Office of Inspector General

Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks

Board of Governors of the Federal Reserve System

September 2012

OFFICE OF INSPECTOR GENERAL

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CONSUMER FINANCIAL PROTECTION BUREAU

September 28, 2012

MEMORANDUM

TO: Michael Gibson
Director, Division of Banking Supervision and Regulation

Sandra Braunstein
Director, Division of Consumer and Community Affairs

FROM: Andrew Patchan Jr. Andrew Patchan Jr.
Associate Inspector General for Audits and Attestations

SUBJECT: OIG Report: *Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks*

The Office of Inspector General of the Board of Governors of the Federal Reserve System (Board) is pleased to present the results of our *Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks.* The financial crisis of 2008–09 caused instability for large parts of the financial system. One of the results of the financial crisis was borrowers defaulting on their mortgage payments and a record number of residential mortgages entering the foreclosure process. In fall 2010, issues surfaced regarding documentation deficiencies and irregularities in foreclosure processing. In response, the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision initiated an interagency review of foreclosure policies and practices. Personnel from several Board divisions were engaged in this review, including the Division of Consumer and Community Affairs (DCCA) and the Division of Banking Supervision and Regulation (BS&R), which served as the Board's project sponsors and co-leads for the effort.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) established the Financial Stability Oversight Council (FSOC) to monitor potential threats to the financial system and provide for more stringent regulation of nonbank financial companies and financial activities that FSOC determines, based on a consideration of risk-related factors, pose risks to financial stability. Dodd-Frank also designated the Board Chairman as a voting member of FSOC.

Given the public attention on foreclosures, the broad requirements of Dodd-Frank, and the Board Chairman's responsibility as a voting member of FSOC, we conducted an audit to assess the Board's activities in response to potential risks related to mortgage foreclosures. To carry out our objective, we reviewed the Board's efforts on the interagency review that addressed foreclosure processing issues. We also obtained information on a related matter, the Federal Reserve Bank of New York's assessment of the mortgage repurchase risk for selected institutions.

Overall, we found that the Board was able to develop approaches and perform activities to assess the foreclosure processing risks. The Board did, however, experience challenges in executing the interagency foreclosure review. DCCA and BS&R faced challenges with managing the review's resource demands and timeline, which delayed other scheduled supervisory activities. The examiners who participated on the interagency foreclosure review were challenged to quickly develop an understanding of the complex legal issues related to foreclosures and to examine a third-party service provider's foreclosure processing activities, with which examiners lacked prior experience. DCCA and BS&R were challenged with identifying staff with necessary expertise to perform the interagency foreclosure review.

Our report contains two recommendations focused on improving the Board's processes for responding to future risks. We recommend that BS&R and DCCA conduct a lessons-learned exercise to evaluate insights gained from the interagency foreclosure review. We also recommend that BS&R assess whether the current processes and tools used to identify staff with specialized skills and competencies are adequate and define a frequency for the periodic review of skill and competency categories.

We provided a draft of our report to you for review and comment. In your consolidated response, included as appendix 1, you stated that staff have conducted an informal assessment of the interagency foreclosure review initiative, which can be leveraged to satisfy the intent of our first recommendation. In regard to our second recommendation, you stated that you agree that an opportunity exists to assess whether the processes used to identify skills and competencies outside of those needed for basic supervision can be enhanced.

We appreciate the cooperation that we received from your staffs during our review. This report will be added to our public website and will be summarized in our next semiannual report to Congress. Please contact Peter Sheridan, Senior OIG Manager, at 202-973-5009 or me at 202-973-5003 if you would like to discuss the report or any related issues.

cc: William Spaniel, BS&R
Suzanne Killian, DCCA
William Lang, Federal Reserve Bank of Philadelphia
Michael Alix, Federal Reserve Bank of New York

