

## APPENDIX 8.0 - FHA DEFECT TAXONOMY (01/15/2025)

### I. PURPOSE

The Defect Taxonomy is FHA's quality assurance framework for [Title II Loan Reviews](#) (V.C.3.b). The Defect Taxonomy provides:

- a consistent method of identifying defects at the loan level;
- useful data and feedback through structured categorization of defects and their sources, causes, and severities; and
- balance between FHA's risk management and quality assurance business processes.

The Defect Taxonomy **does not**:

- establish a universal statement on all monitoring or enforcement efforts by FHA;
- address FHA's response to patterns of loan-level defects, regardless of severity;
- limit FHA's actions with regard to fraud or misrepresentation;
- establish standards for administrative or civil enforcement action, which are currently set forth in law;
- preclude FHA from referring Findings of any severity to HUD's Mortgagee Review Board, Departmental Enforcement Center, Office of Fair Housing and Equal Opportunity, or other HUD offices for violations of HUD requirements;
- affect or override FHA's normal process for referral of fraud, waste, or abuse to the Office of Inspector General.

FHA uses the Defect Taxonomy for loan reviews conducted by the Office of Single Family Housing's Quality Assurance and Processing and Underwriting Divisions located in Headquarters and the Homeownership Centers. Mortgagees may use the Defect Taxonomy as a reference for their own loan-level Quality Control reviews.

The Defect Taxonomy is not used for any type of audit or review separately conducted by HUD's National Servicing Center, Office of Finance and Budget, or Ginnie Mae.

### II. CORE CONCEPTS

A defect is any deviation from HUD policy requirements, regardless of severity.

In the context of Title II Loan Reviews, a Finding refers to a determination by FHA of a defect.

An individual Finding is classified in the Loan Review System (LRS) by its specific defect area, source, and cause.

#### A. Defect Areas

Defect areas represent the fundamental loan characteristics for each review type based on corresponding HUD policy requirements. Applicable policies are listed in each defect area for reference only. They may not be all-inclusive.

- [Underwriting Loan Reviews](#) are categorized into nine defect areas covering loan origination, underwriting, closing, and endorsement for FHA insurance.
- [Servicing Loan Reviews](#) are categorized into six defect areas covering servicing and loss mitigation activities throughout the potential lifecycle of an FHA-insured loan.

## B. Sources and Causes

Sources and causes are used to describe Findings in greater detail based on the underlying HUD policy violation.

## C. Severity Tiers

There are four potential severity tiers, one of which is assigned to each Finding in LRS based on the size and nature of the deviation from FHA requirements. Severity tiers indicate whether a Mortgagee response is required in LRS.

**Tier 1 and 2** Findings are unacceptable and require a Mortgagee response. Potential remedies are listed in each defect area. Severity tiers 1 and 2 align with the definition of [Material Finding](#) (V.A.2.d.i(B)) for Mortgagee Quality Control.

**Tier 1** is used for Findings of fraudulent or materially misrepresented information about which the Mortgagee knew or should have known. See [Fraud or Material Misrepresentation](#) for more details.

**Tier 2** is used for:

- underwriting Findings that would have altered the loan's approval and/or eligibility for FHA insurance;
- servicing Findings that require mitigating documentation, corrective servicing action, and/or financial remediation; and
- instances when required documents are missing or contain insufficient information to determine compliance.

**Tier 3 and 4** Findings are deficient and do not require a Mortgagee response, but optional responses can be submitted.

**Tier 3** is used for:

- underwriting Findings that do not adversely impact the loan's approval and/or eligibility for FHA insurance;
- servicing Findings that do not adversely impact FHA or that are based on loan-level reporting errors that cannot be corrected;
- Findings of noncompliance remedied by the Mortgagee prior to review by FHA; and
- Findings that represent deviations from HUD policy, but which are the consequence of an obligation to comply with other binding federal or state law.

**Tier 4** is primarily used for Findings of fraudulent or materially misrepresented information about which the Mortgagee did not know and could not have known. Tier 4 is also used for underwriting Findings when minor data integrity issues exist that are inconsequential to the loan's approval and eligibility.

Mortgagees may rebut any Finding or severity determination by responding in LRS with supporting information. Rebuttals are based on information available to FHA prior to the initial Finding.

### III. REMEDIES

In addition to referring a Mortgagee to the Mortgagee Review Board, FHA has the authority to pursue loan-level actions and remedies reasonably related to a Mortgagee's underlying violations. Pursuit of such loan-level actions and remedies does not limit FHA's ability to refer a Mortgagee to the MRB or prevent the MRB from initiating its own action where appropriate.

The purpose of remedies is to mitigate risk to FHA and, if applicable, put Borrowers and/or other affected parties in the position they would have been in absent the violation. In some cases, multiple remedies may be used to address the full impact of an individual Finding.

Remedies are described below for unacceptable Findings in LRS. In each defect area, possible remedies for common policy violations are listed in order based on the degree of impact.

#### A. Mitigation

Findings may be mitigated in LRS with the Mortgagee's submission of one of the following as requested by FHA:

- additional documentation and/or information that was not included in the original loan file reviewed by FHA, which demonstrates the Mortgagee's compliance with HUD policy requirements; or
- evidence of corrective actions completed by the Mortgagee which, in FHA's determination, adequately addresses the source and cause of the Finding so that the loan no longer presents an unacceptable risk to FHA.

