

**LIMITED SCOPE AUDIT OF THE CREDIT ENHANCEMENT
RESERVE FUNDS FOR SECURITIZATION TRANSACTIONS
1991-16 and 1992-05**

Audit Report No. 99-027
July 6, 1999

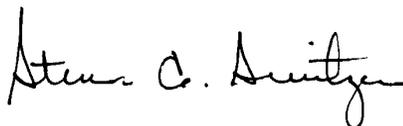


OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: July 6, 1999

TO: John F. Bovenzi
Director, Division of Resolutions and Receiverships



FROM: Steven A. Switzer
Deputy Inspector General for Audit

SUBJECT: *Limited Scope Audit of the Credit Enhancement Reserve Funds for
Securitization Transactions 1991-16 and 1992-05
(Audit Report No. 99-027)*

The Office of Inspector General (OIG) completed a limited scope audit of the credit enhancement reserve funds for single-family residential (SFR) loan securitization transactions 1991-16 and 1992-05. The Resolution Trust Corporation (RTC)¹ began issuing mortgage-backed securities in June 1991. As of November 1998, the RTC and the Federal Deposit Insurance Corporation (FDIC) issued 74 mortgage-backed security transactions (securitizations) with original unpaid principal balances (i.e., book value) of approximately \$43.8 billion. Of these 74 securitizations, 44 were collateralized by SFR mortgage loans with a book value of \$25.3 billion. As of November 1998, the remaining collateral balance of the SFR securitizations totaled \$4.1 billion. The OIG has completed other audits of securitizations and will continue to focus audit effort in this area because the FDIC maintains a significant risk and financial interest in these transactions.

BACKGROUND

At each securitization closing, the trustee, the servicer, and the seller (the RTC for the two selected securitizations) signed a pooling and servicing agreement (PSA) describing the obligations of each party. A trust was created to acquire the RTC-owned mortgages and to issue the pass-through certificates to third-party investors.

¹ The RTC's legislatively mandated sunset date was December 31, 1995. Responsibility for all RTC-related work as of that date was transferred to the Federal Deposit Insurance Corporation in accordance with the RTC Completion Act.

The trustee represents the interests of the certificate holders and acts as administrator of the trust. The trustee's primary role is to compute the amount of monthly distributions payable to the investors and make appropriate distributions according to the terms of the PSA. For transaction 1991-16, the trustee was State Street, Boston, Massachusetts. For transaction 1992-05, the trustee was Bankers Trust of California, Irvine, California.

The servicer performs traditional loan servicing functions of collecting and accounting for borrowers' payments and resolving delinquent loans. The servicer is required to use its best reasonable efforts to collect all payments under the terms of the mortgage loans. However, the servicer is not authorized to modify or forgive the amount of principal and interest due on the mortgage loan. The servicer also prepares electronic remittance reports and forwards the monthly mortgage payments to the trustee so that the investors may be paid. For both securitization transactions, GMAC Mortgage Corporation, Waterloo, Iowa, was the loan servicer.

While the third-party investors are the "regular" certificate holders, the RTC/FDIC is the "residual" certificate holder. Regular certificate holders receive the monthly cash flows of principal and interest payments made by the borrowers. The FDIC retains the residual certificates and is entitled to any remaining assets and cash flows from the securitization after all of the regular certificate holders have been paid in full, net of expenses. To enhance the credit ratings of the securities, the RTC/FDIC established credit enhancement reserve funds (reserve funds) from the sales proceeds of each of the securitizations. The purpose of a reserve fund is to provide investors with a limited amount of protection against credit risks. If realized losses resulting from the sale or liquidation of the underlying collateral of the mortgage loans are incurred, the reserve fund absorbs the realized loss, until it is depleted. At the termination of the securitization or after the liquidation of all of the loans in the securitization (whichever comes first), any remaining balance of the reserve fund returns to the FDIC. Therefore, any erroneous or unnecessary realized losses charged to the reserve fund directly affect the remaining balance and the FDIC's residual interest in the reserve fund.

