DEPARTMENT OF VETERANS AFFAIRS

OFFICE OF INSPECTOR GENERAL

Office of Audits and Evaluations

VETERANS BENEFITS ADMINISTRATION

Exempt Veterans Charged VA Home Loan Funding Fees

REVIEW	REPORT #18-03250-130	JUNE 6, 2019

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Executive Summary

Why the OIG Did This Review

Veterans are generally required to pay a funding fee to VA at loan origination to defray the cost of administering a VA home loan.[1] However, veterans are exempt from paying the funding fee if they are entitled to receive VA disability compensation—a monetary benefit for veterans with service-connected disabilities. VA collected approximately $9.78 billion in funding fees from fiscal year (FY) 2012 through FY 2017. The VA Office of Inspector General (OIG) conducted this review to determine whether the Veterans Benefits Administration (VBA) had adequate controls in place to ensure exempt veterans did not pay unnecessary VA home loan guaranty funding fees and exempt veterans received refunds for any inappropriate charges.

What the Review Found

The review team estimated that from calendar year 2012 through calendar year 2017, VA charged exempt veterans approximately $286.4 million in funding fees. Although these inappropriate charges represented only 3 percent of the total amount of funding fees collected, they affected approximately 72,900 veterans. Moreover, for individual veterans the amount charged can be significant, as the amounts from the sample averaged $4,483 and were as high as $19,470. Furthermore, VBA's Loan Guaranty Service management, which provides oversight of VA's Home Loan Guaranty Program, was aware since October 2014 that thousands of exempt veterans may have been charged home loan funding fees. OIG finds it troubling that senior VBA management was aware that thousands of veterans were potentially owed more than $150 million yet did not take adequate actions to ensure refunds were issued.

To refine the analysis of the inappropriate charges, the review team drew a distinction between "avoidable" charges and "unavoidable" charges. Avoidable charges are those instances where the veterans were exempt from fees at the time of the loan origination.[2] Unavoidable charges occurred when a veteran was correctly charged a fee at loan origination, but the veteran became retroactively exempt. These inappropriate charges included approximately $65.8 million in avoidable and approximately $220.6 million in unavoidable funding fees, which occurred on loans that closed during the period from January 1, 2012, through December 31, 2017. During the same period, Loan Guaranty Service staff issued approximately 19,700 of these veterans' refunds totaling approximately $97 million.

[1] Loan origination date is the date the borrower signs the final loan application.

[2] Some avoidable funding fee charges would be difficult for VA to prevent. For example, when lenders incorrectly collect funding fees despite having information showing veterans are exempt. However, in such cases, VA should be able to detect inappropriate charges and issue refunds.

The team estimated VA had not yet given approximately 53,200 exempt veterans their home loan funding fee refunds for charges totaling approximately $189 million. The review team found that VA owed these veterans funding fee refunds because of inadequate action taken to refund the inappropriate charges, certificates of eligibility (COEs) did not reflect the correct exemption status for veterans, and a lack of an automated process to identify exemption status changes. In addition, staff at the three Regional Loan Centers (RLCs) visited did not consistently obtain documentation showing refunds were applied to the veterans' loan balances. The review team further estimated that VA could owe an additional 34,400 exempt veterans funding fee refunds of $164 million over the next five years if VBA does not implement adequate controls to minimize or detect inappropriate funding fee charges.

In October 2014, St. Paul, Minnesota, RLC management provided Loan Guaranty Service management with an analysis indicating that approximately 48,000 veterans may be due funding fee refunds totaling approximately $151 million.[3] The analysis also estimated it would take four to eight staff one year to refund the inappropriate charges they identified. In May 2016, the former director of Loan Guaranty Service documented a need to address the issue of inappropriate funding fee charges and acknowledged over $150 million in refunds may be due.[4] Disturbingly, as of January 2019, Loan Guaranty Service management had not taken action to issue refunds to these exempt veterans.

The review team also found Loan Guaranty Service staff documented challenges related to the funding fees process from December 2015 through February 2018. However, Loan Guaranty Service management had not taken substantive actions to ensure exempt veterans were not charged funding fees and refunds were issued when inappropriate charges occurred. The former and current directors of Loan Guaranty Service stated they focused on other competing priorities, such as addressing serial refinancing, a high blocked call rate and long wait times, and appraisal timeliness for pending home loans.[5] In addition, information provided by the current director of Loan Guaranty Service stated VA experienced historically high loan volumes three years in a row from FY 2015 through FY 2017.

