddie Mac and Fannie Mae to conform consumer complaint processing under the SAI and ensure compliance with new regulatory requirements announced by the Consumer Financial Protection Bureau. Further, FHFA has made review of the implementation of the SAI a supervisory priority in 2013 and will develop detailed plans for reviewing escalated cases.

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ABBREVIATIONS

BB&T ..... Branch Banking & Trust Corporation

CORE ..... Counterparty Operational Risk Evaluation

Enterprises ..... Fannie Mae and Freddie Mac

Fannie Mae ..... Federal National Mortgage Association

FHFA ..... Federal Housing Finance Agency

Freddie Mac ..... Federal Home Loan Mortgage Corporation

OIG ..... Federal Housing Finance Agency Office of Inspector General

SAI ..... Servicing Alignment Initiative

Federal Housing Finance Agency
Office of Inspector General
Washington, DC

PREFACE

In a 2011 audit, we found that FHFA did not adequately process consumer complaints.[1] Specifically, the agency did not sufficiently define its role in processing complaints; it lacked related policies, procedures, and a consolidated system for tracking complaints; and it failed to perform various oversight functions to ensure compliance with its records management policy and safeguards for personally identifiable information. Because FHFA lacked a sound internal control environment for handling complaints, we concluded that the agency could not provide reasonable assurance that alleged fraud and improper foreclosures were addressed efficiently and effectively.

We therefore recommended that FHFA implement comprehensive policies, procedures, and controls for consumer complaints; assess its allocation of resources for dealing with those complaints; and address any unresolved complaints alleging potential fraud or criminal activity. The agency accepted these recommendations. As of August 2011, it had reviewed an additional 27 complaints alleging fraud. In March 2012, it assessed the sufficiency of allocated resources, and in August 2012 it designed and implemented updated consumer complaints procedures.

This report continues our work in the consumer complaints area by assessing FHFA's oversight of Freddie Mac's controls over mortgage servicers' handling of "escalated" consumer complaints. Servicers' failure to resolve quickly escalated cases can prevent foreclosure alternatives from being adequately explored and may result in losses to the enterprises. The goals of the SAI—developed to help servicers and the enterprises work better with delinquent borrowers and to mitigate enterprise losses—will be difficult to achieve if consumer complaints are not dealt with in an appropriate and timely manner.

OIG is authorized to conduct audits, evaluations, investigations, and other law enforcement activities pertaining to FHFA's programs and operations. As a result of our work, we may recommend policies that promote economy and efficiency in administering FHFA's programs and operations, or that prevent and detect fraud and abuse in them. We believe that this report's

[1] OIG, *Audit of the Federal Housing Finance Agency's Consumer Complaints Process* (AUD-2011-001, June 21, 2011), available at http://www.fhfaoig.gov/Content/Files/AUD-2011-001.pdf.

recommendations (along with those in prior reports) will increase FHFA's assurance that the enterprises are operating safely and soundly, and that their assets are preserved and conserved.

OIG appreciates the cooperation of all those who contributed to this audit, which was led by Tara Lewis, Audit Director, who was assisted by Andrew W. Smith, Audit Manager. It has been distributed to Congress, the Office of Management and Budget, and others and will be posted on OIG's website, www.fhfaoig.gov.

Russell A. Rau
Deputy Inspector General for Audits

BACKGROUND

Freddie Mac owns or guarantees over 10.6 million residential mortgages with a combined unpaid principal balance of $1.6 trillion as of the end of 2012. It pays mortgage servicers fees to interact with consumers (i.e., the borrowers associated with its mortgages) and collect mortgage payments. Among other things, interacting with consumers involves handling complaints that may cover a range of issues, from late fees to claims of inappropriate denial of a loan modification or foreclosure alternative. Most complaints are submitted to mortgage servicers, although Freddie Mac and FHFA also receive them.

More serious complaints are called "escalated cases." According to FHFA and Freddie Mac's Servicing Guide, escalated cases involve:

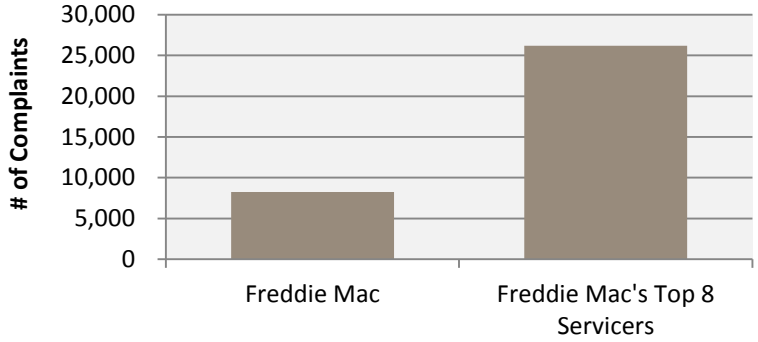
- Foreclosure actions initiated or continued in violation of Fannie Mae or Freddie Mac guidelines;
- Allegations of fraudulent servicing practices;
- Complaints that the borrower was not appropriately evaluated for or inappropriately denied a foreclosure alternative;
- Threats of litigation; or
- Violations of Fannie Mae or Freddie Mac policy timeframes for borrower outreach, evaluation, or the time permitted for borrower response.[2]