The FDIC Division of Resolutions and Receiverships (DRR) Mortgage-Backed Securities Administration (MBS) is responsible for the administration and oversight of the FDIC's securitization program. To fulfill part of its oversight function, MBS hired MGIC Investor Services Corporation (MGIC), Milwaukee, Wisconsin, to perform reasonableness reviews of realized losses submitted by loan servicers of the SFR loan securitizations. MGIC also screens certain realized losses charged to the reserve fund for potential breaches of seller representations and warranties. If a breach of seller representations and warranties is identified, then the realized loss should not be charged to the reserve fund. Instead, the resulting loss should be charged to an FDIC fund that was specifically established to reimburse seller representation and warranty claims. The FDIC Asset Claims Administration (Asset Claims) is responsible for resolving asserted claims of breaches of seller representations and warranties. If MGIC identifies a potential breach of seller representations and warranties, then MGIC is responsible for referring the matter to Asset Claims for resolution.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to: (1) determine whether the realized losses were allowable and adequately supported by documentation and (2) determine if actual principal and interest advances remitted to the trustee by the servicer agree to the principal and interest advances charged to the reserve funds. To accomplish these objectives, we reviewed a sample of the realized losses charged to the reserve funds for securitization transactions 1991-16 and 1992-05 for the month of June 1998. We selected June 1998 because of the significant reserve fund activity as compared to other months. For June 1998, realized losses totaling \$455,267 were charged to the reserve funds for both securitizations (\$244,455 for 1991-16 and \$210,812 for 1992-05). We initially selected for testing 20 loans with realized losses totaling \$453,324 (99.6 percent of June 1998 realized losses). Because the servicer had submitted additional supplemental claims for these 20 loans, we expanded our sample to include the total realized loss for these loans through August 1998, or \$712,458.

Based on survey results, we determined that further audit work related to our objectives was not cost beneficial. However, based on evidence detected in the asset files for eight loans in our sample, we identified a condition outside of the scope of our original objectives whereby the servicer did not perform properly in a bankruptcy proceeding. Because there were actually 16 loans involved in this condition (only 8 of them were included in our original sample), we expanded our audit work by adding a third objective to our audit. Our third objective was to quantify the actual and potential losses erroneously charged to the reserve fund because of the mishandled bankruptcy proceedings for all 16 loans. Our expanded sample of realized losses that we tested totaled \$763,672.

To accomplish our objectives, we interviewed personnel from DRR MBS, GMAC, State Street, Bankers Trust, and MGIC. Additionally, we researched and analyzed GMAC's loan files for supporting documentation relating to the calculations of the realized losses. We reviewed MGIC reports, bankruptcy court records, and the PSAs for each of the two securitizations. We consulted with FDIC Legal Division staff having the requisite expertise with FDIC securitizations. We also spoke to personnel from Asset Claims and reviewed supporting documentation on representations and warranties claims. We conducted the audit in accordance with generally accepted government auditing standards. Audit fieldwork was performed between October 27, 1998 and April 1, 1999.

RESULTS OF AUDIT

We concluded that, except as noted below, GMAC charged the reserve fund for allowable and adequately supported realized losses for our sampled loans. We also confirmed that the principal and interest advances charged to the reserve fund agreed to the amount of principal and interest actually remitted by the servicer to the trustee. However, we determined that GMAC was untimely and ineffective in its efforts to pursue its claim in a Chapter 11 bankruptcy proceeding. GMAC's ineffective participation in the bankruptcy action resulted in improper claims to the reserve fund and the diminishment of the residual value of the collateral loan pool. We calculated the financial loss to the FDIC to be at least \$331,672 as of February 28, 1999. However, until securitization transaction 1991-16 terminates, the exact amount of the total loss cannot be determined.

Additionally, we determined that \$8,607 in realized loss claims were either unsupported by adequate documentation or otherwise inappropriately charged to the reserve fund. This amount represented only 1 percent of the sampled realized loss dollars. Further, we believe that two of the realized losses selected in our sample should be referred to Asset Claims for review to determine if there was a breach of seller representations and warranties. Finally, we identified an opportunity for improved controls over the process for refunding amounts to the reserve fund for representations and warranties claim reimbursements. DRR officials promptly initiated appropriate action to improve this process when we brought the matter to their attention.