To assist lenders in identifying exempt veterans, VBA issues a COE that should reflect an accurate exemption status. However, many COEs reflected an outdated, incorrect, or missing exemption status resulting in veterans being incorrectly charged a funding fee. Loan Guaranty

[3] The St. Paul RLC analysis was not limited to the St. Paul RLC; rather, the analysis included refunds that may be due nationwide. Some of the 48,000 veterans may subsequently have been issued refunds; however, as of January 2019, the review team received no indication that a large-scale effort had been initiated to issue refunds to these veterans.

[4] The current director of Loan Guaranty Service was appointed in 2017, and prior to that he served as the deputy director of Loan Guaranty Service, beginning in 2012. The former director of Loan Guaranty Service held that position beginning in 2012 until 2016.

[5] Serial refinancing is the practice of refinancing multiple times in a short amount of time. Blocked calls end prior to the caller getting a chance to speak with a VA representative.

Service policy did not require COEs to be updated or issued near loan origination, which could have reduced the occurrence of COEs reflecting the incorrect status. In January 2016, Loan Guaranty Service identified the risk associated with inaccurate exemption statuses reflected on COEs; however, as of January 2019, Loan Guaranty Service had not resolved this issue. A related issue is that after generation of some COEs, veterans became entitled to receive VA disability compensation and a funding fee exemption, but lenders or VA staff were not notified to issue funding fee refunds. This occurred because VBA lacked an automated process for identifying exemption status changes. Specifically, Loan Guaranty Service's electronic loan administration system and VBA's disability compensation processing system were not designed to automatically identify home loans for staff to review when a change in funding fee exemption status occurred. In the absence of an automated process, the review team's sample indicated refunds resulted from veteran or lender requests or were identified by Loan Guaranty Service staff during quality reviews.

The RLC staff did not consistently obtain documentation showing refunds were applied to the veterans' loan balances. The review team found VA issued 47 funding fee refunds to lenders out of the sample of 200 loans. The lenders were required to provide VA documentation that the refund was applied to the veteran's loan balance. However, the electronic loan administration system did not contain documentation showing the lenders applied refunds to veterans' loan balances for 43 of the 47 loans.

The review team found Loan Guaranty Service management did not implement a policy to identify and issue refunds for inappropriate funding fee charges. The current director of Loan Guaranty Service stated that Loan Guaranty Service relies on veterans to contact VA and that veterans are required to file a claim to request refunds. However, Loan Guaranty Service has not published a standard form for requesting a funding fee refund; as such, veteran- or lender-initiated refunds are issued without submission of a claim form. It is the review team's opinion that requiring a veteran to submit a claim for a refund improperly places the burden and responsibility solely upon the veteran.

What the OIG Recommended

The OIG recommended the Under Secretary for Benefits ensure Loan Guaranty Service implements:

- A plan to identify exempt veterans who were charged funding fees during the period from January 1, 2012, through December 31, 2017, and issue refunds.
- A plan to identify exempt veterans who were charged funding fees prior to January 1, 2012, and issue refunds.

- A plan to mitigate the lack of real-time funding fee exemption status updates through system enhancements or procedural changes that minimize inappropriate funding fee charges.
- A plan to conduct periodic reviews to identify exempt veterans charged funding fees from January 1, 2018, forward, and issue refunds in a timely manner.
- A plan to consistently obtain documentation and verify lenders apply funding fee refunds to veterans' loan balances in a timely manner.

Management Comments

The Under Secretary for Benefits concurred with Recommendations 1, 2, and 4, and concurred in part with Recommendations 3 and 5. The Under Secretary provided corrective action plans for all recommendations, with a target completion date of July 31, 2019. The Under Secretary for Benefits' comments and corrective action plans for Recommendations 1 through 5 are acceptable and responsive to the intent of the recommendations. The OIG will monitor implementation of planned actions and will close the recommendations when the OIG receives sufficient evidence demonstrating progress in addressing the identified issues. The Under Secretary also included technical comments on the draft report. To address the technical comment related to the analysis conducted by St. Paul Regional Loan Center staff, the OIG made a minor report change to clarify that exempt veterans identified by their analysis "may" be owed refunds. Appendix E provides the full text of the Under Secretary for Benefits' comments.