During the 14-month period between October 1, 2011, and November 30, 2012, Freddie Mac and its eight largest servicers (in terms of the number of loans that they service) received over 34,000 complaints that became escalated cases (Figure 1). FHFA received 565 consumer complaints about Freddie Mac mortgages during this same period.[3]

[2] FHFA, *Servicing Alignment Initiative,* (April 28, 2011); and Freddie Mac, *Single Family Selling/Servicing Guide,* Vol. 2, Sec. 51.5.1 (November 18, 2011).

[3] FHFA does not determine whether complaints are escalated cases, but instead forwards the complaints it receives to Freddie Mac or its servicers, as appropriate.

Figure 1: Escalated Cases Received, October 1, 2011, to November 30, 2012[4]



Handling of Escalated Cases

Specific procedures for handling escalated cases vary from servicer to servicer, but they generally follow a similar process. A servicer's agent, typically working in a call center, receives a complaint and attempts to resolve it, and if it cannot be resolved through the normal channels, it is sent to the escalated complaint department. Similarly, if an elected official (state or federal) or regulating body (such as the Consumer Financial Protection Bureau, Department of Housing and Urban Development, or an attorney general) forwards to a servicer a consumer's complaint, it is automatically referred to the servicer's escalated complaints department. A letter (acknowledging receipt of the complaint) is sent to the borrower or their representative, and all contact with the borrower is documented in a tracking system. An agent in the escalated complaints department is assigned to the case as the single point of contact and corresponds with the borrower until the case is resolved. This agent works with the servicer's business units to resolve the case, performing additional research as needed. Once the agent determines the resolution, a letter describing the steps of the resolution process is sent to the borrower and the tracking system is updated to reflect the resolution date. The amount of time that elapses between the date a complaint is received and the date it is resolved is known as the "resolution time" or "time to resolve."

If Freddie Mac receives a consumer complaint, it is routed to agents who determine if the borrower has contacted the servicer. Freddie Mac then acts as a liaison between the borrower and the servicer. Freddie Mac's agents record all communications with consumers and can access resources within Freddie Mac to answer most questions.

[4] Source: OIG analysis of consumer complaint data from Freddie Mac and its top eight servicers.

If a borrower contacts FHFA, FHFA encourages the consumer to access publicly available information and resources. Those resources include the borrower's servicer, the servicer's primary regulators, the Consumer Financial Protection Bureau's Hotline, and Fannie Mae's and Freddie Mac's websites. FHFA also attempts to determine if the inquiry involves an enterprise-owned loan. However, FHFA does not specifically advocate for consumers or resolve consumer issues. Instead, it uses consumer complaint information to improve regulatory oversight. In most cases, the agency forwards the inquiry to the enterprises, which work with their servicers and borrowers to resolve cases.

Oversight of Escalated Cases

In early 2011, FHFA announced its SAI directive, which was intended to address concerns that the enterprises' differing standards and processes were causing problems in mortgage servicing. In particular, the agency sought to streamline and expedite outreach to delinquent borrowers, align mortgage modification terms, and determine eligibility for and offer foreclosure alternatives to distressed homeowners. The SAI includes requirements for Fannie Mae and Freddie Mac to establish a consistent schedule of performance-based incentive payments for servicers that perform well and penalties for those that do not.