Office of Inspector General

Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks

Board of Governors of the Federal Reserve System

September 2012

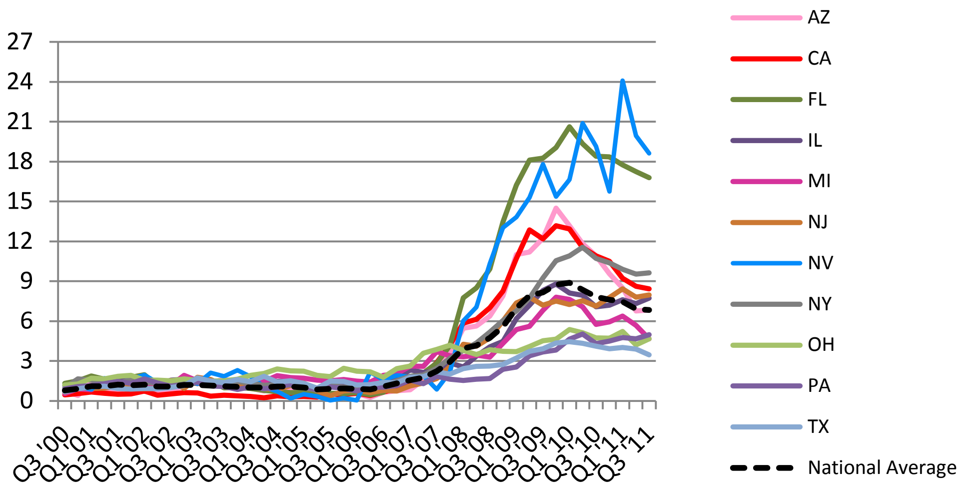
Table of Contents

Background

Foreclosures

The financial crisis of 2008–09 caused instability for large parts of the financial system. One of the results of the financial crisis was borrowers defaulting on their mortgage payments and a record number of residential mortgages entering the foreclosure process.[1] Foreclosures impact institutions, communities, consumers, the housing markets, and the economic recovery. The percentage of U.S. mortgage debt that is more than 90 days late has increased significantly since 2007 (figure 1). According to data supplementing the November 2011 Federal Reserve Bank of New York's *Quarterly Report on Household Debt and Credit*, the national average of mortgage debt that is more than 90 days late hit a peak of approximately 9 percent in the first quarter of 2010. In some states, more than 10 percent of mortgage debt was more than 90 days late in the first quarter of 2010.

Figure 1: Percent of Mortgage Debt More Than 90 Days Late, by State

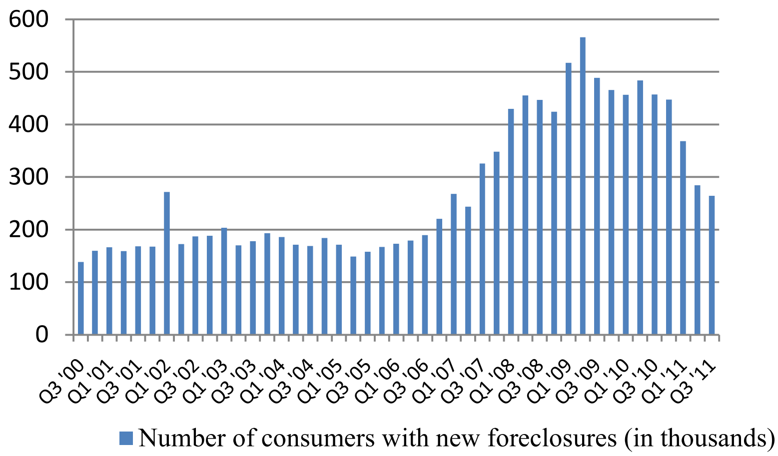


Source: Data supplementing the Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit,* November 2011.

Once a borrower is in default for a specified period, mortgage servicers must assess whether to initiate foreclosure or pursue a foreclosure alternative. Given the record volume of U.S. borrowers in default, mortgage servicers have initiated a large number of foreclosures. A noticeable increase in new foreclosures began in 2007 (figure 2). From the second quarter of 2005 to the second quarter of 2009, new foreclosures increased approximately 281 percent.

1. Foreclosure is a legal proceeding to terminate a borrower's interest in property, instituted by the lender either to gain title or to force a sale in order to satisfy the unpaid debt secured by the property.

Figure 2: Number of U.S. Consumers with New Foreclosures



Source: Data supplementing the Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit,* November 2011.

Mortgage servicers face increased demands when the loans they service are in default. To meet these increased demands, some servicers engage third parties, such as foreclosure attorneys and default-service providers, to assist with the foreclosure process.

In fall 2010, issues surfaced regarding deficiencies and irregularities in foreclosure processing, including foreclosing with inaccurate documentation, assessing inaccurate fees and charges, or foreclosing even when a borrower has been approved for a loan modification. Financial regulators expressed concern that these foreclosure processing issues may have widespread consequences for the housing market and borrowers, such as extended periods of depressed home prices and reduced home-buyer and investor confidence.