VBA has requested a legal opinion from VA's Office of General Counsel to determine whether VA has the authority to issue funding fee refunds directly to veterans in cases where there is a loan balance. The Under Secretary stated having this authority would increase the efficiency in completing refunds timely and would determine the procedural and policy changes implemented going forward. The Under Secretary also stated Loan Guaranty Service has a contingency plan ready for implementation depending on the outcome of the General Counsel's legal opinion.

Additionally, the Under Secretary expressed a concern that OIG's categorization of certain inappropriate funding fee charges as avoidable is misleading, indicating that many such charges are the result of lender errors. The OIG stands by the distinction, which is clearly defined in the report. The Under Secretary also took exception to the five-year monetary impact estimate reflected in the report. The OIG uses the five-year estimate to emphasize the importance of taking corrective actions and to highlight the potential magnitude of identified issues if such actions are delayed or never implemented. The OIG acknowledges that the actual future monetary impact will vary because events and circumstances change. However, that variance is largely dependent on if, when, and how VBA implements its corrective actions.

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Contents

Executive Summary i

Abbreviations vii

Introduction 1

Results and Recommendations 3

Finding: VBA Did Not Prevent Exempt Veterans from Paying Funding Fees and Did Not Always Issue Refunds 3

Recommendations 1–5 12

VBA Management Comments 13

OIG Response 13

Appendix A: Scope and Methodology 15

Appendix B: Statistical Sampling Methodology 17

Appendix C: Monetary Benefits in Accordance with Inspector General Act Amendments 20

Appendix D: VA Loan Guaranty Program Funding Fees Tables 21

Appendix E: Management Comments 22

OIG Contact and Staff Acknowledgments 29

Report Distribution 30

Abbreviations

COE	Certificate of Eligibility
FY	fiscal year
OIG	Office of Inspector General
RLC	Regional Loan Center
VA	Department of Veterans Affairs
VBA	Veterans Benefits Administration
WebLGY	Web-based Loan Guaranty System

Introduction

Objective

The OIG conducted this review to determine whether the Veterans Benefits Administration (VBA) had adequate controls in place to ensure exempt veterans did not pay VA home loan guaranty funding fees and that any inappropriate charges were refunded.

Why the OIG Did This Review

Generally, veterans must pay a funding fee to VA at loan origination to defray the cost of administering a VA home loan. This can be paid by the veteran at the time of loan origination or included in the veteran's loan amount. Veterans are exempt from paying the funding fee if they are entitled to receive VA disability compensation—a monetary benefit for veterans with service-connected disabilities.[6] VA collected approximately $9.78 billion in funding fees for 3.68 million loans during fiscal year (FY) 2012 through FY 2017. Table 1 provides details on loan volume and funding fees received for each fiscal year during this period.

Table 1. Loan Volume and Funding Fee Receipts FY 2012 through FY 2017

Fiscal year	Loan volume	Funding fee receipts
2012	539,884	$1.18 billion
2013	629,312	$1.41 billion
2014	438,398	$1.34 billion
2015	631,142	$1.73 billion
2016	705,474	$1.98 billion
2017	740,389	$2.14 billion
Total	**3,684,599**	**$9.78 billion**

Source: VBA Annual Benefits Report for FY 2012 through 2016 and VBA's Fast Facts for FY 2017.
Note: The dollar figures are rounded for reporting purposes.

Home Loan Guaranty Program

VA's Home Loan Guaranty Program (home loan program) was established in 1944 with the objective of reducing the economic and sociological problems faced by post-war service members. The main purpose of the VA home loan program is to help veterans finance the purchase of homes with favorable loan terms.

[6] A service-connected disability is one that happened during or was made worse by active military service.

VBA administers the home loan program through its eight Regional Loan Centers (RLCs) in Atlanta, Georgia; Cleveland, Ohio; Denver, Colorado; Houston, Texas; Phoenix, Arizona; Roanoke, Virginia; St. Paul, Minnesota; and St. Petersburg, Florida. The Honolulu, Hawaii, VA Regional Office, though not an RLC, is a fully functioning Loan Guaranty Service operation for Hawaii.

Financing for VA home loans is provided through private lenders, such as banks, savings and loan associations, or mortgage companies. To obtain a loan, a veteran must apply through a lender and be approved. Upon loan approval, VA may guarantee a portion of the loan, which protects the lender against loss up to the amount guaranteed.

VBA's Loan Guaranty Service

VBA's Loan Guaranty Service provides oversight of VA's home loan program. Specifically, Loan Guaranty Service conducts monthly reviews of compliance with home loan program laws, regulations, and policies. Loan Guaranty Service also reviews home loan program contracts to ensure compliance with contract terms and that payments made to contractors are appropriate, and it conducts annual operations reviews of all eight RLCs to evaluate program performance.