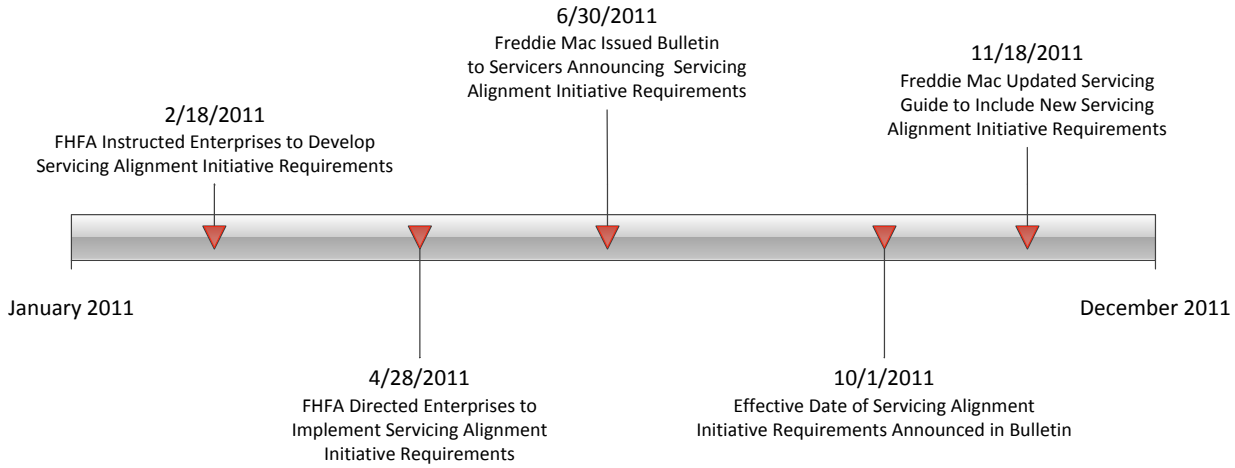
FHFA, through the SAI, and the enterprises, through their Servicing Guides, require servicers to promptly handle and resolve escalated cases within 30 days of receiving them. Servicers must also satisfy the following requirements when handling escalated cases:

- Ensure that staff resolving an escalated case are independent from the personnel that initially handled the borrower's request for assistance;
- Have written procedures and sufficient, adequately trained staff to track and respond to escalated cases;
- Regularly review and assess the adequacy of internal controls and procedures in connection with servicing activities; and
- Take remedial steps if any deficiencies are identified as a result of their review of internal controls, and formally document the results and make them available to the enterprise upon request.

The enterprises incorporated the SAI into their Servicing Guides and all servicers doing business with the enterprises agree to follow the guides. Additionally, in June 2011 Freddie Mac issued a bulletin to servicers that required them to provide monthly reports on escalated cases beginning in October 2011. In November 2011, the reporting requirement—which includes describing the

events of each escalated case by the 12th business day of each month—was consolidated into Freddie Mac's Servicing Guide. Servicers must continue to report each escalated case to Freddie Mac in the monthly report until the case is resolved.[5] According to Freddie Mac officials, if a servicer has not received any escalated cases and has no unresolved cases, it is not required to submit a report. See Figure 2 for a timeline illustrating the implementation of these requirements.

Figure 2: Development and Implementation of New Servicing Requirements[6]



[5] According to the SAI, an escalated case is considered resolved when the complaint has been reviewed in accordance with applicable guidelines; has been evaluated to require no change to the original determination or a proposed resolution has been identified; the proposed resolution has been documented in the applicable servicing system or mortgage file; and the first action to implement the resolution has been taken.

[6] Source: FHFA News Release, *Fannie Mae and Freddie Mac to Align Guidelines for Servicing Delinquent Mortgages,* April 28, 2011; Freddie Mac, *Servicing Alignment Initiative,* Bulletin 2011-11, June 30, 2011; and Freddie Mac, *Single Family Selling/Servicing Guide,* volume 2, chapter 51, section 5.1, November 18, 2011.

FINDING

FHFA and Freddie Mac Oversight Failed to Identify Servicer Noncompliance with Consumer Complaint Requirements

Freddie Mac servicers have largely failed to implement the SAI and Servicing Guide requirements for escalated consumer complaints, particularly those governing reporting to Freddie Mac. Further, seven of Freddie Mac's eight largest servicers did not resolve all escalated cases within the required 30 days and some servicers did not accurately categorize the nature of their cases. This lack of compliance is a result of Freddie Mac's failure to assess escalated case requirements in its servicer reviews and to include consequences for noncompliance in its Servicing Guide. Also, FHFA's own examination of the SAI implementation did not identify servicers' failures to report escalated case information. Rather than conduct independent testing, FHFA relied on internal reports produced by Freddie Mac. FHFA also lacks guidance for examination teams to use when testing the implementation of directives such as the SAI.

Servicers Did Not Uniformly Comply with Escalated Case Requirements

Escalated Cases Not Reported

Evidence suggests that most of Freddie Mac's servicers have not complied with escalated case reporting requirements. Among Freddie Mac's eight largest servicers—which serviced nearly 70% of Freddie Mac's 10.6 million mortgages—four (Bank of America, CitiMortgage, Provident, and Wells Fargo Bank) did not report any escalated cases to Freddie Mac despite handling more than 20,000 such cases during the 14-month period between October 2011 and November 2012.[7] However, when contacted by OIG in connection with this audit, these servicers indicated that they would begin reporting to Freddie Mac.