To assess the potential impact of the foreclosure processing issues, in the fourth quarter of 2010 the Board of Governors of the Federal Reserve System (Board) began collaborating with the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) to conduct an interagency foreclosure review of 14 mortgage servicers.[2] The purpose of the interagency foreclosure review was to evaluate the adequacy of controls and governance over servicers' foreclosure processes and to assess servicers' authority to foreclose. In April 2011, the Board, the OCC, and the OTS issued a report documenting the results of the review titled *Interagency Review of Foreclosure Policies and Practices*.[3] As a result of the review, in April 2011 the Board issued formal enforcement actions

2. The Dodd-Frank Wall Street Reform and Consumer Protection Act, which was enacted on July 21, 2010, abolished the OTS and transferred its powers and authorities to the Board, the OCC, and the FDIC as of July 21, 2011.

3. This report is available at http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm.

against 10 banking organizations, requiring them to address deficient practices in foreclosure processing.

Mortgage Repurchases

Another consequence of the financial crisis was escalating losses in the value of mortgage-backed securities (MBS) due, in part, to borrowers defaulting on the mortgage loans underlying the securities. Escalating losses in MBS have resulted in multiple parties asserting repurchase claims against the parties that originated the mortgages, sold the mortgages, or had related roles. Repurchase risk refers to obligations by institutions to repurchase mortgage loans under certain circumstances, such as situations in which mortgage loans did not meet required underwriting standards.

Residential mortgages are originated by a wide variety of market participants, such as banks, nonbank financial institutions, thrifts, finance companies, investment banks, and corporate issuers. Originating institutions have several options with respect to mortgage loans, including holding the loan or selling the loan to another party. Institutions may sell mortgage loans as whole loans or may sell mortgage loans to a governmental, quasi-governmental, or private entity for assembly into pools of loans. Institutions may also issue securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool, a process known as securitization. MBS are debt obligations that represent claims to the cash flows from pools of mortgage loans. Most MBS are issued by U.S. government agencies or government-sponsored enterprises.[4] Some private institutions, such as brokerage firms and banks, also securitize mortgages, resulting in what are known as private-label MBS.

Defaults in the mortgages underlying MBS can reduce the value of the MBS; in the event of a mortgage repurchase, losses may be transferred to the original seller or the party responsible for the mortgage securitization. Financial institutions make representations and warranties about the mortgage loans either sold as whole loans or securitized into government-sponsored enterprises and private-label MBS. A breach of these representations or warranties allows the purchaser to require the seller to repurchase the specific loan, often at par value. Mortgage loans may be seriously delinquent or in default at the time of the repurchase and thus be valued substantially below par value; if this is the case, the repurchase transfers the potential loss back to the original seller or the party responsible for the mortgage securitization. The monetary losses associated with these transactions constitute repurchase risk.

According to a 2010 Congressional Oversight Panel report, some of the triggers that may force mortgage repurchases include undisclosed liabilities, income or employment misrepresentation, property value falsification, and escrow fund mishandling.[5] The Congressional Oversight Panel

---

4. The government-sponsored enterprises include the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

5. Congressional Oversight Panel, *November Oversight Report: Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation*, November 16, 2010.

report stated that mortgage loans originated in 2005 through 2008 had the highest repurchase demands thus far.

The Federal Reserve Bank of New York initiated an assessment of the potential mortgage repurchase risk for selected institutions. The purpose of this exercise was to assess the impact of mortgage loan repurchases on earnings and capital adequacy for large banks, to use this information to evaluate Capital Plan Reviews, and to provide feedback to firms regarding the relative scope and thoroughness of their mortgage repurchase analysis. In January 2011, a Federal Reserve Bank of New York official briefed the Financial Stability Oversight Council (FSOC) on the assessment.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was enacted in response to the financial crisis of 2008–09, which affected a wide range of financial institutions, markets, and asset classes and caused instability for large parts of the financial system. Section 111 of Dodd-Frank established FSOC to monitor potential threats to the financial system and provide for more stringent regulation of nonbank financial companies and financial activities that FSOC determines, based on a consideration of risk-related factors, pose risks to financial stability. Section 111 of Dodd-Frank also designated the Board Chairman as a voting member of FSOC.[6]

Objective, Scope, and Methodology

Given the public attention on foreclosures, the broad requirements of Dodd-Frank, and the Board Chairman's responsibility as a voting member of FSOC, we conducted an audit to assess the Board's activities in response to potential risks related to mortgage foreclosures. To achieve this objective, we reviewed the Board's activities from October 2010 to April 2011 to assess foreclosure processing issues at selected federally regulated mortgage servicers as part of the interagency foreclosure review. We also obtained information on a related matter, the Federal Reserve Bank of New York's assessment of the mortgage repurchase risk of selected institutions.