#### B. Financial Remediation

Consistent with FHA rules and requirements, Mortgagees may financially remediate certain loan-level Findings by submitting documentation showing completion of the requested action in the amount specified by FHA. Financial remediation may include:

- **refunds** to reimburse unallowable, prohibited or erroneous fees, penalties, or other charges to the Borrower;
- **principal reductions** applied to the unpaid principal balance of the loan. For delinquent/defaulted loans, funds may be applied to the Borrower's suspense account;
- **account adjustments** to the Borrower's loan, escrow, or suspense account in the amount necessary for the Servicer to bring the account in compliance with HUD policy and/or demonstrate corrective action; and
- **remittance** of improperly paid servicing claims and/or loss mitigation incentives to HUD.

### C. Indemnification

When other remedies are not applicable, or when alternatives have been exhausted, Mortgagees may resolve loan-level Findings in LRS by indemnifying HUD against the risk of financial losses.

As specified in each indemnification agreement, the Mortgagee agrees to abstain from submitting an insurance claim to FHA in connection with the loan, or to reimburse FHA for any loss due to claims paid by FHA.

The term of an underwriting indemnification agreement is either 5-Year (from the loan endorsement date shown in FHA Connection) or Life-of-Loan. The term of a servicing indemnification is either 1-Year or 5-Year (from the date the agreement is signed by both the Servicer and FHA) or Life-of-Loan. Expiration of a 1-Year or 5-Year indemnification is subject to conditions detailed in the agreement.

Some general factors used by FHA to determine the term of an indemnification include:

Term	General Factors
1-Year	<p><u>Servicing Only</u></p> <ul style="list-style-type: none"> <li>loan is <b>current</b> at the time of FHA’s review and the Servicer provides documentation of a good faith effort to mitigate the Finding but is unsuccessful due to circumstances beyond the Servicer’s control.</li> </ul>
5-Year	<p><u>Underwriting</u></p> <ul style="list-style-type: none"> <li>violations related to the Borrower’s credit or income, which impact the Borrower’s creditworthiness or capacity to repay the loan; or</li> <li>noncompliance with FHA requirements for verifying and documenting sufficient funds from an acceptable source to facilitate closing, or for determining the assets used to qualify.</li> </ul> <p><u>Servicing</u></p> <ul style="list-style-type: none"> <li>loan is <b>not current</b> at the time of FHA’s review and the Servicer provides documentation of a good faith effort to mitigate the Finding, but is unsuccessful due to circumstances beyond the Servicer’s control; or</li> <li>improperly completed mortgage assumption for a Borrower who was not credit qualified.</li> </ul>
Life-of-Loan	<p>All Tier 1 Findings of fraud or materially misrepresented information.</p> <p><u>Underwriting</u></p> <ul style="list-style-type: none"> <li>violations related to property eligibility or valuation;</li> <li>certain violations of FHA requirements for basic Borrower eligibility; or</li> <li>HECM policy violations.</li> </ul> <p><u>Servicing</u></p> <ul style="list-style-type: none"> <li>loan is in conveyance or claim status and FHA determines that foreclosure or other Home Disposition Options should not have been completed; or</li> <li>certain violations of FHA’s eligibility standards and requirements described in specific defect areas, regardless of the current status of the loan.</li> </ul>

#### IV. FRAUD OR MATERIAL MISREPRESENTATION

All Findings of fraud or materially misrepresented information are referred to the Office of Inspector General, regardless of LRS severity tier or remedy provided by the Mortgagee.

- A. Findings of fraud or materially misrepresented information can fall into one of two severity tiers:
  - **Tier 1:** the Mortgagee knew or should have known.
  - **Tier 4:** the Mortgagee did not know and could not have known.
- B. FHA determines if the Mortgagee knew or should have known based on whether:
  - an employee of the Mortgagee, sponsored Third-Party Originator, or subservicer was involved; and/or
  - red flags in the loan file should have been questioned by the Mortgagee.
- C. FHA's loan review determinations regarding Findings of fraud or misrepresentation do not affect or override any separate determinations of the Office of Inspector General through any audit or investigative process.

## V. UNDERWRITING LOAN REVIEW

[Placeholder for Underwriting Defect Areas 1-9 – existing content of section “V. Underwriting Loan Review”]

All pages that follow represent proposed additions to Handbook 4000.1 Appendix 8.0. For better readability, only the section/page headers are highlighted in the clearance draft.

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## VI. SERVICING LOAN REVIEW

### Defect Area 1

#### Servicer Operations (SO)

Standards and procedures applicable to the servicing of all FHA-insured Single Family Mortgages, including the Servicer's responsibility for records management, required actions, and various processing functions in the course of mortgage servicing regardless of loan performance.