Further, Freddie Mac data on all of its servicers reveals that about 98% (1,179 of 1,207) did not report any escalated cases as of December 2012.[8] Although Freddie Mac officials told us that reports are only required of servicers with escalated cases—and, thus, the lack of reporting may indicate that there were no escalated cases to report—it is highly unlikely that 98% of its servicers had no escalated cases to report given the 6.6 million loans that they manage. In fact,

[7] These large servicers also did not submit escalated case reports in December 2012. Moreover, CitiMortgage and Wells Fargo did not submit reports in January 2013. The complementary four largest servicers, Branch Banking & Trust Corporation (BB&T), GMAC Mortgage, JPMorgan Chase Bank, and US Bank, provided the required escalated case reports.

[8] Freddie Mac noted that 55% of its servicers (661 of 1,207) manage 500 or fewer loans.

four of Freddie Mac's largest servicers, which did not report any escalated cases (despite handling more than 20,000 of them), are included within the 98% of non-reporting servicers. This strongly suggests that many other servicers handled escalated cases but did not comply with the reporting requirements.

A Freddie Mac official asserted there is no way to identify servicers that have received escalated cases but have failed to report such information. Specifically, Freddie Mac does not require servicers to provide a negative response if they have not received any escalated complaints.

The four large non-reporting servicers provided us with various reasons for not reporting escalated cases to Freddie Mac. One servicer told us that it was not aware of the requirement and another said that Freddie Mac had not requested the information during an onsite examination conducted in September 2012. A third servicer stated that it had quality control and governance issues related to reporting escalated cases, and it had informed Freddie Mac that these issues were delaying the servicer's implementation of the SAI.

Together, Freddie Mac's servicers managed loans with a combined unpaid principal balance of more than $1.6 trillion as of December 2012. Many of these servicers also manage loans for Fannie Mae.

Escalated Cases Not Timely Resolved Within 30 Days

Freddie Mac's eight largest servicers handled 26,196 escalated cases during the 14 months between October 2011 and November 2012, and they resolved 25,528 of them during this period. Of the resolved cases, 5,372 (or 21%) exceeded the 30-day time limit specified by FHFA's SAI and Freddie Mac's Servicing Guide. In addition, of the 668 unresolved cases as of November 30, 2012, 398 (or 60%) had not been resolved within the required 30 days.

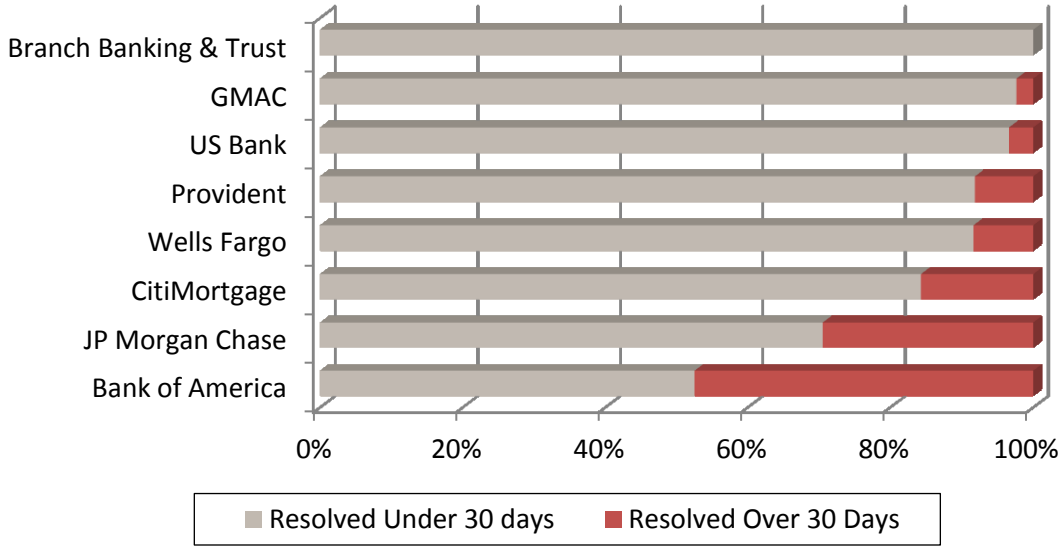
Among the eight largest servicers, only Branch Banking & Trust Corporation (BB&T) resolved all of its escalated cases within 30 days, but that bank had significantly fewer cases to process. The worst performing servicer, Bank of America, handled 4,404 escalated cases and resolved 3,950 of them. Of that number, 1,875 (or 47%) were not resolved within the 30-day time limit; overall, Bank of America took an average of 52 days to resolve its cases, and the longest case required 392 days to resolve. With respect to other large servicers:

- JP Morgan Chase handled 4,367 escalated cases; over 1,200 took over 30 days to resolve; and the longest case required 304 days to resolve;
- CitiMortgage handled 11,503 escalated cases; over 1,700 took over 30 days to resolve; and the longest case required 313 days to resolve;
- Wells Fargo handled 4,784 escalated cases; almost 400 took over 30 days to resolve; and the longest case required 95 days to resolve; and

- Provident handled 345 escalated cases; approximately 30 took over 30 days to resolve; and the longest case required 205 days to resolve.