SECURED CLAIM NOT PROPERLY PURSUED IN CHAPTER 11 BANKRUPTCY PROCEEDINGS

GMAC was untimely and ineffective in its efforts to pursue its claim for repayment from a borrower who defaulted on 16 mortgage loans which were included in the pool of loans supporting RTC securitization 1991-16. GMAC did not properly react to several opportunities to establish, during Chapter 11 bankruptcy proceedings, its claim for repayment of the principal, interest, and other costs to which it was entitled. GMAC's ineffective participation in the bankruptcy action resulted in improper claims to the reserve fund and the diminishment of the residual value of the collateral loan pool. We calculated the financial loss to the FDIC to be at least \$331,672 as of February 28, 1999. However, until securitization transaction 1991-16 terminates, the exact amount of the total loss cannot be determined.

Section 3.01 of the PSA states that the servicer shall service and administer the mortgage loans in accordance with accepted servicing practices. Section 3.02 of the PSA states that the servicer shall use its best reasonable efforts to collect all payments called for under the terms and provisions of the mortgage loans. However, GMAC's efforts in the Chapter 11 bankruptcy proceedings did not satisfy the performance standards required by the PSA.

According to GMAC loan files, the borrower defaulted on 16 variable interest rate mortgage loans in November and December 1991. In April 1992, the borrower filed for Chapter 11 bankruptcy. The intention of the borrower was to restructure his debts and repay them from the rental income that he was collecting on 67 rental properties. Although the borrower's debt restructuring plan was amended several times during the bankruptcy proceedings, his expressed intention was to repay GMAC and other secured creditors in full. The total amount of all unpaid principal, accrued interest, escrow deficiencies, and legal fees was to be included as the principal amount of a new, fixed-interest rate loan paying 9 percent per year on a 30-year amortization schedule. The new loan would require a balloon payment at the end of the sixth year.

Representing GMAC in the bankruptcy proceedings were the firms Thorson and Berg, St. Paul, Minnesota, and, later, Anderson and Greenfield, Philadelphia, Pennsylvania. Because the bankruptcy proceedings were held in Philadelphia, the firm Anderson and Greenfield was engaged to attend the hearings and directly represent GMAC's interest in the bankruptcy process.

In his bankruptcy petition, the borrower provided a schedule of all of his creditors and his estimates of indebtedness. The borrower listed his debt obligation to GMAC at \$707,931. However, according to GMAC documents, the actual unpaid principal balances of the borrower's loans totaled \$748,438. Additionally, interest was continuing to accrue subsequent to the borrower's last loan payments in late 1991, and GMAC had paid escrow expenses on behalf of the borrower for which it was not reimbursed. GMAC and its attorneys on several occasions calculated the borrower's debt obligation, but they did not legally establish the correct amount of GMAC's claim in the bankruptcy court. File documents disclosed that GMAC did not meet the September 1992 deadline (bar date) for filing the amount of its claim (proof of claim) with the court. Furthermore, at the various bankruptcy hearings, GMAC's attorneys did not object to the borrower's schedule of debts in his proposed debt restructuring plan, nor did they file any motions with the court to have the appropriate amount of GMAC's claim determined. At the final bankruptcy hearing, on June 28, 1993, creditors were given several weeks to file the proper amount of their claims with the court. However, there was no evidence that GMAC's attorneys took advantage of this opportunity. In July 1993, the court confirmed the borrower's debt restructuring plan, and in September 1993, the borrower began repayment of his debts in accordance with the terms of the approved plan.

In December 1993, GMAC became aware that the debt restructuring plan approved by the court resulted in a repayment schedule that was insufficient to satisfy the total amount of the borrower's indebtedness. GMAC engaged another law firm, Fredrikson and Byron, Minneapolis, Minnesota, to review the bankruptcy matter and to file an appeal of the terms of the debt restructuring plan approved by the court. The appeal, filed in April 1995, argued that GMAC, as a secured creditor, was not legally required to file a proof of claim to preserve its claim with regard to the Chapter 11 bankruptcy process. GMAC maintained that the court should amend the debt restructuring plan to require payment of its claim of \$914,867, or \$206,936 more than previously confirmed by the court. However, the court rejected GMAC's appeal primarily because GMAC and its attorneys had previous opportunities to establish GMAC's claim in the bankruptcy proceedings but failed to do so before the debt restructuring plan had been confirmed and implemented.

