Audit Report

OIG-12-054

SAFETY AND SOUNDNESS: OCC's Supervision of National Bank's Foreclosure Practices

May 31, 2012

Office of Inspector General

DEPARTMENT OF THE TREASURY

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Abbreviations

ARM	adjustable rate mortgage
CFPB	Consumer Financial Protection Bureau
CNBE	Chief National Bank Examiner
FDIC	Federal Deposit Insurance Corporation
FRB	Board of Governors of the Federal Reserve System
GSE	government sponsored enterprise
MERS	Mortgage Electronic Registration Systems, Inc.
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision

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May 31, 2012

Thomas J. Curry
Comptroller of the Currency

This report presents the results of our audit of the Office of the Comptroller of the Currency's (OCC) supervision of foreclosure practices at national banks with large mortgage servicing portfolios during the period 2008 through 2010. Our audit objectives were to determine (1) the sufficiency of existing procedures for supervising loan documentation and foreclosure practices at national banks which own or service mortgage loans and (2) the effectiveness of the application of these procedures.

We included this audit in the *Office of Inspector General Fiscal Year 2011 Annual Plan* in response to reports of "robo-signing" and document manipulation by financial institutions pursuing foreclosure in connection with the wave of mortgage defaults caused by the economic crisis. Also, this is an area of OCC supervision that we had not previously reviewed.

We conducted our field work principally from November 2010 through March 2011. We interviewed OCC management for Large Bank Supervision, as well as examiners in charge and mortgage lead examiners at three large mortgage servicers. We reviewed documentation related to the planning and execution of examination procedures at these banks during the period 2008 through 2010. In addition, we reviewed the report and supporting enforcement actions from the *Interagency Review of Foreclosure Policies and Practices* that was issued jointly by the Board of Governors of the Federal Reserve System (FRB), OCC, and the former Office of Thrift Supervision (OTS), in April 2011.[1,2] Appendix 1 contains a more detailed description of our objectives, scope, and methodology.

Results in Brief

OCC examination procedures during the period 2008 through 2010 were not sufficient in scope or application to identify significant weaknesses in national banks' foreclosure documentation and processing functions. During this time OCC did not consider foreclosure documentation and processing to be an area of significant risk and, as a result, did not focus examination resources on this function. The nature and extent of concerns found by OCC during its inter-agency horizontal review[3] of mortgage foreclosure processes at major mortgage servicers indicate that OCC underestimated the level of risk in the function during the period we reviewed. We noted a number of conditions that, taken together, may have contributed to this underestimation. These conditions are discussed in more detail in the findings and recommendations section of this report. In addition, we noted that the Mortgage Banking Comptroller's Handbook, which, among other things, provides the suggested examination procedures covering foreclosures, had not been updated in 13 years.

We are recommending that OCC (1) continue initiatives to enhance examiner focus on operational risk in its examination planning, (2) determine whether a more specific coding of foreclosure related complaints would enhance OCC's ability to identify potential concerns with servicer performance, (3) update the Mortgage Banking Comptroller's Handbook, and (4) develop policies requiring the periodic review and update of Comptroller's handbooks.

In a written response, which is included as appendix 2, OCC

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[1] Effective July 21, 2011, in accordance with P.L. 111-203, the functions of OTS were transferred to FRB, the Federal Deposit Insurance Corporation (FDIC), and OCC.
[2] OCC's press release and links to the joint report and related enforcement actions are at http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html.
[3] The term horizontal review refers to a bank examination in which the regulator simultaneously performs the same examination procedures across a group of institutions.

agreed to the recommendations. OCC stated that it (1) had undertaken a number of actions to enhance examiner focus on operational risk; (2) had reviewed the coding of foreclosure-related consumer complaints and determined that the current coding was sufficient to identify consumer concerns; (3) planned to update the Mortgage Banking Comptroller's Handbook as part of its broader project to integrate OCC and OTS policies and examination handbooks; and (4) recently issued a policy development manual that addresses the development and updating of OCC handbooks. We consider the actions taken and planned by OCC to be responsive to our recommendations. However, OCC will need to identify and record planned completion dates for taking certain corrective actions in the Joint Audit Management Enterprise System (JAMES), the Department of the Treasury's audit recommendation tracking system.