Figure 3 shows the level of compliance among the eight largest servicers.

Figure 3: Consumer Complaints Taking More Than 30 Days to Resolve



FHFA implemented the SAI to enhance the quality of servicing practices by placing a strong emphasis on earlier and more frequent borrower contact to expedite borrower resolution for a foreclosure alternative. When properly implemented and followed, the 30-day resolution requirement is intended to assist at-risk borrowers to maintain homeownership. Equally important, it helps minimize Freddie Mac's credit losses related to additional foreclosure actions and maintaining an inventory of foreclosed properties.

Escalated Case Resolutions Inaccurately Categorized

Some of Freddie Mac's largest servicers also did not accurately categorize the nature of their escalated cases. According to the SAI and Freddie Mac's Servicing Guide, an escalated case is considered resolved when the complaint has been reviewed in accordance with applicable guidelines and the servicer:

- Determines that there is no change in its original determination or identifies a proposed resolution that corresponds to one of the resolution categories;
- Documents the proposed resolution in its servicing system or mortgage file including the date the resolution was reached; and
- Takes the first action to implement the resolution.

Servicers are required to report the resolution of escalated cases, using the following 13 resolution categories:

- Foreclosure Completed
- Loan Payoff
- Deed-in-Lieu of Foreclosure
- Forbearance Plan
- Foreclosure Initiated/Pending
- Action Not Allowed – Bankruptcy in Progress
- Home Affordable Modification Program (HAMP)
- HAMP Trial Period Plan
- Non-HAMP Modification
- Other Foreclosure Alternative
- Repayment Plan
- Short Sale
- No Action Taken (Borrower current and determined able to pay)

We found notable instances of inconsistencies and inaccuracies among the categories used by the largest eight servicers to track the proposed resolutions in the servicing system. For example, instead of 13, one servicer used 61 different categories to identify the types of resolutions of its escalated cases. In addition, about 2,000 (or 8%) of the 25,528 cases resolved by Freddie Mac's eight largest servicers between October 1, 2011, and November 30, 2012, lacked a resolution category, as required. Using inaccurate and inconsistent resolution categories (or not using them at all) is problematic because, without such data, Freddie Mac's ability to identify significant trends in the nature of escalated cases and how they are handled may be impaired.

Freddie Mac Oversight Did Not Adequately Address Escalated Cases

Servicer Reviews Did Not Include Testing for Escalated Case Requirements

During 2012, Freddie Mac conducted 38 onsite operational reviews of its largest national and regional servicers. With the exception of one servicer review conducted in March 2012, Freddie Mac made no findings at all regarding its servicers' handling of escalated cases. In the case of the one servicer, Freddie Mac found that the servicer failed to establish a process for reviewing and responding to escalated cases as required by the SAI. As of January 2013, Freddie Mac had approved the servicer's corrective action plan to resolve the issue.

Notably, Freddie Mac reviewed one servicer three times (in June, September, and November 2012) without making any findings related to escalated cases. By contrast, Fannie Mae reviewed the same servicer once and determined that it was not in compliance with the SAI and Fannie Mae's guidance governing the handling of escalated cases. Fannie Mae then directed the servicer to implement new controls to resolve escalated borrower inquiries in a timely manner in accordance with its Servicing Guide.

Whereas Fannie Mae has implemented testing procedures with respect to its servicers, Freddie Mac has not. Lack of testing procedures reduces the likelihood of finding servicer noncompliance with escalated case requirements. The Freddie Mac officials we interviewed

stated that they planned to add steps related to escalated cases to their review plans in January 2013.

Servicing Guide Lacked Performance-Based Incentives Related to Escalated Cases

According to FHFA, implementation of the SAI must include performance-based incentive payments for compliance and penalties for noncompliance. Our analyses showed that, although Freddie Mac established consequences in its Servicing Guide (such as fees) for failing to perform foreclosure actions in accordance with required timelines, there were no corresponding penalties (such as fines) for servicers' lack of reporting escalated cases in either FHFA or Freddie Mac guidance. Indeed, Freddie Mac's Servicing Guide, servicer scorecard, and related performance evaluation, all of which are tools used by the enterprise to measure servicers' performance, did not include penalties for failure to report escalated case information. Freddie Mac officials informed us that they plan to add reporting of escalated cases to its servicer scorecard in the near future.[9]

Escalated Case Information Not Used Internally

Freddie Mac did not use the escalated case information it received from servicers to identify areas of elevated risk. The Counterparty Operational Risk Evaluation (CORE) team—which reviews servicer performance for compliance with Freddie Mac's requirements—used a risk-based approach to enhance its standard review programs. The CORE team's approach included meeting with various business line managers to understand the emerging risks of their servicers. This process of internally sharing escalated case information, to be used to identify elevated risk, is illustrated in the CORE Manual, which includes the following:

> The CORE team will strive to capitalize on the wealth of information already maintained by Freddie Mac relative to each Counterparty through effective and regular communication with Business Units. This is to ensure that CORE remains aligned with Freddie Mac's overall risk management efforts.