HUD Policy References – Handbook 4000.1	
Forward	HECM
Rehabilitation Escrow Account (II.A.8.a.xviii) Assumptions – Origination/Underwriting (II.A.8.n) Servicing Roles and Responsibilities (III.A.1.a) Responsibility for Servicing Actions (III.A.1.b) Providing Information to HUD (III.A.1.c) Communication with Borrowers and Authorized Third Parties (III.A.1.d) Post-endorsement Mortgage Amendments (III.A.1.j) Disclosures (III.A.1.m) Record Retention – Servicing File (III.A.1.n) Presidentially-Declared Major Disaster Areas (III.A.2.n) Programs and Products (III.A.3) Assumptions – Servicing/Loss Mitigation (III.A.3.b)	Servicing in Compliance with Law (III.B.1.a) Responsibility for Servicing Actions (III.B.1.b) Providing Information to HUD (III.B.1.c) Communication with Borrowers and Authorized Third Parties (III.B.1.d) Set-Asides (III.B.1.i) Completion of Required Repairs (III.B.1.l) Post-endorsement HECM Amendments (III.B.1.o) Occupancy Certification (III.B.1.p) Property Maintenance (III.B.1.q) Optional Assignment (III.B.1.r) Demand Assignment (III.B.1.s) Repurchase of Previously Assigned HECM (III.B.1.t) Record Retention (III.B.1.v) Presidentially-Declared Major Disaster Areas (III.B.3.a)
<b>Sources</b> 1. Servicing File 2. Sale of Mortgage 3. Servicing Transfer 4. Borrower Communications and Requests 5. Partial Release or Modification of Security 6. Assumption Processing 7. Property in Presidentialy-Declared Major Disaster Area 8. 203(k) Rehabilitation Mortgage Program 9. HECM Repair Set-Aside 10. HECM Certifications and Determinations 11. Other Servicer Responsibility or Obligation	<b>Causes</b> A. Incomplete or insufficient servicing records and/or audit trail B. Servicing activity not completed as required C. Unallowable, prohibited, or improperly assessed fees/penalties/charges D. Mortgage record change or update not reported to FHA as required E. Violation of program or product-specific requirement F. Evidence of fraud or misrepresentation

*Defect Area 1 (continued)*  
**Servicer Operations (SO)**

<i>Severity Tiers</i>	
<b>Unacceptable</b>	
<b>1</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer knew or should have known</b> .
<b>2</b>	<p><u><b>Forward</b></u></p> <ul style="list-style-type: none"> <li>Required documentation is missing or incomplete, and FHA is unable to determine compliance with servicing requirements as a result.</li> <li>Failure to report servicing transfer or mortgage sale to FHA as required.</li> <li>Mortgage assumption was improperly processed or reported and/or completed without credit qualifying per program requirements.</li> <li>Required servicing activities or property inspections for escrowed repairs or rehabilitation were not completed in accordance with HUD program requirements.</li> <li>Failure to obtain HUD approval for a partial release or modification of security that impacts the Property Value.</li> </ul> <p><u><b>HECM</b></u></p> <ul style="list-style-type: none"> <li>FHA inspection was not conducted to document completion of repairs required after closing (Set-Aside) or after hazard insurance claim.</li> <li>Required repairs were not completed and delays were not supported in accordance with HUD policy.</li> <li>Required servicing activities related to death notices or occupancy certifications were not completed in accordance with HUD policy.</li> </ul>
<b>Deficient</b>	
<b>3</b>	<ul style="list-style-type: none"> <li>Required documentation is missing or incomplete, but FHA is able to determine compliance based on other information contained in the Servicing File.</li> <li>Servicing was not conducted in accordance with specific FHA requirements, but defects are inconsequential and do not require loan-level corrective action.</li> <li>Inaccurate/erroneous data is revealed in the Servicing File or reported to FHA, but errors are inconsequential.</li> <li>Apparent defects are present with respect to HUD policy, but the actions were required to comply with other federal or state law.</li> </ul>
<b>4</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer did not know and could not have known</b> .



*Defect Area 1 (continued)*  
**Servicer Operations (SO)**

<i>Severity Tiers</i>	
Remedies	
<b>1</b>	Life-of-Loan Indemnification
<b>2</b>	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Correct any reporting issues and provide documentation showing Borrower was notified of any changes in writing.</li> <li>• FHA will accept a 5-Year indemnification agreement for unqualified mortgage assumptions that otherwise meet HUD eligibility requirements.</li> <li>• FHA will accept documentation showing a principal reduction for Findings related to incomplete property repairs or rehabilitation. <ul style="list-style-type: none"> <li>o If the Property does not meet HUD’s Minimum Property Requirements (MPR) or Minimum Property Standards (MPS), FHA will request a principal reduction made <b>before, and in addition to</b>, Life-of-Loan indemnification.</li> </ul> </li> <li>• 1-Year indemnification is used for general servicing violations that cannot otherwise be addressed with mitigating documentation or corrective action at the loan level.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• Document the completion of repairs to bring the Property into compliance with HUD’s MPR and MPS.</li> <li>• For HECM violations, Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action.</li> </ul>

**Defect Area 2**

**Account Administration (AA)**

Standards and procedures specific to the accounting and administrative functions in connection with the servicing of performing FHA-insured Single Family Mortgages, including various routine activities and related reporting, disclosures, and documentation requirements.