Background

The OCC's primary mission is to charter, regulate, and supervise all national banks and federal savings associations. It also supervises the federal branches and agencies of foreign banks. OCC's goal in supervising banks and federal savings associations is to ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products.

National banks service mortgages loans held in their own portfolios and those owned by others. Since economies of scale are important to maintaining profitability in mortgage servicing, a majority of the mortgage loan servicing is performed at the largest financial institutions.[4] These large financial institutions are generally national banks supervised under OCC's large bank supervision process. Because of the vast operating scope of large banks, OCC assigns examiners to work on-site at these institutions. This enables OCC to maintain an ongoing program of risk assessment, monitoring, and communication with bank management and directors. The foundation of large bank supervision is a risk assessment framework designed to determine

[4] OCC and OTS Mortgage Metrics Report First Quarter 2011 (Washington, DC, June 2011). Data collected from eight national banks and one thrift with the largest mortgage servicing portfolios represents 63 percent of all first-lien residential mortgages outstanding in the country.

if banks are effectively assessing risks throughout their entire enterprise. These high level risk assessments drive the OCC supervisory strategies for the institution. Supervisory strategies are plans which detail OCC examination activities, e.g., targeted reviews or ongoing monitoring, to be undertaken at the institution during the examination year. These strategies are designed to address the bank's specific risk profile, including areas of potential or actual risk, emerging risks, and regulatory mandated examination areas.

Typically, the mortgage servicer manages a pool of loans for the loans' investor. These investors may include other financial institutions, securitization trustees,[5] or government sponsored enterprises (GSE).[6] The mortgage servicer processes transactions such as borrower payments and escrow disbursements. The servicer also remits the principal and interest collected to the investor, net of a servicing fee. When borrowers are delinquent in making their payments, servicers perform a range of default management services intended to resolve the delinquency and avoid foreclosure. However, if these actions are unsuccessful, the servicer will initiate foreclosure proceedings on behalf of the investor.

The relationship between the servicer and the investor is defined by contract and the relationship with the borrower during the foreclosure process is governed primarily by state law. Other than a requirement that national banks maintain loan administration procedures covering the foreclosure process,[7] there are no federal laws or regulations covering foreclosure documentation and processing.

During the economic crisis, the performance of mortgage loans deteriorated significantly leading to increasing rates of foreclosure during the period 2008 through 2010. In the fall of 2010, reports of widespread irregularities and potential violations of law in the

[5] A securitization trustee is a third party retained to administer a trust that holds underlying assets supporting an asset-backed security.
[6] GSEs are financial services corporations created by the U.S. Government to enhance the flow of credit to certain sectors of the economy, including education, agriculture and home finance. Examples of GSEs are the Federal National Mortgage Corporation (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Government National Mortgage Association (Ginnie Mae).
[7] 12 CFR 34.62, Real Estate Lending Standards

documentation and processing of foreclosures prompted Congress to hold hearings[8] on the matter. At these hearings, the Acting Comptroller of the Currency testified that OCC was aware of the increases in foreclosure rates and that, in response, OCC examination resources had been focused on ensuring that the loss mitigation and modification processes designed to prevent foreclosure were operating effectively. He further stated that internal audit, quality control, and consumer complaints had not indicated that foreclosure documentation and processing were areas of concern.

In response to these reports, OCC directed large national banks to review their foreclosure processes. Working with the former OTS, FRB, and FDIC, OCC initiated a horizontal review of foreclosure practices at 14 major mortgage servicers. At the 8 national banks included in the horizontal review, OCC consistently found deficiencies and weaknesses in the banks' foreclosure processes. These included weak management oversight, foreclosure document deficiencies, poor oversight of third-party foreclosure service providers, and inadequate risk control systems. As part of the horizontal review, OCC also examined Mortgage Electronic Registration Systems, Inc. (MERS) and found concerns with corporate governance and control over information systems.[9] On April 13, 2011, FRB, OCC, and the former OTS issued a joint report on the results of the interagency horizontal review along with formal enforcement actions entered into with the mortgage servicers and third-party mortgage service providers subject to review.

The regulatory environment surrounding mortgage servicing continues to evolve. Developing national mortgage servicing standards has been suggested and certain state attorneys general are working toward a comprehensive settlement with some banks

[8] U.S. Senate Committee on Banking, Housing, and Urban Affairs: Problems in Mortgage Servicing from Modification to Foreclosure, Part I, Nov. 16, 2010, and Part II, Dec. 10, 2010. U.S. House of Representatives Committee on Financial Services: Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing, Nov. 18, 2010.