Certificate of Eligibility

A Certificate of Eligibility (COE) is a document showing a veteran's eligibility to participate in the VA home loan program. A veteran's length of service, duty status, and character of service determine eligibility for specific home loan benefits. Lenders use the COE to determine a veteran's funding fee exemption status. Either veterans or lenders can request a COE from VA during the loan process. If the COE indicates that a veteran is eligible for the exemption, the lender should not collect the VA funding fee.

VA Funding Fees

When a veteran obtains a VA-guaranteed home loan, the lender collects the funding fee and submits it electronically through the VA Funding Fee Payment System. VA funding fees range from 0.5 percent to 3.3 percent of the loan amount. Appendix D provides detailed tables that further explain funding fee percentages.

If exempt veterans believe they were charged funding fees, either the veteran or the lender may request a refund. RLC staff determine whether a refund is due and the amount, as well as who should receive the refund. If a veteran paid the funding fee at loan origination and is due a refund, then VA is required to pay the veteran the refund. If the funding fee was included in the loan, then VA pays the lender the refund, which the lender must apply towards the veteran's loan balance. RLC staff must review and decide all refund requests within 10 business days of the initial request date.

Results and Recommendations

Finding: VBA Did Not Prevent Exempt Veterans from Paying Funding Fees and Did Not Always Issue Refunds

The review team estimated, based on a statistical sampling of loans, that VA owed refunds to approximately 53,200 exempt veterans for loan funding fee charges. This occurred because of inadequate action taken to refund the inappropriate charges, COEs not reflecting the correct exemption statuses for veterans, and a lack of an automated process to identify exemption status changes. These charges totaled approximately $189 million on home loans originated from January 1, 2012, through December 31, 2017. Of the loans that the team reviewed, the average funding fee charged to these exempt veterans was $4,483, and the fee was as high as $19,470. The review team estimated that VA could owe an additional 34,400 exempt veterans funding fee refunds of $164 million over the next five years if adequate controls are not implemented to minimize or detect these inappropriate charges.

The review team also found that since at least October 2014, Loan Guaranty Service management was aware that VA may have owed thousands of exempt veterans' refunds for funding fee charges. In October 2014, St. Paul RLC management provided Loan Guaranty Service management with a nationwide analysis of loans originated from October 1, 2006, through May 31, 2014, which estimated almost 48,000 exempt veterans may be owed approximately $151 million in refunds.[7] The review team found Loan Guaranty Service management did not implement a policy to identify and issue refunds for inappropriate funding fee charges.

Where VA issued refunds to exempt veterans, the review team determined that the RLC staff did not consistently obtain documentation showing refunds were applied to the veterans' loan balances. The review team found documentation showing that lenders applied refunds to veterans' loan balances for just four of 47 refunds that should have been applied to loan balances. As of January 2019, documentation for the remaining 43 refunds was unavailable. As a result, VA had no reasonable assurance that lenders applied those refunds to veterans' loan balances.

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[7] Loan origination date is the date the borrower signs the final loan application.

What the OIG Did

The scope of this review included approximately 77,800 veterans who were exempt, originated VA-guaranteed home loans, and paid funding fees during the period January 1, 2012, through December 31, 2017. The team reviewed a statistical sample of 100 loans from the universe of approximately 8,900 from the period of January 1, 2017, through December 31, 2017. In addition, the team reviewed a statistical sample of 100 loans from the universe of approximately 68,900 from the period January 1, 2012, through December 31, 2016.

The review team used VBA's electronic systems, including the web-based Loan Guaranty System (WebLGY) and the Veterans Benefits Management System, to review relevant documentation required to assess whether exempt veterans paid VA home loan funding fees, and if applicable, were refunded the funding fees. The OIG team also interviewed management and staff at three RLCs, VBA's Central Office in Washington, D.C., and Nashville, Tennessee. Appendices A and B provide additional details on what the OIG did, with Appendix A addressing the scope of work and the methodology used, and Appendix B setting forth the statistical sampling methodology.