HUD Policy References – Handbook 4000.1	
Forward	HECM
Rehabilitation Escrow Account (II.A.8.a.xviii) Payment Administration (III.A.1.e) Servicing Fees and Charges (III.A.1.f) Escrow (III.A.1.g) Insurance Coverage Administration (III.A.1.h) Mortgage Insurance Premium Remittance (III.A.1.i) Mortgage Insurance Premium Cancellation (III.A.1.k) Mortgage Insurance Termination (III.A.1.l) Adjustable Rate Mortgages (III.A.3.a)	Borrower Disbursements (III.B.1.e) Payment Administration (III.B.1.f) Servicing Fees and Charges (III.B.1.g) Interest Rate Changes for Adjustable Rate HECMs (III.B.1.h) Set-Asides (III.B.1.i) Allowable Fees and Charges (III.B.1.j) Prepayment (III.B.1.k) Insurance Coverage Administration (III.B.1.m) Mortgage Insurance Premium Remittance (III.B.1.n) Mortgage Insurance Termination (III.B.1.u)
<b>Sources</b> <ol style="list-style-type: none"> <li>1. Payment Administration</li> <li>2. Prepayment</li> <li>3. Costs, Fees, and Charges</li> <li>4. Escrow Management and Property Charge Disbursements</li> <li>5. Annual Escrow Analysis</li> <li>6. Adjustable Rate Mortgage (ARM) Annual Review</li> <li>7. Insurance Coverage Administration</li> <li>8. Mortgage Insurance Premium (MIP) Remittance</li> <li>9. Mortgage Payoff</li> <li>10. Cancellation or Termination of Mortgage Insurance</li> <li>11. HECM Life Expectancy Set-Aside (LESA) Administration</li> <li>12. HECM Disbursements, Account Analysis, or Repair Set-Aside</li> <li>13. HECM Payment Plan Changes</li> </ol>	<b>Causes</b> <ol style="list-style-type: none"> <li>A. Incomplete or insufficient servicing records and/or audit trail</li> <li>B. Servicing activity not completed as required</li> <li>C. Calculation errors or unallowable/prohibited fees/penalties/charges</li> <li>D. Account status not reported to FHA as required</li> <li>E. Violation of program or product-specific requirement</li> <li>F. Evidence of fraud or misrepresentation</li> </ol>

Defect Area 2 (continued)

Account Administration (AA)

<i>Severity Tiers</i>	
<b>Unacceptable</b>	
<b>1</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer knew or should have known</b> .
<b>2</b>	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Full payments were not applied correctly or prepayments were not applied as requested by the Borrower.</li> <li>• Annual escrow analysis was not performed or escrow amounts were inaccurately calculated resulting in a shortage.</li> <li>• Escrow funds were not disbursed on a timely basis and fees/penalties/charges were improperly deducted from the Borrower’s escrow account or otherwise charged to the Borrower as a result.</li> <li>• Unallowable or prohibited Late Charges, attorney’s fees, or other fees/penalties/charges were improperly collected and/or charged to the Borrower’s account.</li> <li>• Failure to obtain the Borrower’s consent to terminate mortgage insurance.</li> <li>• Failure to timely cancel or terminate MIPs.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• Failures or inaccuracies related to HECM account administration, including payments, Disbursements, and Repair Set-Aside or surplus.</li> <li>• LESA improperly administered resulting in unpaid Property Charges, late fees, or penalties assessed to the Borrower, account analysis, payments or Disbursements, and MIPs.</li> <li>• Noncompliance with rules and requirements related to payment of force-placed insurance premiums.</li> </ul>
<b>Deficient</b>	
<b>3</b>	<ul style="list-style-type: none"> <li>• Servicing record, individual account information, or reporting data is missing, but FHA is able to determine compliance based on other information contained in the Servicing File.</li> <li>• Individual accounting or administrative activity was not conducted in accordance with specific FHA requirements, but defects are inconsequential and do not require loan-level corrective action.</li> <li>• Inaccurate/erroneous data is revealed in the Servicing File or reported to FHA, but errors are inconsequential.</li> <li>• Apparent defects are present with respect to HUD policy, but the actions were required to comply with other federal or state law.</li> </ul>
<b>4</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer did not know and could not have known</b> .

Defect Area 2 (continued)

Account Administration (AA)

Severity Tiers	
Remedies	
1	Life-of-Loan Indemnification
2	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>Reverse or refund any unallowable or prohibited fees/penalties/charges.</li> <li>Reverse or refund any fees/penalties/charges resulting from improperly applied payments, ARM adjustments, and/or late escrow disbursements. <ul style="list-style-type: none"> <li>If payments are reduced as a result of ARM adjustment, refund the excess payments with interest on the excess at the index rate from the date of payment to the date of refund.</li> </ul> </li> </ul> <p><b>AND</b></p> <ul style="list-style-type: none"> <li>Provide documentation showing the Borrower was notified of any account adjustments in writing.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>Refund the Borrower the amount of surplus Repair Set-Aside or add the amount to the Borrower’s Principal Limit.</li> <li>For HECM violations, Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action.</li> </ul>

**Defect Area 3**

**Delinquent and Default Servicing (DS)**

Standards and procedures applicable to the servicing of non-performing FHA-insured Single Family Mortgages, including the Servicer’s responsibility for records management, accounting, and administrative functions, required actions, and various processing functions in the course of delinquent and default mortgage servicing.