[9] MERS is a private company created by the mortgage banking industry to streamline the mortgage process. MERS acts as the nominal mortgagee in the county land records for the lender and servicer and tracks transfers of the mortgage in its proprietary information system with the goal of eliminating the need for assignment upon transfer of servicing. The practice of MERS acting in the capacity of mortgagee has been widely accepted within the mortgage industry.

that, among other goals, would define standards of servicer behavior. In addition, the Consumer Financial Protection Bureau (CFPB), which commenced operations in July 2011, will play a major, but not yet fully defined, role in supervising mortgage lending and servicing at banks with greater than $10 billion in total assets.[10]

Findings and Recommendations

Finding 1 OCC Underestimated the Level of Risk in Foreclosure Documentation and Processing

According to OCC's Comptroller's Handbook for Large Bank Supervision, examiners should undertake a careful and thoughtful assessment of a bank's current and anticipated risks when developing the supervisory strategy for a bank. OCC was aware of increases in foreclosure rates and did identify increasing mortgage delinquency and foreclosure rates as risk factors in the supervisory strategies that we reviewed during our audit. However, this did not prompt OCC to identify foreclosure documentation and processing by national banks as an area of significant risk during the 2008, 2009, or 2010 examination cycles. As a result, OCC did not focus examination procedures on this function nor did they ensure whether the banks' internal audit and quality assurance functions provided sufficient coverage of the function. Instead, OCC examination resources were focused on loss mitigation and modification processes designed to prevent foreclosure. These findings, along with the nature and extent of concerns found by the interagency horizontal review, lead us to conclude that OCC underestimated the risk related to foreclosure documentation and processing.

We noted several factors which may have contributed to this underestimation. Notwithstanding these factors, we believe OCC

[10] CFPB was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) as an independent bureau within FRB with a goal of empowering consumers with the information needed to make appropriate financial decisions. Under Dodd-Frank, CFPB will have the authority to set and enforce consumer protection rules related to mortgages, credit cards, and other consumer financial products and services.

could have been better equipped to identify the key risks in a bank's foreclosure documentation and processing function.

- Foreclosure is primarily governed by individual state law and the portfolios of large mortgage servicers generally contain loans from many states. Accordingly, the risks associated with foreclosure documentation and processing is significantly increased overall because of the inherent complexity introduced by each state's own set of laws and regulations. Since the expertise of most OCC examiners lies primarily in issues of safety and soundness and compliance with federal laws and regulations rather than state laws and regulations, the degree of risk associated with foreclosure documentation and processing was not fully appreciated by the examiners.

- As will be discussed further in finding 2 below, *The Comptroller's Handbook for Mortgage Banking* had not been updated since 1998. As a result, examiners could not use or rely on this source for adequate guidance on key risks related to foreclosure.

- OCC's large bank supervision process did not require examiners to document their assessment of risk at a functional process level when developing supervisory strategies. As a result, we could not determine whether the consideration of the impact of risk factors identified in the supervisory strategies (e.g., increasing mortgage delinquency and foreclosure rates) on foreclosure documentation and processing was sufficient.

OCC management told us that they believed the underestimation of risk in this area to be more an error in judgment than of documentation. We were also told that while the core risk assessment process for large banks was conducted by examiners with a deep knowledge of the institutions they examine, OCC, nevertheless, identified a need for enhanced examiner focus on operational risk when preparing these assessments. To address the need for enhanced focus on operational risk, we were told that OCC is currently pursuing a number of initiatives including issuing additional examiner guidance. OCC also recently added a position for an operational risk subject matter expert to support examiners in the field. That said, OCC officials opined that the current level of detail in documenting risk assessments is sufficient given the immense size and operational diversity of large financial institutions. To prepare a risk assessment at the individual functional process level, in their view, would require an impractical level of documentation and still be subject to errors in judgment.