The debt restructuring plan approved by the court resulted in repayment terms which relieved the borrower from repaying \$206,936 of principal and more than \$84,430 of interest over the 6-year term of the restructured loan. Additionally, GMAC claimed and was reimbursed \$27,567 from the reserve fund for legal fees incurred in the unsuccessful appeal of the court-approved debt restructuring plan. These costs would not have been incurred had GMAC properly established its claim during the bankruptcy proceedings. Furthermore, because GMAC did not properly establish its claim in the Chapter 11 proceedings, the FDIC may have lost more than \$12,739 of investment interest on the losses charged to the reserve fund and interest overpayments to the trust certificate holders. Therefore, as of February 28, 1999, losses for these 16 loans totaled \$331,672.

We found no evidence that GMAC attempted to obtain reimbursement from its attorneys for their ineffective performance in the bankruptcy proceedings. In April 1996, GMAC began submitting claims to the reserve fund to cover some of the losses that resulted from the reduced borrower payments required by the debt restructuring plan. The reduced amount of collections

from the borrower also resulted in less income to the trust, which affected the financial interests of the FDIC and other certificate holders.

GMAC's ineffective efforts in the Chapter 11 proceedings were detrimental to the financial interests of the FDIC in two ways. The loss of collections from the borrower resulted in improper charges to the reserve fund and lost interest earnings on reserve fund balances. In addition, the residual value of the collateral loan pool was diminished. The reduction in collections delayed the retirement of the trust certificates and resulted in additional payments of interest to the certificate holders. These losses will increase until securitization 1991-16 is ultimately terminated.

The FDIC's right to an immediate recovery from GMAC for improper charges to the reserve fund is clearly supported by the terms of the PSA. However, an FDIC recovery for the diminishment of the residual value of the collateral loan pool is dependent upon whether or not the securitization trustee, State Street, will require GMAC to reimburse the trust for the loss of collections. If the trustee takes no action to obtain reimbursement prior to the termination of the trust, then the FDIC's remaining recourse is to pursue a recovery directly from GMAC. According to FDIC officials, the trustee may not require GMAC to reimburse the trust because it may deem the shortfall of trust income to be immaterial. Consequently, MBS stated it intended to pursue reimbursement for the total loss of collections and to reimburse the trust later, if necessary.

We spoke with GMAC officials regarding our findings. Although GMAC officials agreed with the concept of the findings, they stated that they would independently recalculate the amount of lost collections. GMAC stated it intended to use its calculation of the lost collections in negotiating a settlement with the FDIC.

The reserve fund losses discussed above were not reviewed by MGIC, DRR's oversight contractor. Reportedly, MGIC requested supporting documentation from GMAC to perform a review, but the documentation was not provided. DRR and MGIC took no further action to review the losses. In the OIG report entitled *Audit of the Credit Enhancement Reserve Fund for Securitization Transaction 1993-03* dated November 24, 1998, we recommended measures that would strengthen DRR's process for reviewing realized losses. Consequently, we are not repeating the recommendation in this report.

Recommendation

The Manager, MBS Administration, DRR, should:

- (1) Disallow, at a minimum, \$331,672 for losses that were incurred through February 28, 1999 and negotiate an appropriate settlement agreement with the servicer to obtain restitution for the total losses related to the Chapter 11 bankruptcy proceedings.

REALIZED LOSS CLAIMS INCLUDED UNSUPPORTED AND INAPPROPRIATE COSTS

The audit disclosed \$7,156 of unsupported costs and \$1,451 of inappropriate costs, which represent 1 percent of the realized losses that we sampled for the period April 1996 to August 1998. These results suggest that GMAC was maintaining adequate support for most of the corporate advances charged to the reserve fund for the two securitization transactions. Nevertheless, the servicer is required to maintain adequate supporting documentation for all realized losses charged to the reserve fund.

Section 3.04 of the PSA states that the servicer shall keep and maintain separate accounting records for each mortgage loan for the purpose of justifying any withdrawal from the certificate account. The PSA also requires the servicer to retain this documentation for its most recent 5 fiscal years.