We reviewed supporting documentation addressing the purpose of the interagency foreclosure review, participants involved in the effort, work performed, and results of the review. We interviewed Board personnel from the Division of Consumer and Community Affairs (DCCA), the Division of Banking Supervision and Regulation (BS&R), the Division of Research and Statistics (R&S), and the Legal Division who were involved in evaluating the foreclosure

---

6. FSOC is chaired by the Secretary of the Treasury. FSOC's voting members include the heads of the Board, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the OCC, the FDIC, the Federal Housing Finance Agency, the National Credit Union Administration, the Consumer Financial Protection Bureau, and an independent appointee with insurance expertise. FSOC's nonvoting members include the heads of the Office of Financial Research and the Federal Insurance Office, a state banking supervisor, a state insurance commissioner, and a state securities commissioner.

processing issues or who otherwise supported the review. Our interviewees included project sponsors and managers, economists, and attorneys. We also reviewed the process that the Board used to identify examiners for this effort, as well as training materials that the Board prepared for Federal Reserve System participants on the interagency review. In addition, we reviewed examination and supervisory guidance related to foreclosures.

We reviewed documentation from the Federal Reserve System and third-party sources to obtain additional background on the foreclosure processing and mortgage repurchase risk issues. This documentation included testimony delivered by Board Governors as well as other federal government officials regarding foreclosure processing and mortgage repurchases, a Congressional Research Service report addressing documentation problems in foreclosure processes,[7] a Congressional Oversight Panel report that examined the consequences of mortgage irregularities for financial stability and foreclosure mitigation,[8] and an audit completed by the Government Accountability Office that addressed foreclosure documentation problems.[9]

We reviewed documentation to determine the Board's responsibilities in relation to financial stability and systemic risk monitoring, including Dodd-Frank provisions that relate to systemic risk. We reviewed testimony delivered by Board officials regarding Board efforts to monitor potential risks and support financial stability. We also reviewed documentation regarding FSOC, including its various committees to support the monitoring of systemic risk.

We conducted our fieldwork from February 2011 through August 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the review to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives. This report has two recommendations.

Findings, Conclusions, and Recommendations

Overall, we found that the Board was able to develop approaches and perform activities to assess the foreclosure processing risks. The Board collaborated with the OCC, the FDIC, and the OTS to perform an interagency foreclosure review to assess the extent and potential impact of deficiencies in foreclosure processing. In addition, the Federal Reserve Bank of New York conducted an assessment to quantify the potential mortgage repurchase risk for selected institutions. While the Board was able to develop approaches and perform activities to assess the foreclosure processing issues through its participation in the interagency foreclosure review, it

7. David H. Carpenter, "*Robo-Signing" and Other Alleged Documentation Problems in Judicial and Nonjudicial Foreclosure Processes,* Congressional Research Service, November 15, 2010.

8. Congressional Oversight Panel, *November Oversight Report: Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation*, November 16, 2010.

9. Government Accountability Office, *Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight*, May 2, 2011.

faced challenges in performing this review. First, DCCA and BS&R, which served as the Board's project sponsors and co-leads for the effort, faced challenges with managing the review's resource demands and timeline, which delayed other scheduled supervisory activities. Second, the examiners who participated on the interagency foreclosure review had to quickly develop an understanding of the legal nature of the issues and examine a third-party service provider's operations, with which examiners lacked prior experience. Third, DCCA and BS&R faced challenges identifying staff with specialized skill sets and expertise to perform the interagency foreclosure review.

Recommendation 1: We recommend that BS&R and DCCA conduct a lessons-learned exercise to evaluate insights gained from the interagency foreclosure review.