In addition, we found other factors that may have contributed to OCC's failure to adjust its examination procedures with regard to what turned out to be serious foreclosure issues. As mentioned previously, the Acting Comptroller of the Currency testified before the Senate Committee on Banking, Housing, and Urban Affairs that neither banks' internal quality control tests and internal audits nor data from OCC's consumer call center suggested that foreclosure document processing was an area of concern. In this regard

- OCC examiners told us that they relied on this absence of foreclosure documentation and processing issues noted by the banks' internal audit and quality assurance functions. We believe this reliance was misplaced. Bank internal audit plans, internal audit reports, and quality assurance test documentation included in OCC examination workpapers and reviewed during our audit showed that these internal risk monitoring functions did not focus on foreclosure documentation and processing. Instead the banks' internal risk monitoring work was primarily concentrated on loss mitigation/modification processes and compliance with investor guidelines.

- Consumer complaints received by OCC's Customer Assistance Group (CAG)[11] are coded at five levels driven by product type and the relationship of the complaint to federal regulation. Foreclosure concerns are generally tied to violations of state laws and regulations, which are not contemplated by CAG's base coding structure. In 2008, in

[11] OCC's Customer Assistance Group (CAG) maintains a call center and website to help customers resolve issues with national banks and their operating subsidiaries. This group answers questions and provides informal guidance related to applicable banking laws and regulations, and general banking practices. CAG also provides an avenue to offer informal consumer education on banking and the use of credit

response to rising delinquencies and foreclosures, CAG added an early warning code to track mortgage-related complaints where the complainant mentioned foreclosure as an issue or a potential concern. However, the coding of these issues and resulting summary reporting did not categorize the specific nature of the concern with the foreclosure, such as whether the concern related to foreclosure documentation and processing. CAG reporting using this early warning code showed that foreclosure related complaints were 8.3 percent (5,976 complaints) and 11.2 percent (8,691 complaints) of the total complaints received by OCC in 2009 and 2010, respectively.

Finding 2 The Mortgage Banking Comptroller's Handbook Was Outdated

As stated in the Government Accountability Office's *Standards for Internal Control in the Federal Government*, effective internal control helps in managing change to cope with shifting environments and evolving demands and priorities.[12] Accordingly, a process should be in place to periodically assess the completeness and relevance of examiner guidance.

OCC's *The Mortgage Banking Comptroller's Handbook* provides examiners background narratives on the mortgage process as well as suggested examination procedures. However, we found that it had not been updated since the late 1990's (narratives were last updated in March 1996; procedures were last updated in March 1998). As a related observation, we noted that OCC does not have a documented policy requiring the periodic review and update of Comptroller's Handbooks.

Mortgage banking has changed significantly since the last handbook update with a greater emphasis on asset securitization and the proliferation of new mortgage products such as option ARMs and subprime mortgages, not to mention the more current increases in delinquency and foreclosure rates. The general mortgage banking principles and suggested examination procedures presented in the handbook remain valid but because they have not

[12] GAO/AIMD-00-21.3.1, Nov. 1999

been updated to include more recent considerations, they are not complete. For example, the handbook does not address issues such as the impact of asset securitization on loan documentation and foreclosure, use of electronic mortgage registration vendors such as MERS, or the heavy reliance of third party attorneys to ensure compliance with state foreclosure laws and regulations.

According to OCC officials, examiners use the Comptroller's Handbooks as a starting point in developing examination procedures and experience and professional judgment are also drawn upon in developing a final examination program. OCC has also issued supplemental mortgage banking guidance to examiners in the past 13 years (e.g., Bulletin OCC 2007-26, Subprime Mortgage Lending: Statement on Subprime Lending). However, we believe that the lack of updates to this kind of basic examination guidance increases the risk of ineffective supervision. Accordingly, to facilitate more effective supervision, we believe that OCC needs a mechanism in place to ensure that basic internal control structures such as Comptroller's Handbooks are updated regularly, and particularly when conditions change within the banking industry.

Recommendations

We recommend that the Comptroller of the Currency do the following:

1. Continue efforts to enhance examiner focus on operational risk when conducting risk assessments and preparing supervisory strategies. Also, when relying on internal bank documents such as internal audit plans and reports to assess risk, examiners should ensure that the scope of the internal review work covers the operational risks being assessed.