We reviewed the supporting documentation for the corporate advances charged to the reserve fund and assessed whether the documentation was sufficient to support the expense and to assess the appropriateness of the claim. We deemed a cost to be unsupported if the servicer could not provide documentation that an expense was incurred, such as an invoice from an outside party, or paid, such as a copy of a check. We also considered a cost unsupported if we could not determine the specific service provided. We concluded that a cost was inappropriate if the cost was avoidable, a duplicate payment, or was otherwise erroneously claimed. Finally, our review included tests for unrecorded income. Unrecorded income would have had the effect of overstating the amount of the realized loss charged to the reserve fund.

GMAC did not provide support for \$7,156 of corporate advances for attorney fees, foreclosure and eviction costs, homeowners' association fees, utilities, inspections, and a broker price opinion. Additionally, we identified inappropriate claims of \$1,451 for late fees related to homeowners' association dues, duplicate payment of attorney fees, an expense incurred after asset disposition, and unrecorded income.

Recommendation

The Manager, MBS Administration, DRR, should:

- (2) Disallow \$8,607 for unsupported and inappropriate charges to the reserve fund (\$7,156 of which is unsupported).

REALIZED LOSSES CHARGED TO THE RESERVE FUND MAY HAVE BEEN MORE APPROPRIATELY CHARGED TO THE REPRESENTATIONS AND WARRANTIES FUND

GMAC was reimbursed from the reserve fund for two loan losses when we believe these two losses should have been referred to DRR's Asset Claims Administration (Asset Claims) to determine if the loans were breaches of seller representations and warranties. If the asserted

breaches of representations and warranties are confirmed by Asset Claims, then the reserve fund was overcharged by \$93,895 for these two realized loss reimbursements. We do not consider the \$93,895 to be questioned costs because GMAC is entitled to reimbursement from either the reserve fund or the representations and warranties fund. However, we believe that MBS should refer these losses to Asset Claims to determine the proper resolution of these claims.

For the first loan, GMAC documented that the RTC, as the seller in securitization transaction 1992-05, represented that a particular mortgage loan was a Veterans Administration (VA) guaranteed loan as of the transaction date. After the loan went into default, GMAC found that the originating lender, ComFed Savings Bank, Lowell, Massachusetts, failed to file the proper documentation with the VA to guarantee the loan. Therefore, the loan was not guaranteed by the VA. In Section 2.03 of the PSA, the seller represented and warranted that information provided at the closing of this transaction about the underlying mortgage loans was correct. By incorrectly representing this loan as a VA guaranteed loan at closing, the seller may have breached the representations and warranties section of the PSA. GMAC charged the reserve fund \$72,368 for the loss on this loan. MGIC's review of this realized loss did not result in a referral to Asset Claims.

For the second loan, GMAC's loan files showed evidence that the deed of trust described a vacant lot as the security collateral for the loan. In Section 2.03(a)(v)(w) of the PSA, the seller represented and warranted that each mortgage loan assigned to the trustee as of the closing date was secured by a mortgage on either a one-to-four-family residential real property, a condominium unit, or a planned unit development or is a co-op loan. Since this mortgage loan was secured solely by land, it should not have been included in securitization 1992-05. GMAC charged the reserve fund \$21,527 for the loss on this loan. MGIC's review of this loan resulted in the detection of a potential breach of representations and warranties. However, MGIC did not refer the loss to Asset Claims for further review. According to MGIC, GMAC could have pursued a recovery for the loss in two ways: (1) GMAC could have tried to reform the mortgage's legal description of the property, foreclose upon and sell the property; or (2) it could have filed a claim with the title company. Until GMAC exhausted its recovery efforts, MGIC believed that referring the loss to Asset Claims for a potential breach was premature. GMAC charged the realized loss to the reserve fund in July 1998. However, as of February 1999, no recoveries were made and GMAC no longer believed that any recovery from the title company was feasible.

Because we are taking exception to the total realized losses claimed for these two loans, we did not review the adequacy of the supporting documentation to substantiate the accuracy of the realized loss calculation. Therefore, we believe that MBS should refer these two loans with realized losses charged to the reserve fund to Asset Claims for appropriate resolution.

Recommendation

The Manager, MBS Administration, DRR, should:

- (3) Refer the two loan losses to Asset Claims Administration for a determination of whether the losses are breaches of seller representations and warranties.