We believe that the challenges faced by the Board in performing the interagency foreclosure review can be analyzed to identify opportunities to improve future risk monitoring. A lessons-learned exercise allows an organization to evaluate its performance and identify areas for improvement. During our audit, we identified the following challenges that we believe should be considered in such an exercise: (1) managing the resource demands of the interagency review, (2) developing an understanding of the legal aspects inherent in the review, and (3) examining a third-party service provider's foreclosure processing activities.

Managing the Review's Resource Demands

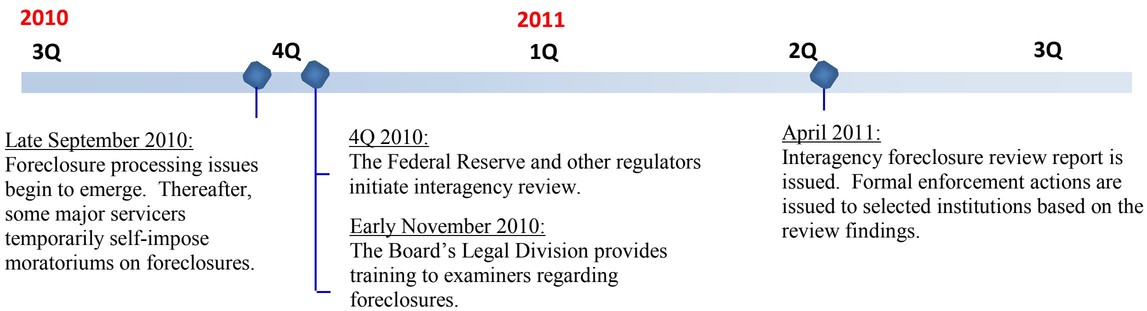
The interagency foreclosure review required the Board to assemble a large team due to the complexity of the foreclosure issues as well as the review's ambitious scope and timeline. While the Board was able to draw upon existing resources to conduct the review, these resource demands delayed other regularly scheduled examination activities.

Foreclosures are a complex area, and the multifaceted nature of the foreclosure processing issues required the Board to assemble a team with varied skill sets to assess different dimensions of the issues. To assess these issues, Board management drew upon both Board and Federal Reserve Bank staff and assembled a project team of over 30 members. Board divisions engaged in these activities included DCCA, BS&R, R&S, and the Legal Division. Staff with specialized skill sets and expertise were involved in assessing various dimensions of the foreclosure processing issues or otherwise supporting the interagency review.

Management from DCCA and BS&R oversaw the review. Economists from R&S assessed potential economic ramifications of the issues, such as potential impacts on the housing market. Attorneys from the Legal Division developed and provided training, provided legal support, and evaluated files from a legal perspective to determine whether there were any deficiencies. Federal Reserve Bank examiners conducted reviews of selected institutions.

The scope of the interagency review included 14 federally regulated mortgage servicers as well as selected third-party service providers. In addition, the Board sent a questionnaire to 10 additional institutions that engage in mortgage servicing. The interagency review also had a tight timeline; it was conducted over a period of approximately five months. Tasks completed within the timeline included planning the review, identifying resources for the review, providing training to Federal Reserve Bank examiners regarding foreclosures, conducting the review, and preparing and issuing a report in conjunction with the other federal agency participants. Figure 3 shows several key milestones.

Figure 3: Interagency Foreclosure Review Timeline



To support the review, Federal Reserve Board and Federal Reserve Bank staff often had to assume responsibilities in addition to their regular duties. Several regularly scheduled examinations were delayed to accommodate the review.

Developing an Understanding of the Legal Nature of the Issues

While Board management was able to identify experienced examiners to participate in the interagency review, some examiners had limited knowledge of the legal aspects inherent in the review. Foreclosures represent a complex area generally governed by state law, which can vary considerably from state to state. In addition, prior supervisory approaches did not target irregularities in foreclosure documentation in conducting examinations of servicers subject to Federal Reserve supervision.

Individual states have distinct foreclosure-related statutes, rules, and court precedents. For example, in jurisdictions known as "judicial foreclosure states," the lender must establish its claim before a judge that a borrower is in default; in nonjudicial states, a foreclosure can proceed upon adequate and timely notice to the borrower, as defined by statute. Our review of documentation indicated that examiners generally assess firms' legal risks as part of their examinations of firms' compliance process. In remarks delivered at the National Consumer Law Center's Consumer Rights Litigation Conference, a Board Governor noted that, as a general matter, the Federal Reserve reviews supervised banking organizations' compliance procedures as part of the examination process. The Board Governor noted, however, that federal examiners typically are not experts in the application of each state's laws, especially in an area as complex as mortgage foreclosure procedures.