HUD Policy References – Handbook 4000.1	
Forward	HECM
203(k) Rehabilitation Mortgage Insurance Program – Servicing (II.A.8.a.xx) Mortgages in Delinquency or Default (III.A.2.a) Reporting to Consumer Reporting Agencies and the IRS (III.A.2.c) Late Charges (III.A.2.d) Partial Payments for Mortgages in Default (III.A.2.e) Lien Status (III.A.2.f) Imminent Default (III.A.2.g) Early Default Intervention (III.A.2.h) Presidentially-Declared Major Disaster Areas (III.A.2.n) Presidentially-Declared COVID-19 National Emergency (III.A.2.o) Reinstatement (III.A.2.r) Programs and Products (III.A.3)	Use of Counseling Agencies (III.B.2.a) Due and Payable Servicing (III.B.2.b) Defaults for Unpaid Property Charges (III.B.2.c) COVID-19 HECM Property Charge Repayment Plan (III.B.3.c)
<b>Sources</b> <ol style="list-style-type: none"> <li>1. Delinquency or Default Status</li> <li>2. Partial Payments or Suspense Account</li> <li>3. Late Charges and Fees</li> <li>4. Collection Notices and Communications</li> <li>5. Early Default Intervention</li> <li>6. Non-Monetary Default</li> <li>7. Imminent Default</li> <li>8. Bankruptcy</li> <li>9. Mortgage Reinstatement</li> <li>10. Delinquent 203(k) Mortgages</li> <li>11. Property Occupancy Status or Condition</li> <li>12. HECM Default</li> <li>13. HECM Deferral Period</li> <li>14. Other Delinquent and Default Servicing Requirement</li> </ol>	<b>Causes</b> <ol style="list-style-type: none"> <li>A. Incomplete or insufficient servicing records and/or audit trail</li> <li>B. Servicing activity not completed as required</li> <li>C. FHA delinquency and default reporting inaccurate, incomplete, or contrary to policy</li> <li>D. Requirements related to property inspections, repairs, or preservation not met</li> <li>E. Violation of program or product-specific requirement</li> <li>F. Evidence of fraud or misrepresentation</li> </ol>

*Defect Area 3 (continued)*

**Delinquent and Default Servicing (DS)**

<i>Severity Tiers</i>	
<b>Unacceptable</b>	
<b>1</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer knew or should have known</b> .
<b>2</b>	<p><u><b>Forward</b></u></p> <ul style="list-style-type: none"> <li>• Failure to notify each Borrower, co-signer, and any other party requiring notice by state law that the Mortgage is in Default.</li> <li>• Failure to satisfy other HUD requirements to communicate with Borrowers in Default.</li> <li>• Failure to ensure the accuracy of all information reported to consumer reporting agencies.</li> <li>• Partial Payments were returned to the Borrower without meeting the criteria for returning payments and/or suspense funds equal to at least one full monthly installment were not applied according to HUD policy.</li> <li>• Unallowable Late Charges, attorney’s fees, inspection fees, or other fees or penalties were assessed and/or charged to the Borrower’s suspense account.</li> <li>• Escrow funds were not disbursed on a timely basis and fees or penalties were charged to the Borrower’s suspense account as a result.</li> <li>• Failure to obtain required property inspections to adequately determine occupancy and/or property condition.</li> <li>• Failure to perform required Property Preservation and Protection actions.</li> </ul> <p><u><b>HECM</b></u></p> <ul style="list-style-type: none"> <li>• Noncompliance with HECM-specific requirements including Due and Payable policies, Deferral Period, and cure policies.</li> </ul>
<b>Deficient</b>	
<b>3</b>	<ul style="list-style-type: none"> <li>• Required documentation is missing, but FHA is able to determine delinquent and default servicing compliance based on other information contained in the Servicing File.</li> <li>• Delinquent and default servicing was not conducted in accordance with specific FHA requirements, but defects are inconsequential and do not require loan-level corrective action.</li> <li>• Partial Payments were returned to the Borrower without a letter of explanation, but the Servicing File demonstrates the criteria were met for returning the payments.</li> <li>• Inaccurate/erroneous data is revealed in the Servicing File or reported to FHA, but errors are inconsequential.</li> <li>• Apparent defects are present with respect to HUD policy, but the actions were required to comply with other federal or state law.</li> </ul>
<b>4</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer did not know and could not have known</b> .

*Defect Area 3 (continued)*

**Delinquent and Default Servicing (DS)**

<i>Severity Tiers</i>	
<b>Remedies</b>	
<b>1</b>	Life-of-Loan Indemnification
<b>2</b>	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Correct accounting issues and provide documentation showing the Borrower was notified of errors or account adjustments in writing.</li> <li>• Refund the Borrower’s account any late fees, penalties, or other charges paid or accrued from the month in which the violation initially occurred.</li> <li>• For Property Preservation and Protection violations resulting from servicing failures, complete all required repairs and designate related costs as non-recoverable to prevent inclusion in any future HUD claims. <ul style="list-style-type: none"> <li>o Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action.</li> </ul> </li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• For HECM violations, Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action.</li> </ul>

**Defect Area 4**

**Loss Mitigation Processing (LP)**

Standards and procedures applicable for loss mitigation processing, review activities, required reporting, communications, and financial evaluation for all available loss mitigation alternatives to foreclosure.