This finding discusses:

- Exempt veterans charged funding fees
- Refunds not processed due to competing priorities
- Legislative requirements
- Lack of automated process to identify exemption status changes
- Missing documentation

Exempt Veterans Charged Funding Fees

The review team estimated 72,900 exempt veterans paid approximately $286.4 million in funding fees during the period from January 1, 2012, through December 31, 2017.[8] These charges included approximately $65.8 million in avoidable and approximately $220.6 million in unavoidable funding fees.[9] During the same period, Loan Guaranty Service staff issued approximately 19,700 of these veterans' refunds totaling approximately $97 million. The review team estimated VA still owed approximately 53,200 exempt veterans $189 million dollars in funding fee refunds. Loan Guaranty Service did not issue funding fee refunds to approximately 73 percent of the 72,900 exempt veterans who originated VA-guaranteed home loans during the period January 1, 2012, through

[8] The $286.4 million in inappropriate funding fee charges represented approximately 3 percent of the $9.78 billion in funding fees collected from FY 2012 through FY 2017. Although inappropriate charges represented a relatively small percentage of all funding fees collected, thousands of veterans were negatively affected.

[9] The review team categorized inappropriate funding fee charges as avoidable and unavoidable to make a distinction between charges that could and could not have been detected as inappropriate at the time of loan origination.

December 31, 2017. Refunds that were issued resulted because of requests from veterans or lenders, or the inappropriate charges were identified during quality reviews. Table 2 summarizes the estimated number of exempt veterans with funding fee charges, estimated amount of the charges, number of veterans still owed refunds, and estimated total amount of the refunds due.

Table 2. Inappropriate Funding Fee Charges

Calendar year	Estimated number of exempt veterans with funding fee charges	Estimated dollars charged	Estimated number of veterans due refunds	Estimated refunds due
2017	8,500	$44,200,000	6,900	$32,700,000
2012–2016	64,400	$242,200,000	46,400	$156,300,000
Total	**72,900**	**$286,400,000**	**53,200***	**$189,100,000***

Source: VA OIG analysis of statistically sampled loans from January 1, 2012, through December 31, 2017.
Note: The dollar figures and numbers are rounded for reporting purposes.
** The totals do not sum due to rounding.*

If Loan Guaranty Service management does not implement processes to minimize or detect inappropriate funding fee charges, the review team estimated that VA could owe another 34,400 exempt veterans refunds of approximately $164 million over the next five years.[10] Based on this review, it is the team's opinion that this problem probably existed prior to 2012.

Avoidable Funding Fees

The review team estimated, based on the sample review, that VA owed approximately 14,100 veterans $41.5 million in refunds for avoidable funding fees charged during the period January 1, 2012, through December 31, 2017. The team considered funding fee charges as "avoidable" when veterans were exempt at the time of loan origination, but were incorrectly charged funding fees. Some avoidable funding fee charges would be difficult for VA to prevent. For example, when lenders incorrectly collect funding fees despite COEs showing veterans are exempt. However, in such cases, VA should be able to detect inappropriate charges and issue refunds.

[10] The review team added the calendar year 2017 estimates of 2,500 veterans owed $9.9 million in avoidable refunds and 4,400 veterans owed $22.8 million in unavoidable refunds, for a total of 6,900 veterans (2,500 plus 4,400) owed $32.7 million ($9.9 million plus $22.8 million) in refunds. The review team then multiplied those totals by five to estimate the number of veterans who were due refunds for calendar years 2018 through 2022. This resulted in a five-year estimate of approximately 34,400 (6,900 x 5) veterans owed $163.6 million ($32.7 million x 5). (Variance due to rounding.)

Table 3 summarizes the estimated number of veterans with avoidable funding fee charges, estimated amount of the charges, number of veterans still owed refunds, and estimated total amount of the refunds due.

Table 3. Avoidable Funding Fee Charges

Calendar year	Estimated number of veterans with avoidable funding fee charges	Estimated avoidable dollars charged	Estimated number of veterans due refunds	Estimated refunds due
2017	3,200	$14,900,000	2,500	$9,900,000
2012–2016	15,500	$50,900,000	11,600	$31,600,000
Total	**18,700**	**$65,800,000**	**14,100**	**$41,500,000**

Source: VA OIG analysis of statistically sampled loans from January 1, 2012, through December 31, 2017.
Note: The dollar figures and numbers are rounded for reporting purposes.

Although COEs are supposed to indicate veterans' exemption status, the review team found the exemption status on some COEs were outdated, incorrect, or missing. The team also identified loans where the funding fee exemption status correctly showed the veterans as being exempt; however, lenders still collected VA funding fees from those veterans. Of the 200 loans sampled, 62 contained avoidable funding fees charged. Examples of the three most common avoidable funding fee charges follow.