   Management Response

   Consistent with the recommendation, OCC has undertaken a number of actions to enhance examiner focus on operational risk, especially with respect to larger institutions. These actions included issuing guidance in September 2011 directing examiners to better leverage OCC's Risk Assessment System as a tool to identify, communicate, and accomplish appropriate responses to the buildup of risks or deficiencies in risk management systems. At year end 2011, risk assessments for institutions in OCC's Large Bank program reflected operational risk as the top ranked risk.

Within the Large Bank program, the Operations Risk Strategy Guidance for fiscal years 2012 and 2013 directed examiners to integrate their assessments of operational risk emanating from system, processes, talent, and external event-related issues across all function areas of the bank. Specifically related to mortgage banking, OCC's Large Bank Mortgage Banking Strategy Guidance places top priority on the evaluation of actions undertaken to address the foreclosure consent orders at applicable institutions. Examiners will also evaluate the foreclosure processing self-assessments and necessary corrective actions required at other companies with mortgage servicing activity. The strategy guidance also calls for examiners to re-assess how institutions have strengthened their internal risk management functions and processes in the mortgage servicing area.

OCC continues to discuss operational risk work, approaches, issues, and trends internally as well as externally with FRB, FDIC, and international regulatory colleagues. Additionally, all examiners were informed that operational risk is a primary concern requiring continued examiner attention particularly in operations with high transaction volume or high growth.

<u>OIG Comment</u>

OCC's actions, taken and ongoing, are responsive to our recommendation. OCC will need to record a planned completion date for all corrective actions in JAMES as appropriate.

2. Determine whether a more specific coding of foreclosure related complaints would enhance OCC's ability to identify potential concerns with servicer performance.

Management Response

OCC reviewed the coding of foreclosure-related consumer complaints and determined that the current coding was sufficient to identify consumer concerns. OCC commented that most complaints are not so specific as to identify documentation, process, or breach of state law as the basis for complaint, but if a consumer did complain on that basis, the system has the ability to capture those issues in the record. OCC also commented that complaint data alone would be unlikely to identify something so specific and invisible to the customer as documentation or process issues and absent such granularity in the complaints, additional coding would not improve its understanding of servicer performance.

OIG Comment

We accept OCC's determination that the current coding of foreclosure-related consumer complaints is sufficient to identify consumer concerns, and we consider this recommendation closed. That said, we believe OCC should periodically review the coding of complaints to ensure OCC's ability to identify potential concerns.

3. Update the Mortgage Banking Comptroller's Handbook to provide a more complete coverage of key processes and risks in the mortgage banking environment.

   Management Response

   OCC commented that it planned to complete this action as part of its broader project to integrate the OCC and OTS policies and examination handbooks. OCC's goal for completing an updated, merged Mortgage Banking Handbook is early 2013. In its response, OCC also identified a number of related guidance and examination procedure issuances that it has made apart from an update to the Mortgage Banking Handbook.

   OIG Comment

   OCC's proposed action is responsive to the recommendation. OCC will need to record its planned completion date in JAMES.

4. Develop a policy for the periodic review and, as needed, update of the Comptroller's Handbooks.

   Management Response

   OCC's Chief National Bank Examiner's (CNBE) office recently issued a policy development manual that addresses the development and updating of OCC handbooks. The manual directs CNBE staff as they develop new policies and regulations to determine whether examination handbooks and procedures need to be updated. CNBE managers will be instructed to identify and prioritize handbooks that may need substantial revisions and that will require substantial time and resources.

   OIG Comment

   OCC's corrective action, if implemented as described, is responsive to the recommendation.

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We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-0384 or James Lisle, Audit Manager, at (202) 927-6345. Major contributors to this report are listed in appendix 3.

Jeffrey Dye /s/
Director of Banking Audits

The objectives of this audit were to determine:

- The sufficiency of existing Office of the Comptroller of the Currency (OCC) procedures for supervising loan documentation and foreclosure practices at national banks, which own or service mortgage loans; and,

- The effectiveness of the application of these procedures.

To achieve the audit objectives, we evaluated the extent of supervisory coverage of the foreclosure documentation and processing function and selected a sample of three banks with large servicing portfolios. These banks were Bank of America, National Association; J.P. Morgan Chase, National Association; and Wells Fargo, National Association. In connection with our audit, we performed the following.

- Reviewed the OCC's Mortgage Banking Comptroller's Handbook, related bulletins, regulations and guidance.

- Interviewed OCC management responsible for the supervision of national banks with large mortgage servicing portfolios.