Although the CORE team relies on input from Freddie Mac's business units, it did not incorporate escalated case data, which can be an important indicator of the quality of servicing and underwriting of enterprise loans, into its risk analysis. Specifically, for the 28 servicers that reported escalated case information, Freddie Mac did not forward the escalated case information

[9] In February 2013, Freddie Mac provided us with its updated servicer scorecards (also known as the Executive Summary Reports) dating back to November 2012. The scorecards included escalated case information from those servicers who were reporting or identified certain servicers who did not provide information for that month. However, as noted in this report, there is no way to determine the accuracy of this information because servicers are not required to provide a negative response if they did not have escalated cases to report.

to its CORE team. As a result of our review, Freddie Mac officials stated that they would provide escalated case information to the CORE team for consideration in performing reviews.

FHFA Oversight Failed to Identify Noncompliance with Consumer Complaint Requirements

Examination of Freddie Mac's Implementation of the SAI Failed to Identify Servicer Noncompliance

FHFA's examination of Freddie Mac's implementation of the SAI, which was being finalized as of January 2013, did not identify servicers' failure to report escalated cases or resolve them within 30 days. In August 2012, FHFA initiated its first examination of Freddie Mac's implementation of the SAI. The planned scope of the examination included, among other things, Freddie Mac's monitoring of the servicers' compliance with the SAI. Specific to consumer complaints, FHFA's examination included the following planned procedures:

- For borrower contact, review the adequacy and effectiveness of new standards and timelines for borrower calls and call center activities. Also, review new processes and controls put in place to monitor compliance with the SAI.
- For delinquency management, review the adequacy and compliance with the process for reviewing and escalating borrower complaints and disputes.

However, our interviews with FHFA officials about the examination's findings revealed that their examination team was unaware that almost all of Freddie Mac's servicers failed to report escalated cases to Freddie Mac. The examination team did not perform independent testing of servicer compliance, but instead relied on internal reports produced by Freddie Mac related to testing servicers' compliance with implementation of the SAI. The examination team noted that the enterprise's reports did not identify any problems with servicers failing to report. Yet, as described above, our analyses showed that Freddie Mac was not testing servicers' compliance with requirements for handling escalated cases, which explains why Freddie Mac's reports—with one exception—did not contain instances of reporting violations. FHFA's failure to conduct independent testing of servicer compliance resulted in its reliance on incomplete data supplied by Freddie Mac and faulty conclusions about Freddie Mac's implementation and oversight of the SAI.

No Examination Guidance for FHFA Directives

Finally, FHFA did not publish guidance for examining Freddie Mac's implementation of FHFA directives, including the SAI. Specifically, FHFA's Supervisory Guide, related advisory

bulletins, and the Supervision Handbook do not contain guidance as to how to test enterprise compliance with FHFA directives.[10] FHFA agreed that as of February 2013, there is no explicit guidance controlling examinations of compliance with FHFA's directives; however, FHFA officials advised that they are now discussing developing such guidance.

As of February 2013, FHFA has issued 133 directives: 59 to both enterprises, 41 to Freddie Mac, and 33 to Fannie Mae. According to FHFA, guidance on examining directives would provide a high-level framework for an examiner who intends to review the implementation of an FHFA directive.

[10] FHFA, *Supervisory Guide*, Version 2.0 (September 8, 2009). FHFA, *Supervision Handbook*, Version 2.1 (June 16, 2009).

CONCLUSION

FHFA developed the SAI as part of an effort to keep homeowners in their homes; help servicers interact with delinquent borrowers in a way that is timely, efficient, and fair; and make enterprise loss mitigation programs more effective. However, these goals are at risk of not being achieved. Servicers, Freddie Mac, and FHFA have not adequately fulfilled their respective roles relative to an important aspect of the SAI: addressing and resolving escalated consumer complaints in a timely and consistent manner. FHFA must take immediate action to improve servicer reporting, which will in turn help the agency to ensure that escalated cases are resolved before homeowners and the enterprises unnecessarily suffer adverse consequences such as foreclosure. Strengthened oversight—through actions aimed specifically at improving servicer compliance with escalated case requirements—can benefit homeowners, Freddie Mac, and ultimately taxpayers.