Example 1: Veteran Became Exempt after COE Issued

For 20 of 62 loans reviewed with avoidable funding fee charges, the COE correctly indicated a funding fee status of nonexempt when issued. These veterans subsequently received an award of service-connected compensation after the COE was issued, but prior to loan origination. Loan Guaranty Service policy did not require COEs to be updated or issued near loan origination, which could have reduced the occurrence of COEs reflecting the incorrect status. As a result, these veterans were incorrectly charged a funding fee despite receiving VA compensation for service-connected disabilities as of the date of loan origination.

For example, a veteran's COE dated January 17, 2017, correctly showed the veteran as "nonexempt" from paying a funding fee. In July 2017, the veteran became entitled to receive VA disability compensation effective as of January 13, 2017. However, no updated COE was issued showing the veteran was now exempt from the funding fee, and the lender incorrectly charged the veteran the fee upon loan origination in November 2017. As a result, the veteran was incorrectly charged approximately $2,000.

Example 2: COE Did Not Reflect Correct Exemption Status

For 16 of the 62 loans reviewed with avoidable funding fee charges, the COE incorrectly indicated a funding fee status of nonexempt despite the veteran receiving VA compensation for service-connected disabilities at the time the COE was issued. As a result, these veterans were incorrectly charged a funding fee despite receiving VA compensation for service-connected disabilities as of the date of loan origination.

For example, an exempt veteran had been receiving VA disability compensation since March 2011. A COE was issued in September 2017 for the veteran's new home purchase. The veteran's exemption status on the COE incorrectly showed "nonexempt," despite the veteran receiving VA disability compensation for more than six years prior to the generation of the COE. As a result, the lender incorrectly charged the veteran nearly $5,800.

Example 3: Lender Collected Funding Fee Despite COE Showing Correct Exemption Status

For 15 of the 62 loans reviewed with avoidable funding fee charges, the COE correctly indicated a funding fee status of exempt; however, these veterans were incorrectly charged a funding fee despite receiving VA compensation for service-connected disabilities as of the date of loan origination.

For example, a veteran's COE correctly indicated the veteran was exempt from paying a funding fee due to receipt of VA disability compensation. However, the lender incorrectly charged the veteran the fee upon loan origination. As a result, the lender incorrectly charged the veteran approximately $10,700.

For the remaining 11 of 62 loans reviewed with avoidable funding fee charges, the COE was either not in WebLGY, or the COE did not include any exemption status.

Unavoidable Funding Fees

The team considered funding fee charges as "unavoidable" when veterans were correctly charged funding fees at the time of loan origination, but these veterans became retroactively exempt. The review team estimated, based on the sample review, that VA owed approximately 39,200 veterans $147.6 million in refunds for unavoidable funding fee charges on home loans that originated from January 1, 2012, through December 31, 2017. VA owes these veterans refunds of the fees because they became entitled to receive VA disability compensation with an effective date that was prior to loan origination, resulting in a change in their exemption status.[11] Table 4 summarizes the estimated number of veterans with unavoidable funding fee charges, estimated amount of the charges, number of veterans still owed refunds, and estimated total amount of the refunds due.

Table 4. Unavoidable Funding Fee Charges

Calendar year	Estimated number of veterans with unavoidable funding fee charges	Estimated unavoidable dollars charged	Estimated number of veterans due refunds	Estimated refunds due
2017	5,300	$29,200,000	4,400	$22,800,000
2012–2016	48,900	$191,300,000	34,800	$124,700,000
Total	**54,200**	**$220,600,000***	**39,200**	**$147,600,000***

Source: VA OIG analysis of statistically sampled loans from January 1, 2012, through December 31, 2017.
Note: The dollar figures and numbers are rounded for reporting purposes.
** The totals do not sum due to rounding.*

The COEs that lenders used reflected the correct funding fee status of nonexempt because the veterans were not receiving VA disability compensation at the time of loan origination. However, these veterans became retroactively eligible to receive a funding fee exemption effective on a date that was prior to loan origination. As a result, these veterans were exempt from paying the funding fees, and VA should have issued them refunds. Example 4 describes this type of funding fee charge.

Example 4: Veteran Owed Funding Fee Refund Due to a Retroactive Change in Exemption Status

A veteran's COE dated July 13, 2017, correctly showed the veteran as "nonexempt" from paying a funding fee. The lender charged the veteran the fee upon loan origination in August 2017. In March 2018, the veteran became entitled to receive VA disability compensation effective February 1, 2017. The veteran should have received a refund of approximately $15,200, since VA disability compensation was effective prior to the date of loan origination.