- Interviewed OCC examiners in charge and mortgage lead examiners at the banks in our sample.

- Interviewed the OCC Ombudsman and reviewed complaint reporting generated by OCC's Customer Assistance Group.

- Reviewed OCC supervisory strategies covering the mortgage banking function at the banks in our sample for the period 2008 through 2010.

- Reviewed OCC supervisory letters to determine the scope of targeted reviews touching upon the default administration or foreclosure function during the audit period.

- Reviewed OCC examination documentation related to the banks' internal risk monitoring functions' (i.e., internal audit, quality assurance) coverage of foreclosure and, as necessary, OCC monitoring of these functions.

- Reviewed OCC supervisory letters documenting the results of procedures performed during the inter-agency horizontal review of mortgage foreclosure at major mortgage servicers.

We performed our audit field work from November 2010 through March 2011 and certain follow-up procedures in November 2011.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Jeffrey Dye, Director of Banking Audits

From: Thomas J. Curry, Comptroller of the Currency

Date: May 15, 2012

Subject: Comments on Draft Report: OCC's Supervision of National Banks' Foreclosure Practices

You conducted an audit of the OCC's supervision of foreclosure practices at national banks with large mortgage servicing portfolios for the period beginning in 2008 and concluding with the 2010 horizontal examination. Your objectives were to determine the sufficiency of existing procedures for supervising loan documentation and foreclosure practices at national banks that own or service mortgage loans and to determine the effectiveness of the application of these procedures. I appreciate this opportunity to offer thoughts on your findings and recommendations.

Finding 1: OCC Underestimated the Level of Risk in Foreclosure Documentation and Processing.

Recommendations:

1) Continue efforts to enhance examiner focus on operational risk when conducting risk assessments and preparing supervisory strategies. Also, when relying on internal bank documents such as internal audit plans and reports to assess risk, examiners should ensure that the scope of the internal review work covers the operational risks being assessed.

2) Determine whether a more specific coding of foreclosure related complaints would enhance OCC's ability to identify potential concerns with servicer performance.

OCC Discussion and Actions:
We agree with your recommendations. As we have publicly testified, a variety of factors contributed to a focus by the OCC on aspects of mortgage servicing that were viewed as presenting higher risk than foreclosure documentation and processing.

Consistent with your first recommendation, the OCC has undertaken a number of actions to enhance examiner focus on operational risk, especially with respect to larger institutions that are supervised in the OCC's Large Bank Program (Large Banks). The OCC's Risk Assessment System is one tool we use to identify and communicate concerns about the quality and quantity of a bank's risk activities. In September 2011, we issued guidance to all OCC examiners to better leverage that system as a tool to identify, communicate, and effect appropriate responses to the buildup of risks or deficiencies in risk management systems. At year end 2011, our risk assessments for institutions in our Large Bank program reflected operational risk as the top ranked risk among the OCC's eight categories.

Within our Large Bank program, our Operational Risk Strategy Guidance for fiscal years 2012 and 2013 have directed examiners in Large Banks to continue to integrate their assessments of operational risk emanating from systems, processes, talent, and external event-related issues across all functional areas of the bank. Examiners in each functional area are expected to evaluate risk governance, risk and performance metrics, risk profiles, self-assessments of internal controls, audit assessments, analyses of how capital calculations impact business lines, and other available MIS.

Specifically related to mortgage banking, our Large Bank Mortgage Banking Strategy Guidance places top priority on the evaluation of actions undertaken to address the foreclosure consent orders at applicable institutions. This will include loan-level testing and validation during the latter part of calendar year 2012 and into 2013. Examiners will also evaluate the foreclosure processing self-assessments and necessary corrective actions required at other companies with mortgage servicing activity. The focus of these activities will be on the effectiveness of bank management's corrective actions related to operational breakdowns including sufficiency of staffing levels and expertise, comprehensive policies and operating procedures, effective use and upgrading of processing technology, and development and implementation of comprehensive MIS. The strategy guidance also calls for examiners to re-assess how institutions in our Large Bank program have strengthened their internal risk management functions and processes in the mortgage servicing area, including the comprehensiveness and frequency of review, the extent of validation testing, and the quality and sufficiency of control function staffing.