Our review of documentation indicated that the Federal Reserve System's examination process relies on a risk-focused framework and that historically, the Federal Reserve System's supervisory approach had not targeted irregularities in foreclosure documentation in conducting examinations of servicers subject to its supervision. To ensure that the examiners assigned to the review understood foreclosure processing issues, the Legal Division provided training and assistance. This training addressed preconditions to foreclosure, types of foreclosure, and documents needed to foreclose, among other topics. In addition, some Legal Division attorneys assisted on examinations. They evaluated files from a legal perspective to determine whether there were any deficiencies. DCCA management indicated that it is developing an updated foreclosure work program to be used in examinations based on insights gained from its efforts as part of the interagency foreclosure review.

Examining a Third-party Service Provider's Foreclosure Processing Activities

During the interagency review, the Board also faced challenges in conducting reviews of a third-party service provider's operations. As a part of the interagency foreclosure review, Federal Reserve personnel examined two businesses within the Lender Processing Services (LPS) company, DOCX and Default Solutions, using the Board's authority under the Bank Service Company Act. LPS is a leading third-party service provider of default management services to the mortgage industry, including services related to foreclosures. Prior to the interagency review, Federal Reserve System examiners had not conducted operations reviews related to these two LPS businesses. Examiners were able to execute the review, but they initially faced challenges in understanding the businesses and in developing a work program for the examination.

Under the Bank Service Company Act, federal banking agencies have authority to examine service providers to which banks have outsourced key services to the same extent as if the services were being performed by the bank itself on its own premises.[10] LPS provides default management services to a number of financial institution clients. These clients include depository institutions regularly examined by, or subsidiaries or affiliates of depository institutions subject to examination by, the Board and other federal banking agencies.

Prior to the interagency review, the Federal Reserve System had examined certain information technology components of LPS as part of the Federal Financial Institutions Examination Council Multi-Regional Data Processing Servicer Program. This program considers an organization for review if it processes "mission-critical applications for a large number of financial institutions that are regulated by more than one agency, thereby posing a high degree of systemic risk."[11]

Our review also determined that examiners had not previously conducted operations reviews related to LPS's default management services, including the policies, procedures, or controls surrounding the production or execution of documents used in the foreclosure process. Thus, examiners lacked knowledge of those policies, procedures, and controls, including compliance with applicable legal requirements, and faced challenges in developing a work program for the examination.

---

10. 12 U.S.C. § 1861-67

11. Federal Financial Institutions Examination Council Multi-Regional Data Processing Servicer Program, http://ithandbook.ffiec.gov/it-booklets/supervision-of-technology-service-providers/multi-regional-data-processing-servicer-program.aspx.

Management's Response

Regarding recommendation 1, the Division Directors stated the following:

> Staff from the Divisions have already conducted an informal assessment of the interagency foreclosure review initiative. We believe we can leverage that work and document our findings to satisfy the intent of this recommendation. In particular, we will review our processes to determine if improvements can be made in risk monitoring that would better position us to address future problems that may occur.

OIG Comment

In our opinion, the actions described by the Division Directors are responsive to our recommendation, and we plan to follow up on their actions to ensure that the recommendation is fully addressed.

Recommendation 2: We recommend that BS&R (a) assess whether the current processes and tools used to identify staff with specialized skills and competencies are adequate and (b) define a frequency for the periodic review of skill and competency categories.

At the onset of the interagency foreclosure review, the Board had to identify examiners with specialized expertise in mortgage servicing. While the Federal Reserve System has an internal system to track examiner skills and competencies, the system was not used to staff the review because it did not provide the level of detail necessary to identify staff with mortgage servicing skills. While the Board was able to bring the right resources to bear for this particular review, challenges in identifying staff with necessary skills could hinder efficiency and effectiveness in responding to future risks.