INTERNAL CONTROLS OVER THE PROCESSING OF REFUNDS TO THE RESERVE FUND COULD BE STRENGTHENED

DRR's MBS and Asset Claims offices did not coordinate sufficiently to ensure proper accounting of loan losses initially classified as reserve fund claims but later classified as RTC representations and warranties claims. As a result, reserve fund balances and the representations and warranties fund balances were not accurately stated. We found only one error in our sampled losses and the error did not materially misstate either of the fund balances. However, an opportunity exists for MBS and Asset Claims to strengthen their internal controls over the processing of refunds to the reserve fund for representations and warranties to prevent similar errors from occurring in the future.

During our fieldwork, we noted the following situation. GMAC submitted an officer's certificate to the trustee and to MGIC for a realized loss. MGIC then screened the loss and determined that it was a potential breach of RTC representations and warranties made under sections 2.04(b), 2.05, 2.06, and 2.07 of the PSA. Asset Claims performed a review of the loss and confirmed the breach. Asset Claims then initiated a reimbursement to the reserve fund and charged the loss to the FDIC fund designated for representations and warranties claim reimbursements.

However, GMAC was unaware that MGIC referred this loss to Asset Claims as a potential breach. Prior to the completion of Asset Claims' review, GMAC submitted a supplemental officer's certificate to the trustee (but not to MGIC, because GMAC was not required to do so) to reimburse the reserve fund for a hazard insurance refund. Because MGIC was unaware of the supplemental officer's certificate, MGIC did not refer the correct cumulative amount of the loss to Asset Claims. Consequently, Asset Claims reimbursed the reserve fund an incorrect amount.

This error occurred because there was no control mechanism established between MGIC and the servicers to ensure that the servicers were notified when MGIC identified a potential breach of representations and warranties. If MBS or MGIC communicated to servicers that a potential breach of representations and warranties had been identified, then the servicers would know not to submit future supplemental officer's certificates to the trustee for reimbursement from the reserve fund. Further, there was no control mechanism established between Asset Claims and MBS to coordinate transfers of funds between the reserve funds and the representations and warranties funds. According to MBS officials, there was no formal communication between Asset Claims and MBS regarding the ultimate resolution of representations and warranties claims. MBS did not know whether or not the claims were accepted or whether a partial or full reimbursement, if any, was made to the reserve fund by Asset Claims. This situation presented a potential problem. If Asset Claims only partially reimbursed the amount of the loss referred to it by MGIC, then the remaining unsupported or unsubstantiated balance of the loss should not be charged to the reserve fund. In this situation, the servicer should either substantiate the remaining balance or reimburse the reserve fund. Furthermore, if MBS was not informed that the reserve fund was partially reimbursed (or reimbursed at all), then no action to correct the situation with the servicer would be likely.

When the OIG identified the need for improved controls over this process with MBS, MBS immediately collaborated with MGIC and Asset Claims to develop the following plan to improve the processing of representations and warranties claims initially classified as realized losses:

- When MGIC identifies a potential breach, MGIC will notify the servicer that they intend to recommend reimbursement to Asset Claims. MGIC will also request the servicer to provide copies of all supplemental officer's certificates submitted to date and to refrain from filing future supplemental officer's certificates to the trustee.
- Upon Asset Claims' approval of a breach, Asset Claims will notify the trustee, the servicer, and MGIC of the approval. The trustee should refrain from making any further draws from the reserve funds and submit the supplemental officer's certificates directly to Asset Claims.
- MGIC will inform the servicer when claims are paid by Asset Claims and reinforce that supplemental officer's certificates are to be filed with Asset Claims.
- MBS will implement procedures to update STAC (the database on securitization activity maintained by MBS's contractor, Univest) regarding claims approved and paid by Asset Claims. This update should provide MGIC with the ability to verify that Asset Claims has not previously paid a claim on an asset. Therefore, if a supplemental officer's certificate is mistakenly submitted to the trustee for a loss previously deemed to be a breach, MGIC will be able to determine whether Asset Claims has ever paid a claim on the asset.
- MGIC will review supplemental officer's certificates in an attempt to determine whether the officer's certificate is related to an asset with a breach. If the supplemental officer's certificate was not included in the recommended reimbursement, then the certificate will be submitted to Asset Claims.