HUD Policy References – Handbook 4000.1	
Forward	HECM
Loss Mitigation Review Process (III.A.2.i) HUD’s Loss Mitigation Program (III.A.2.j) Loss Mitigation Incentives (III.A.2.m) Presidentially-Declared Major Disaster Areas (III.A.2.n) Presidentially-Declared COVID-19 National Emergency (III.A.2.o) Programs and Products (III.A.3)	Defaults for Unpaid Property Charges (III.B.2.c) COVID-19 HECM Property Charge Repayment Plan (III.B.3.c)
<b>Sources</b> <ol style="list-style-type: none"> <li>1. Review Processing</li> <li>2. Borrower Eligibility</li> <li>3. Financial Evaluation</li> <li>4. Escrow Analysis, Shortages, or Advances</li> <li>5. Trial Payment Plan (TPP)</li> <li>6. Communications and Notices</li> <li>7. Bankruptcy</li> <li>8. Loss Mitigation Agreements</li> <li>9. Loss Mitigation Incentives</li> <li>10. Other Loss Mitigation Requirement</li> </ol>	<b>Causes</b> <ol style="list-style-type: none"> <li>A. Incomplete or insufficient servicing records and/or audit trail</li> <li>B. Loss mitigation activity not completed as required</li> <li>C. Calculation errors or unallowable/prohibited fees/penalties/charges</li> <li>D. Loss mitigation reporting inaccurate, incomplete, or contrary to policy</li> <li>E. Violation of program or product-specific requirement</li> <li>F. Evidence of fraud or misrepresentation</li> </ol>



Defect Area 4 (continued)

Loss Mitigation Processing (LP)

Severity Tiers	
Unacceptable	
1	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer knew or should have known.</b>
2	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>Loss mitigation activities were not conducted within HUD-specified time frames.</li> <li>Failure to follow the Loss Mitigation Option Priority Waterfall.</li> <li>Failure to fully document all required information obtained through communication with the Borrower and the loan was not reviewed for loss mitigation as a result.</li> <li>Borrower's request for loss mitigation was improperly processed and was not reviewed as required.</li> <li>Financial evaluation is not supported by documentation in the Servicing File, or Servicer calculation errors result in improper review for Loss Mitigation Options.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>HECM loss mitigation Repayment Plan review activities were not completed in accordance with HUD program requirements.</li> </ul>
Deficient	
3	<ul style="list-style-type: none"> <li>Loss mitigation was not processed in accordance with specific FHA requirements and/or loss mitigation notifications did not include all required elements, but defects are inconsequential and do not require loan-level corrective action.</li> <li>Required financial documents are missing, but FHA is able to determine loss mitigation compliance based on other information contained in the Servicing File.</li> <li>Inaccurate/erroneous data is revealed in the Servicing File or reported to FHA, but errors are inconsequential.</li> <li>Apparent defects are present with respect to HUD policy, but the actions were required to comply with other federal or state law.</li> </ul>
4	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer did not know and could not have known.</b>

Defect Area 4 (continued)

Loss Mitigation Processing (LP)

Severity Tiers	
Remedies	
1	Life-of-Loan Indemnification
2	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Notify the Borrower of the servicing error.</li> <li>• Complete the Loss Mitigation Option that puts the Borrower in the position they would have been in absent the violation. <ul style="list-style-type: none"> <li>◦ If the appropriate Loss Mitigation Option is unavailable or insufficient, complete a comparable alternative.</li> </ul> </li> <li>• FHA will accept indemnification (1-Year or 5-Year) only when the Servicer provides documentation of a good faith effort to complete the remedies above but is unsuccessful due to circumstances beyond the Servicer's control.</li> </ul> <p><b>AND</b></p> <ul style="list-style-type: none"> <li>• Remit the amount of any loss mitigation incentives to HUD.</li> <li>• Refund the Borrower's account any late fees paid or accrued from the month in which the loss mitigation failure initially occurred.</li> <li>• Correct any credit reporting negatively impacted by the failure.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• For HECM violations, Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action.</li> </ul>

Defect Area 5

Home Retention (HR)

Compliance with standards and requirements for various Home Retention Options from processing through completion of related servicing activities. Minimum property acceptability and eligibility standards for FHA insurance, including program and product-specific variations.