[11] According to VBA's Guaranteed Loan Processing Manual, M26-1, Chapter 3.2.d, *Fees and Charges Paid by the Borrower*, Reasons for Refunding the Funding Fee, the veteran is exempt at the time of closing if awarded compensation with an effective date prior to closing.

Refunds Not Processed Due to Competing Priorities

Since at least October 2014, Loan Guaranty Service management was aware that exempt veterans had been charged home loan funding fees. In October 2014, St. Paul RLC management provided an analysis to the former and current directors of Loan Guaranty Service, as well as other management officials.[12] The analysis indicated that approximately 48,000 loans may be due funding fee refunds totaling approximately $151 million based on funding fees inappropriately paid from October 1, 2006, through May 31, 2014. According to St. Paul RLC's analysis, most of the 48,000 were the result of unavoidable funding fee charges. As of January 2019, the review team received no indication that a large-scale effort had been initiated to issue refunds to these veterans.

The review team also found Loan Guaranty Service staff documented concerns related to the funding fees process from December 2015 through February 2018. For example, in January 2016, Loan Guaranty Service identified risks associated with the accuracy of exemption statuses on COEs. However, as of January 2019, Loan Guaranty Service management had not taken substantive actions to ensure exempt veterans were not charged funding fees and refunds were issued when inappropriate charges occurred.

When asked what actions they had taken regarding the October 2014 analysis, the current and former directors of Loan Guaranty Service stated that their focus was on other competing priorities. For example, the current director reported that from FY 2014 through FY 2016 there was a significant increase in the amount of serial refinancing.[13] He also reported efforts to reduce a high blocked call rate and long wait times from FY 2015 to FY 2017.[14] As another example, the current director reported concentrating on improving appraisal timeliness during FY 2016 and FY 2017 because a shortage of appraisers resulted in veterans having to wait weeks for an appraisal to be completed. In addition, information provided by the current director of Loan Guaranty Service stated VA experienced historically high loan volumes three years in a row from FY 2015 through FY 2017.

The current director of Loan Guaranty Service stated he considered contracting out the task of issuing refunds, but never requested the award of a contract because other priorities, discussed in the paragraph above, took precedence. He also stated addressing inappropriate charges and refunds did "not represent a long term, sustained need . . . ." Therefore, he did not request additional staffing. The current director also stated other initiatives provided Loan Guaranty

[12] The current director of Loan Guaranty Service was appointed in 2017, and prior to that he served as the deputy director of Loan Guaranty Service, beginning in 2012. The former director of Loan Guaranty Service held that position beginning in 2012 until 2016.

[13] According to information received from the current director of Loan Guaranty Service, serial refinancing is the practice of refinancing multiple times in a short amount of time.

[14]According to information received from the current director of Loan Guaranty Service, blocked calls end prior to the caller getting a chance to speak with a VA representative.

Service with a bigger return for staff time spent and it "was not logical" to divert untrained staff from other business lines. He added he had a finite number of staff and pulling them from his established priorities "would not have been sensible."

Although the current and former directors of Loan Guaranty Service identified several priorities, their priorities should have included issuing funding fee refunds to exempt veterans and implementing controls to minimize or detect future inappropriate charges. The October 2014 St. Paul RLC analysis estimated it would take four to eight VA staff members one year to refund the inappropriate charges identified. VA staff that would be needed depended on lenders and servicers willingness to help. Furthermore, the RLC recommended that additional staff, number not specified, should be assigned to process refunds for other exempt veterans charged funding fees.

Legislative Requirements

The review team found Loan Guaranty Service management did not implement a policy to identify and issue refunds for inappropriate funding fee charges. The current director of Loan Guaranty Service stated that Loan Guaranty Service relies on veterans to contact VA. The current director also stated that it was not clear if Loan Guaranty Service was able to extend refunds that were not applied for by veterans. However, the review team found Loan Guaranty Service has not published a standard form for requesting a funding fee refund; as such, veteran- or lender-initiated refunds are issued without submission of a claim form. The review team also found that VA issued 47 funding fee refunds to lenders out of a sample of 200 loans reviewed. Of the 47 refunds, only four refunds contained documentation in WebLGY showing that the veteran initiated the funding fee refund request.