As part of our audit, we reviewed documentation regarding the systems and processes that are used to maintain skills and competency information for supervision staff at the Board and the Reserve Banks. The documentation indicated that the Federal Reserve System tracks information regarding the skills of supervision staff at the Board and Federal Reserve Banks. Board and Federal Reserve Bank management groups have identified 29 roles and associated skills as well as 78 competencies for which competency definitions are documented. On an annual basis, each Federal Reserve Bank is responsible for assigning roles, skills, and a skills rating for each examiner. We determined that a "mortgage banking" competency exists, but it is broadly defined. While "mortgage servicing operations" is included in the broad definition of "mortgage banking," the competency list does not have a distinct category addressing servicing or servicing operations that can be queried to identify staff with expertise in this area. Accordingly, management was not able to use this system to identify resources for the interagency review.

A BS&R official informed us that Federal Reserve System personnel can request the addition of new competency categories in this system. However, no requests have been received for new categories since the rollout of the process approximately two years ago. We reviewed documentation that indicates the Board will coordinate an effort to review and modify the skills and roles definitions on an annual or as-needed basis.

In light of the system limitations discussed above, the Board relied on a manual process to identify examiners with the necessary expertise to staff the interagency review. In October 2010, the Board held a conference call with Federal Reserve Bank Central Points of Contact and asked them to provide the names of personnel with mortgage servicing expertise, specifically knowledge of mortgage servicing operations and processes. Accordingly, the Central Points of Contact identified staff for the examinations. In addition, various Board divisions provided extra resources to assist where needed. While the Board was able to bring the right resources to bear for the interagency review, challenges in identifying staff with necessary skills could hinder efficiency and effectiveness in responding to future risks.

Management's Response

Regarding recommendation 2, the Division Directors stated the following:

> We agree that there is an opportunity to assess whether the processes used to identify skills and competencies outside of those needed for basic supervision can be enhanced. That assessment will include a determination of whether the existing expectation of annual updates to staffs' skills and roles is appropriate.

OIG Comment

In our opinion, the actions described by the Division Directors are responsive to our recommendation, and we plan to follow up on their actions to ensure that the recommendation is fully addressed.

Appendix

Appendix 1 – Management's Response

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

DIVISION OF CONSUMER AND
COMMUNITY AFFAIRS

September 20, 2012

Mr. Andrew Patchan, Jr.
Associate Inspector General
for Audits and Attestations
Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau
Washington, DC 20551

Dear Mr. Patchan,

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) report on the Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks. As you noted in the report, in spite of the challenges related to the complexity of the subject matter and in identifying staff with the necessary skill sets, the Board successfully assembled and deployed a multi-disciplinary team from several Board Divisions, as well as from the Reserve Banks to address the issues related to deficiencies in mortgage foreclosure processes at the largest mortgage servicers in the country. In addition, the Board collaborated with the OCC, the FDIC and the OTS to simultaneously conduct on-site reviews at fourteen mortgage servicers.

These reviews were undertaken to evaluate the adequacy of controls and governance over servicers' foreclosures processes and to assess the servicers' authority to foreclose. The reviews represent an unprecedented effort among the banking regulators to coordinate supervisory activities using standardized work programs that were designed on a collaborative basis to guide the work of the agencies' examiners. The examiners assigned to each of the servicers met frequently by conference call to share information and ensure consistency. As a result, the agencies were well-positioned at the conclusion of the interagency reviews to determine that coordinated enforcement actions were appropriate and to execute the actions quickly.

The OIG's report contains two recommendations. The first is that BS&R and DCCA conduct a lessons-learned exercise to evaluate insights gained from the interagency foreclosure review. Staff from the Divisions have already conducted an informal assessment of the interagency foreclosure review initiative. We believe we can leverage that work and document our findings to satisfy the intent of this recommendation. In particular, we will review our processes to determine if improvements can be made in risk monitoring that would better position us to address future problems that may occur.

The OIG's second recommendation is for BS&R to (a) assess whether the current processes and tools used to identify staff with specialized skills and competencies are adequate and (b) define a frequency for the periodic review of skill and competency categories. We agree that there is an opportunity to assess whether the processes used to identify skills and competencies outside of those needed for basic supervision can be enhanced. That assessment will include a determination of whether the existing expectation of annual updates to staffs' skills and roles is appropriate.

We would like to thank the OIG team for the professionalism and courtesy that they exhibited throughout the review.

Sincerely,

Michael S. Gibson
Director
Division of Banking Supervision and Regulation

Sandra F. Braunstein
Director
Division of Consumer and Community Affairs