HUD Policy References – Handbook 4000.1	
Forward	HECM
Loss Mitigation Home Retention Options (III.A.2.k) Presidentially-Declared Major Disaster Areas (III.A.2.n) Presidentially-Declared COVID-19 National Emergency (III.A.2.o) Programs and Products (III.A.3)	Defaults for Unpaid Property Charges (III.B.2.c) COVID-19 HECM Property Charge Repayment Plan (III.B.3.c)
<b>Sources</b> <ol style="list-style-type: none"> <li>1. Postponement of Servicemember Payments</li> <li>2. Forbearance Plan</li> <li>3. Standalone Loan Modification</li> <li>4. Standalone Partial Claim</li> <li>5. Combination Loan Modification and Partial Claim</li> <li>6. Payment Supplement</li> <li>7. HECM Repayment Plan</li> <li>8. Borrowers in Foreclosure</li> <li>9. Other Home Retention Option</li> </ol>	<b>Causes</b> <ol style="list-style-type: none"> <li>A. Incomplete or insufficient servicing records and/or audit trail</li> <li>B. Servicing activity not completed as required</li> <li>C. Home Retention Option did not reinstate the loan</li> <li>D. Home Retention Option standards/requirements not met</li> <li>E. Presidentially-Declared Disaster/emergency program requirements not met</li> <li>F. Evidence of fraud or misrepresentation</li> </ol>

**Defect Area 5 (continued)**  
**Home Retention (HR)**

<i>Severity Tiers</i>	
<b>Unacceptable</b>	
<b>1</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer knew or should have known.</b>
<b>2</b>	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Servicing File does not support Borrower eligibility for the Home Retention Option received.</li> <li>• Improperly paid Partial Claim as the result of policy violations, calculation errors, impermissible or unsupported charges, fees, or amounts and/or process timing issues.</li> <li>• Unallowable or improperly calculated amount included in total outstanding debt to be resolved or capitalized.</li> <li>• Borrower was ineligible for the Home Retention Option received.</li> <li>• Improperly completed FHA-HAMP Loss Mitigation Option after TPP failure.</li> <li>• Failure to ensure first lien position through the completion of a loan modification.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• Improperly completed HECM Loss Mitigation Option and property charge default was not cured as a result.</li> <li>• Borrower’s ability to support the HECM Repayment Plan is not evident in the Servicing File.</li> <li>• Borrower was ineligible for the HECM Loss Mitigation Option received based on HUD program-specific requirements.</li> </ul>
<b>Deficient</b>	
<b>3</b>	<ul style="list-style-type: none"> <li>• Required documentation is missing, but FHA is able to determine compliance with Home Retention Option requirements based on other information contained in the Servicing File.</li> <li>• Home Retention Option was not processed in accordance with specific FHA requirements, but defects are inconsequential and do not require loan-level corrective action.</li> <li>• Inaccurate/erroneous data is revealed in the Servicing File or reported to FHA, but errors are inconsequential.</li> <li>• Apparent defects are present with respect to HUD policy, but the actions were required to comply with other federal or state law.</li> </ul>
<b>4</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer did not know and could not have known.</b>

**Defect Area 5 (continued)**  
**Home Retention (HR)**

<i>Severity Tiers</i>	
<b>Remedies</b>	
<b>1</b>	Life-of-Loan Indemnification
<b>2</b>	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Notify the Borrower of the servicing error.</li> <li>• Complete the Loss Mitigation Option that puts the Borrower in the position they would have been in absent the violation. <ul style="list-style-type: none"> <li>◦ If the appropriate Loss Mitigation Option is unavailable or insufficient, complete a comparable alternative.</li> </ul> </li> <li>• FHA will accept indemnification (1-Year or 5-Year) only when the Servicer provides documentation of a good faith effort to complete the remedies above but is unsuccessful due to circumstances beyond the Servicer's control.</li> </ul> <p>AND</p> <ul style="list-style-type: none"> <li>• Remit the amount of any loss mitigation incentives to HUD.</li> <li>• Refund the Borrower's account any late fees paid or accrued from the month in which loss mitigation failure initially occurred.</li> <li>• Correct any credit reporting negatively impacted by the failure.</li> </ul> <p><b><u>Improperly Paid Partial Claims</u></b></p> <ul style="list-style-type: none"> <li>• For overpaid Partial Claims, remit the overpayment amount to HUD.</li> <li>• If the Borrower or Property was ineligible for a Partial Claim, remit the entire Partial Claim amount and any incentives to HUD.</li> <li>• If the Partial Claim failed to fully reinstate the loan, adjust the Borrower's account in the amount of the Partial Claim shortage.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• For HECM violations, Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action(s).</li> </ul>

**Defect Area 6**

**Home Disposition (HD)**

Compliance with standards and requirements for various Home Disposition Options and includes foreclosure processing through property conveyance, claims, and other related matters.

HUD Policy References – Handbook 4000.1	
Forward	HECM
Foreclosure of Mortgage during Rehabilitation Period (II.A.8.a.xx(D)) Home Disposition Options (III.A.2.l) Presidentially-Declared Major Disaster Areas (III.A.2.n) Presidentially-Declared COVID-19 National Emergency (III.A.2.o) Foreclosure (III.A.2.s) Programs and Products (III.A.3)	Due and Payable Servicing (III.B.2.b) Initiation of Foreclosure and Reasonable Diligence Time Frames (III.B.2.d) Sale of Property Acquired through Foreclosure or DIL (III.B.2.e) Claims (III.B.2.f) Presidentially-Declared Major Disaster Areas (III.B.3.a) Mortgagee Optional Election Assignment (III.B.3.b)
<b>Sources</b> <ol style="list-style-type: none"> <li>1. Pre-Foreclosure Sale (PFS)</li> <li>2. Deed-in-Lieu (DIL) of Foreclosure</li> <li>3. Foreclosure Review and Activities</li> <li>4. Fees and Costs</li> <li>5. Foreclosure During 203(k) Rehabilitation Period</li> <li>6. Foreclosure Processing</li> <li>7. Conveyance and Payment of Claim</li> <li>8. Claims Without Conveyance of Title (CWCOT)</li> <li>9. HECM Property Disposition</li> <li>10. Other Home Disposition Option</li> </ol>	<b>Causes</b> <ol style="list-style-type: none"> <li>A. Incomplete or insufficient servicing records and/or audit trail</li> <li>B. Servicing action not completed as required</li> <li>C. Home Disposition Option improperly executed</li> <li>D. Eligibility or qualification requirements for Home Disposition Option not met</li> <li>E. Violation of program or product-specific requirement</li> <li>F. Evidence of fraud or misrepresentation</li> </ol>