We commend MBS and Asset Claims for initiating prompt and appropriate action to coordinate their work and communicate more effectively. We believe that these procedures, if followed, will enhance controls and prevent errors such as those discussed above from occurring in the future. Implementation of these procedures will also assist DRR and Asset Claims in meeting their 1999 Annual Performance Goals related to strengthening oversight methodologies for securitization transactions and strengthening policies and procedures for processing receivership claims. The OIG may review the effectiveness of the revised procedures in future audits.

Recommendation

The Manager, MBS Administration, DRR, and the Manager, Asset Claims Administration, DRR, should:

- (4) Formalize the plan, as discussed above, into a memorandum of understanding and disseminate the new procedures to the appropriate staff for implementation.

MANAGEMENT RESPONSE AND OIG ANALYSIS

On June 17, 1999, the DRR's Deputy Director, Franchise and Asset Marketing Branch and Deputy Director, Asset Management Branch provided a written response to the draft report.

DRR agreed to disallow \$340,279 in questioned costs and initiate action on our other recommendations. With respect to our recommendation that DRR establish a memorandum of understanding to improve the processing of representations and warranties claims initially classified as realized losses, DRR felt that disseminating its new procedures to all affected parties would suffice. We accept that action as responsive to our recommendation.

The Corporation's response to the draft report provided the elements necessary for management decision on the report's recommendations. Therefore, no further response to this report is necessary. Appendix II presents management's proposed action on our recommendations and shows that there is management decision for each recommendation in this report.

As a result of our audit, we will report questioned costs of \$340,279 (of which, \$7,156 is unsupported) in our *Semiannual Report to the Congress*.



FDIC

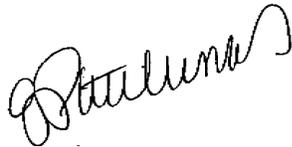
Federal Deposit Insurance Corporation
Division of Resolutions and Receiverships
1776 F Street, N.W.
Washington, D.C. 20429

APPENDIX I

DATE: June 17, 1999 Revision

TO: Marilyn R. Kraus
Deputy Assistant Inspector General

FROM:  James R. Wigand
Deputy Director
Franchise and Asset Marketing Branch
Division of Resolution and Receiverships


Gail Patelunas
Deputy Director
Asset Management Branch
Division of Resolution and Receiverships

RE: Draft Report Entitled "Limited Scope Audit of the Credit Enhancement Reserve Funs for Securitization Transactions 1991-16 and 1992-05"
(Audit No. 98-702) - DRR Response

The following is DRR management's response to the above-mentioned report.

1) **Disallow, at a minimum, \$331,672 of losses that were incurred through February 28, 1999 an negotiate and appropriate settlement agreement with the servicer to obtain restitution for the total losses related to the Chapter 11 bankruptcy proceedings**

A. Management Response:

DRR will disallow \$331,672. However, GMAC disputes the amount and is in the process of providing MBS Administration with its own analysis of the loss.

B. Corrective Action to be Taken Along with Expected Completion Date:

The FDIC will review GMAC's information, reconcile the difference, and come to an agreement with GMAC on the amount that should be reimbursed. The reimbursement of the credit reserve should be completed by October 31, 1999

C. Documentation that will confirm the completion of the corrective action.

Copies of all correspondence and email confirmations from the Division of Finance that confirm GMAC has reimbursed the FDIC.

2) Disallow \$8,607 of charges to the reserve fund (\$7,156 of which is unsupported).

A. Management response:

We concur with this recommendation. GMAC verbally indicated they will reimburse the credit reserve for this amount.

B. Corrective Action to be Taken Along with Expected Completion Date:

The FDIC will request that GMAC confirm their verbal agreement in writing and reimburse the credit reserve for the amount that the OIG recommends is disallowed. GMAC is expected to complete the reimbursement by August 31, 1999.

C. Documentation that will confirm the completion of the corrective action.

Copies of all correspondence and email confirmations from the Division of Finance that confirm GMAC has reimbursed the FDIC.

3) Refer the two loan losses to Asset Claims Administration for a determination of whether the losses are breaches of seller representations and warranties.

A. Management response:

We concur with this recommendation.