RECOMMENDATIONS

To improve servicer compliance with escalated case requirements, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac requires its servicers to:

1. Report escalated consumer complaint information—to include a negative response if servicers have not received any escalated complaints—on a monthly basis.

2. Resolve escalated consumer complaint information within 30 days.

3. Categorize resolved escalated consumer complaint information in accordance with resolution categories defined in the Servicing Guide.

To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac:

4. Includes testing of servicers' performance for handling and reporting escalated cases as part of its reviews of servicers' performance.

5. Identifies and addresses servicer operational challenges with implementing the escalated case requirements as part of the testing of the servicers' performance for handling and reporting escalated cases.

6. Establishes penalties in the Servicing Guide, such as fines or fees, for servicers' lack of reporting escalated cases.

7. Expands the servicer scorecard and servicer performance evaluations to include reporting of escalated cases.

8. Provides information on escalated cases received from servicers to internal staff (the CORE team) responsible for testing servicer performance.

To improve its own oversight, FHFA should:

9. Develop and implement FHFA examination guidance related to enterprise implementation and compliance with FHFA directives.

SCOPE AND METHODOLOGY

The objective of this performance audit was to assess FHFA's oversight of Freddie Mac's controls over servicers' handling of escalated consumer complaint cases.

We performed fieldwork for this audit from August 2012 through February 2013. We conducted this audit at FHFA's office in Washington, D.C., and Freddie Mac's office in McLean, Virginia. We interviewed FHFA, Freddie Mac, and selected servicer personnel.

The scope of our audit related specifically to escalated consumer complaints received by selected servicers for Freddie Mac funded loans. We relied on computer-processed and hardcopy data from FHFA, Freddie Mac, and selected servicers.

To achieve the audit objective, we:

- Judgmentally selected and tested the consumer complaints processes for Freddie Mac's eight largest servicers (measured in terms of volume of loans managed);
- Analyzed escalated consumer complaint case data, related specifically to Freddie Mac funded loans, from October 2011 to November 2012, for the eight largest servicers;
- Interviewed FHFA officials on policies and examination work related to the implementation of the SAI; and
- Reviewed onsite servicer reviews conducted by Freddie Mac and Fannie Mae.

We also assessed the internal controls related to our audit objective. Internal controls are an integral component of an organization's management that provides reasonable assurance that the following objectives are 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, and include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance. Based on the work completed on this performance audit, we consider weaknesses in FHFA's supervisory oversight of Freddie Mac's controls over servicers' handling of escalated consumer complaint cases to be significant in the context of the audit's objective.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan audits and obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for the finding and conclusion included herein, based on our audit objective.

APPENDIX A:
FHFA's Comments on Finding and Recommendations

Federal Housing Finance Agency

MEMORANDUM

TO: Russell A. Rau, Deputy Inspector General for Audit

FROM: Jon D. Greenlee, Deputy Director, Division of Enterprise Regulation
Nina A. Nichols, Deputy Director, Division of Supervision Policy and Support

SUBJECT: Audit Report: Enhanced FHFA Oversight is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements (Audit Assignment: AUD-2012-014)

DATE: March 15, 2013

This memorandum transmits the Federal Housing Finance Agency's (FHFA) management responses to the recommendations in the report prepared by FHFA-OIG on Audit AUD-2012-014, *Enhanced FHFA Oversight is Needed to Improve Mortgage Servicer Compliance with Consumer Complaint Requirements.* We appreciate the opportunity to provide feedback on this draft report and the FHFA-OIG findings.

FHFA appreciates and concurs with the importance of ensuring timely and responsive resolution of consumer complaints, particularly complaints of a more serious nature deemed to be "escalated cases". In fact, FHFA recognized the importance of escalated case processing as one part of its broader Servicing Alignment Initiative (SAI) that improved mortgage servicing practices for consumers. FHFA's supervisory strategy for 2013 has identified as a key priority the review of the Enterprises' implementation of all aspects of SAI and not just the handling of escalated cases. The FHFA OIG report points to areas of potential operational weakness in escalated case processing, which will inform FHFA's SAI examination review.

FHFA concurs with the spirit and intent of the recommendations in the FHFA-OIG report. However, FHFA believes its ability to commit to carrying out the specific recommendations in the OIG report may be limited given the final rules announced on January 17, 2013 by the Consumer Financial Protection Bureau (CFPB). These final rules amend Regulation X and Regulation Z, and implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Attached are (1) a Summary and (2) a Factsheet of the final mortgage servicing rules issued by CFPB on January 17, 2013. While the full impact of these final rules on servicer operations is currently being assessed, FHFA believes they are likely to affect in greater or lesser degree all of the recommendations in the OIG report.