**Defect Area 6 (continued)**  
**Home Disposition (HD)**

<i>Severity Tiers</i>	
<b>Unacceptable</b>	
<b>1</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer knew or should have known.</b>
<b>2</b>	<p><b><u>Forward</u></b></p> <ul style="list-style-type: none"> <li>• Unable to determine compliance with Home Disposition Option requirements due to missing/incomplete documentation.</li> <li>• HUD-approved extension or variance was not obtained as required and servicing records do not indicate a permissible reason or supporting documentation for exceeding HUD-specified time frames.</li> <li>• Foreclosure alternatives were not exhausted before foreclosure was initiated and/or completed.</li> <li>• Foreclosure was not initiated within HUD’s specified time frame and claim was submitted without required curtailment.</li> <li>• Claim was overpaid due to unsupported, unallowable or prohibited fees/penalties/charges, or other miscalculations.</li> <li>• Property is in unacceptable conveyance condition due to Servicer neglect or ineligible for CWCOT due to Surchargeable Damage.</li> <li>• Failure to ensure PFS Arm’s Length Transaction requirements were met.</li> <li>• Failure to follow property valuation requirements.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• Noncompliance with HECM disposition requirements including Property sale, assignment, foreclosure, claims, or other cure policies.</li> <li>• Unacceptable property condition due to disrepair, Servicer neglected Property Preservation and Protection, and/or required inspections.</li> </ul>
<b>Deficient</b>	
<b>3</b>	<ul style="list-style-type: none"> <li>• Foreclosure was not initiated within HUD’s specified time frame and curtailment will be required at claim submission.</li> <li>• HUD-approved extension or variance was not obtained as required, but the Servicing File contains evidence to support approval if extension or variance had been requested.</li> <li>• Home Disposition Option was not processed in accordance with specific FHA requirements, but defects are inconsequential and do not require loan-level corrective action.</li> <li>• Inaccurate/erroneous data is revealed in the Servicing File or reported to FHA, but errors are inconsequential.</li> <li>• Apparent defects are present with respect to HUD policy, but the actions were required to comply with other federal or state law.</li> </ul>
<b>4</b>	Evidence of fraudulent or materially misrepresented information about which the <b>Servicer did not know and could not have known.</b>

**Defect Area 6 (continued)**  
**Home Disposition (HD)**

<i>Severity Tiers</i>	
<b>Remedies</b>	
<b>1</b>	Life-of-Loan Indemnification
<b>2</b>	<p><b><u>Forward</u></b></p> <p><b><u>Loan Status – Pre-Foreclosure/Foreclosure</u></b></p> <ul style="list-style-type: none"> <li>• Notify the Borrower of the servicing error.</li> <li>• Complete the Loss Mitigation Option that puts the Borrower in the position they would have been in absent the violation. <ul style="list-style-type: none"> <li>◦ If the appropriate Loss Mitigation Option is unavailable or insufficient, complete a comparable alternative.</li> <li>◦ Foreclosure must be suspended during the loss mitigation process and canceled upon completion of a Loss Mitigation Option.</li> </ul> </li> <li>• FHA will accept a 5-Year indemnification only when the Servicer provides documentation of a good faith effort to complete the remedies above but is unsuccessful due to circumstances beyond the Servicer’s control.</li> </ul> <p>AND</p> <ul style="list-style-type: none"> <li>• Remit the amount of any incentives to HUD.</li> <li>• Refund the Borrower any improperly assessed fees/penalties/charges.</li> <li>• Correct any credit reporting negatively impacted by the failure.</li> </ul> <p><b><u>Loan Status – Conveyance/Claim</u></b></p> <ul style="list-style-type: none"> <li>• For improperly paid claims, remit any overpaid amount and incentive fee to HUD.</li> <li>• For improperly paid conveyance claims due to incomplete repairs less than \$5,000, remit the cost of the repairs to HUD.</li> <li>• Life-of-Loan indemnification is the only available remedy in LRS when documentation in the Servicing File demonstrates the foreclosure should not have been completed, or the Property was ineligible for the Home Disposition Option or claim type received.</li> </ul> <p><b><u>HECM</u></b></p> <ul style="list-style-type: none"> <li>• For HECM violations, Life-of-Loan indemnification is the only available remedy in LRS if the Servicer is unable to provide mitigating documentation and/or complete corrective action.</li> </ul>