B. Corrective Action to be Taken Along with Expected Completion Date:

MBS Administration will submit the loans in question to Asset Claims so that they can review them as representation and warranties claims. MBS Administration will also advise GMAC of this action and ask them to work with Asset Claims to complete this claim by August 31, 1999.

C. Documentation that will confirm the completion of the corrective action.

Copies of all correspondence and email confirmations from GMAC and Asset Claims that confirm the loans have been reviewed.

4) Formalize the plan, as discussed in the draft audit report, into a memorandum of understanding and disseminate the new procedures to the appropriate staff for implementation.

A. Management response:

We concur with this recommendation, except that we believe that new procedures instead of a memorandum of understanding would be sufficient.

APPENDIX I

B. Corrective Action to be Taken Along with Expected Completion Date:

MBS Administration and Asset Claims have prepared draft procedures (see attachment) which will be approved and disseminated to the appropriate staff by August 31, 1999.

C. Documentation that will confirm the completion of the corrective action.

Copies of the new procedures and confirmation that these procedures have been distributed.

cc: Director of Internal Control Management
Director, Division of Resolutions and Receiverships
DRR Associate Director (Internal Review)

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MBS Audit Claims Procedures

As a result of an IG audit of the credit enhancement reserve funds for Securitization transactions 1991-16 and 1992-05, the following procedures are to be implemented immediately for all residential Mortgage Backed Securities (MBS) audit claims:

Claim Set Up

Upon receipt of a documented standard/full audit claim from MGIC (as contractor for MBS Administration), Asset Claims Administration (ACA) will log the claim into WRAPS using the claim worksheet. The claim acknowledgement letter will be sent to the transaction loan servicer with a copy to the Trustee and MGIC. The claim receipt acknowledgment letter will serve as notice to all parities that an Officer's Certificate draw has been referred to FDIC ACA for processing as a representations and warranty claim.

Supplemental Officer's Certificates

Upon receipt of the claim acknowledgment letter, the servicer is on notice that a reserve fund draw has been referred to ACA. The servicer should send a copy of any Supplemental Officer's Certificates to the ACA. The Trustee is on notice that FDIC ACA has received a representation and warranty claim arising from the MGIC audit of funds drawn from the transaction reserve account. MGIC will forward a copy of any supplemental Officer's Certificates received for any audit claims referred to ACA. ACA will review the information and request supporting documentation as necessary to update the claimed amount.

Processing Claim Approval and Payment

The claim approval letters should be directed to the Trustee as managers of the credit enhancement reserve funds. All payments for valid standard/full audit claims should be made to the trustee with direction that the payment is for replenishment of the transaction reserve account.

WRAPS to STAC Upload

Each month, ACA will provide MBS Administration with a file containing the audit claims approved during a rolling three month period. The file contains the following data elements:

- Master Contract Number
- Master Contract Name
- WRAPS Contract Number and WRAPS Claim Number
- Receivership Number
- CP FIN Number
- Claim Type Code
- Number of Assets Repurchased
- Asset Number
- Approved Date
- Claim Status Code

Claim Reason Code and Claim Reason Description
Claim Sub-reason Code and Claim Sub-reason Description
First portion of the Claim Comments
Control Number
Total Payment Amount
Payment Number
Payment Request Date

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid.

Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Corporation agreed with the recommendation. GMAC disputes the amount of losses. The Corporation will review GMAC's analysis, reconcile the difference, and seek reimbursement.	October 31, 1999	Confirmation from FDIC Division of Finance	\$331,672 disallowed costs	Yes
2	The Corporation agreed with the recommendation. The Corporation will seek reimbursement of \$8,607 in charges to the reserve fund.	August 31, 1999	Confirmation from FDIC Division of Finance	\$8,607 disallowed costs	Yes
3	The Corporation agreed with the recommendation. MBS administration will submit the loans in question to FDIC Asset Claims for review as a representations and warranties claims.	August 31, 1999	Confirmation from FDIC Asset Claims	Not Applicable	Yes
4	The Corporation agreed with the recommendation. MBS and Asset Claims have prepared draft procedures relating to Audit Claim Procedures that will be approved and disseminated to staff.	August 31, 1999	Copies of approved procedures	Not Applicable	Yes