FHFA-OIG recommends that:

To improve servicer compliance with escalated case requirements, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac requires its servicers to:

1. Report escalated consumer complaint information -- to include a negative response if servicers have not received any escalated complaints – on a monthly basis.
2. Resolve escalated consumer complaint information within 30 days.
3. Categorize resolved escalated consumer complaint information in accordance with resolution categories defined in the Servicing Guide.

To enhance Freddie Mac's oversight of its servicers, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac:

4. Includes testing of servicers' performance for handling and reporting escalated cases as part of its reviews of servicers' performance.
5. Identifies and addresses servicer operational challenges with implementing the escalated case requirements as part of the testing of the servicers' performance for handling and reporting escalated cases.
6. Establishes penalties in the Servicing Guide, such as fines or fees, for servicers' lack of reporting escalated cases.
7. Expands the servicer scorecard and servicer performance evaluations to include reporting of escalated cases.
8. Provides information on escalated cases received from servicers to internal staff (the CORE group) responsible for testing servicer performance.

To improve its own oversight, FHFA should:

9. Develop and implement FHFA examination guidance related to Enterprise implementation and compliance with FHFA directives, to include the SAI.

Management Response: Agree

FHFA agrees with the intent of these recommendations and agrees to implement them as the Agency works with the Enterprises during 2013 to not only conform consumer complaint processing under the Servicing Alignment Initiative, but to ensure all servicer operations comply with the new requirements of Regulation X and Regulation Z by January 10, 2014, the effective date of these regulations.

Although FHFA had already made the review of SAI a key supervisory priority in 2013, we will develop more detailed plans to review escalated cases by June 30, 2013. FHFA will also develop separate general supervisory guidance for examining compliance with FHFA directives within one year of the issuance date of the OIG report.

Attachments

(1) "Summary of the final mortgage servicing rules", CFPB, January 17, 2013
(2) Factsheet –CFPB, January 17, 2013

cc: Richard Hornsby, Chief Operating Officer
Sandra Thompson, Deputy Director, Division of Housing Mission and Goals
Mark Kinsey, Chief Financial Officer
Bruce Crandlemire, Senior Advisor for IG Operations
John Major, Internal Controls and Audit Follow-Up Manager

APPENDIX B:
OIG's Response to FHFA's Comments

On March 15, 2013, FHFA provided comments to a draft of this report, agreeing with the recommendations and identifying FHFA actions to address them.

FHFA stated it concurs with the importance of ensuring timely and responsive resolution of consumer complaints, particularly complaints of a more serious nature deemed to be escalated cases.

FHFA plans to implement the audit recommendations by working with both enterprises—Freddie Mac and Fannie Mae—to conform consumer complaint processing under the SAI and ensure compliance with new regulatory requirements announced by the Consumer Financial Protection Bureau in final rules issued in January 2013. The new requirements implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Further, FHFA has made review of the SAI a supervisory priority in 2013 and will develop detailed plans for reviewing escalated cases. Finally, FHFA plans to develop supervisory guidance for examining compliance with FHFA directives.

We consider FHFA's actions to be sufficient to resolve the recommendations, which will remain open until we determine that the agreed upon corrective actions are completed and responsive to the recommendations. We have attached the agency's full response (see Appendix A), which was considered in finalizing this report. Appendix C provides a summary of management's comments on the recommendations and the status of agreed-to corrective actions.

APPENDIX C:
Summary of Management's Comments on the Recommendations

This table presents management's responses to the recommendations in our report and the status of their resolution as of the date when the report was issued.

Rec. No.	*Corrective Action: Taken or Planned*	*Expected Completion Date*	*Monetary Benefits*	*Resolved[a] Yes or No*	*Open or Closed[b]*
1 through 8	FHFA agrees to implement the recommendations as the agency works with the enterprises during 2013 to not only conform consumer complaint processing under the Servicing Alignment Initiative, but to ensure all servicer operations comply with the new requirements of Regulation X and Z by January 10, 2014, the effective date of these regulations.	1/10/ 2014	$0	Yes	Open
	FHFA will develop more detailed plans to review escalated cases by June 30, 2013.	6/30/2013	$0	Yes	Open
9	FHFA will develop separate general supervisory guidance for examining compliance with FHFA directives within one year of the issuance date of the OIG report.	3/31/2014	$0	Yes	Open

(a) Resolved means: (1) management agrees with the recommendation, and the planned, ongoing, or completed corrective action is consistent with the recommendation; (2) management does not agree with the recommendation, but alternative action meets the intent of the recommendation; or (3) management agrees to the OIG monetary benefits, a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

(b) Once OIG determines that the agreed-upon corrective actions have been completed and are responsive to the recommendations, the recommendations can be closed.

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