In addition to our strategy guidance, we continue to discuss operational risk work, approaches, issues, and trends internally within our Large Bank Operational Risk and Mortgage Banking Network Groups as well as externally with the Federal Reserve, FDIC, and international regulatory colleagues. Our National Risk Committee has also sent a message to all OCC examiners noting that operational risk is a primary concern requiring continued examiner attention particularly in operations with high transaction volume or high growth.

Regarding your second recommendation, we have reviewed the coding of foreclosure-related consumer complaints and have determined that current coding is sufficient to identify consumer concerns. The OCC's consumer complaint process is designed to inform and assist consumers in resolving their questions, concerns, and complaints regarding financial matters and the institutions that the OCC supervises, and the coding of complaints keys off the issues they identify. At the time of your review, the Customer Assistance Group (CAG) complaint process and its coding was current and valid based on the complaints received. Most complaints are not so specific as to identify documentation, process, or breach of state law as the basis for complaint, but if a consumer did complain on that basis, the system has the ability to capture those issues in the record.

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The OCC's complaint system includes the entire consumer complaint as submitted by the borrower, the bank's response to date, and many other important pieces of information. It is an effective resource for our supervisors, but it is an adjunct to and not a proxy for the examination process. Complaint data alone would be unlikely to identify something so specific and invisible to the customer as documentation or process issues and absent such granularity in the complaints, additional coding would not improve our understanding of servicer performance.

Finding 2: The OCC's Mortgage Banking Comptroller's Handbook was last updated in 1998 and thus lessened its effectiveness for examiners and increased the risk of ineffective supervision.

Recommendations:

1) Update the Mortgage Banking Comptroller's Handbook to provide a more complete coverage of key processes and risks in the mortgage banking environment.

2) Develop a policy for the periodic review and, as needed, update of the Comptroller's Handbook.

OCC Discussion and Actions:
We agree that the OCC's Mortgage Banking Handbook needs to be updated to reflect changes in mortgage banking, and we plan to complete this action as part of our broader project to integrate the OCC and OTS policies and examination handbooks. However, as your report notes, the OCC has issued guidance to bankers and examiners that supplements the general guidance in the Mortgage Banking Handbook. These include interagency guidance on nontraditional mortgages and subprime mortgages (OCC Bulletins 2006-41 and 2007-26, respectively) and the 2007 interagency statement on working with mortgage borrowers. We also issued guidance on Third Party Vendor Management (OCC Bulletin 2001-47). We would also note that the OTS's One- to Four-Family Residential Real Estate examination handbook was updated in 2011 and is available to all OCC examiners for reference. The updated material contained in the OTS handbook on topics such as option ARM and subprime mortgages will be included in our revised, combined handbook.

More recently, we have issued guidance and examination procedures that directly address some of the issues that examiners identified during our foreclosure review. In May 2011, we issued revised examination procedures for the Protecting Tenants at Foreclosure Act (OCC Bulletin 2011-15) and Servicemembers Civil Relief Act (OCC Bulletin 2011-16) to incorporate various statutory changes. We also issued guidance to bankers and examiners on foreclosure management (OCC Bulletin 2011-29) and potential issues with foreclosed residential properties (OCC Bulletin 2011-49). We will incorporate examination procedures to assess compliance with these two foreclosure bulletins when we update our Mortgage Banking Handbook. Our goal is to have an updated, merged Mortgage Banking Handbook completed by early next year.

As we discussed during your audit, there are a number of initiatives under way that could significantly affect the rules and requirements for mortgage banking. These include ongoing discussions about the development of national standards for mortgage servicers, as well as

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various requirements mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, including those related to risk retention and qualified mortgages. These changes, once completed, would be addressed in guidance to bankers and examiners and then in a subsequent handbook revision.

With respect to your second recommendation, the Chief National Bank Examiner's (CNBE) office recently issued a CNBE policy development manual that addresses the development and updating of OCC handbooks. The manual directs CNBE staff as they develop new policies and regulations to determine whether examination handbooks and procedures need to be updated. As part of each CNBE manager's annual business plan, CNBE managers will be instructed to identify and prioritize handbooks that may need substantial revisions and that will require substantial time and resources.

Thank you for the opportunity to review and comment on the draft report. If you need additional information, please contact Morris Morgan, Deputy Comptroller for Large Bank Supervision at 202-874-4610.

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