The review team did not find statutory or regulatory requirements for exempt veterans to submit a claim to receive a refund for inappropriate funding fee charges. Additionally, the VA's Chief Counsel, Loan Guaranty National Practice Group, Office of General Counsel, indicated that whether an application is required depends on how VA classifies funding fee refunds. Specifically, according to the chief counsel, if VA classifies these refunds as a benefit, then an application form is required. Conversely, according to the chief counsel, if VA classifies these refunds as overpayments received by VA, then VA should return the amounts overpaid. The review team found requirements that an application is only necessary when a veteran submits a claim for benefits such as VA disability compensation.[15] However, the review team does not consider a funding fee refund a claim for benefits because a refund is not an entitlement issue, rather funds owed the veteran that must be repaid if an exempt veteran was charged. It is also the

[15] 38 Code of Federal Regulations §3.151, "*Claims for disability benefits*, (a) *General.* A specific claim in the form prescribed by the Secretary must be filed in order for benefits to be paid to any individual under the laws administered by VA. (38 United States Code 5101(a).)."

review team's opinion that requiring a veteran to submit a claim for a refund improperly places the burden and responsibility solely upon the veteran.

Lack of Automated Process to Identify Exemption Status Changes

The WebLGY system interfaces with VBA's Corporate Data Warehouse to obtain disability compensation information. However, WebLGY did not automatically identify home loans for review when a change in funding fee exemption status occurred.[16] The Corporate Data Warehouse does not update WebLGY when an exemption status changes.

The current director of Loan Guaranty Service reported directing staff to determine what Loan Guaranty Service system enhancements could be done to positively affect funding fees. The current director reported Loan Guaranty Service was coordinating the redesign in FY 2016 with the Office of Information and Technology. According to a Loan Guaranty Service presentation, new system functionality will be released in 2019, with future loan origination functionality in the next two to four years. Until Loan Guaranty Service's loan administration system can automatically identify exemption status changes, Loan Guaranty Service should conduct periodic reviews to identify future exempt veterans charged these fees.

Missing Documentation

Loan Guaranty Service staff does not consistently obtain documentation showing refunds were applied to veterans' loan balances. When a home loan includes VA funding fees and the veteran is due a refund, VA must issue the refund to the current loan lender, servicer, or veteran.[17] The lender or servicer is required to submit evidence to VA showing that the refund was applied to the veteran's loan balance. The review team found that VA issued 47 funding fee refunds to lenders out of a sample of 200 loans reviewed. Four of the 47 refunds had documentation in WebLGY showing the lenders or servicers applied the refunds to loan balances. For the remaining 43 refunds, the team could not find documentation in WebLGY showing the lenders or servicers applied the refunds to loan balances or refunded the veterans. Without documentation, VA has no reasonable assurance that lenders or servicers applied those refunds to the balances of veterans' loans. The team requested evidence that these refunds were applied to the veterans' loans. As of January 2019, the team had not received this documentation.

RLC Reviews

The review team found Loan Guaranty Service guidance did not require RLCs to use a standardized process to monitor whether lenders and servicers properly applied refunds to loan

[16] WebLGY enables participating lenders to electronically submit a loan to VA for guaranty.

[17] VA defines a servicer as a mortgage company that collects funds for a debt incurred by a borrower to purchase a home.

balances. Management at the Atlanta, Georgia, and St. Paul, Minnesota, RLCs used spreadsheets, and the Denver, Colorado, RLC's management used WebLGY. The Denver RLC management's use of a system reminder to check on the status of applying the refund to the loan balance provided the best results of the two methods observed by the review team. The current director of Loan Guaranty Service stated the Denver RLC process is still being considered along with alternative methods.

Conclusion

Loan Guaranty Service management did not have adequate controls to prevent exempt veterans from incurring home loan funding fee charges. Management also did not ensure RLC staff issued refunds of inappropriate charges. Loan Guaranty Service management reported that they faced many challenges from FY 2008 through FY 2018 and did not fully address these issues due to competing priorities. They were made aware of about 48,000 exempt loans that may be due refunds over $151 million in 2014 but did not protect these veterans' financial interests. Because inappropriate funding fee charges were not refunded, many exempt veterans may have suffered significant financial losses. Furthermore, in the limited instances when Loan Guaranty Service issued refunds, they lacked adequate controls to ensure lenders applied the refunds to affected loan balances.

Recommendations 1–5

1. Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to identify exempt veterans who were charged funding fees during the period from January 1, 2012, through December 31, 2017, and issue refunds.
2. Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to identify exempt veterans who were charged funding fees prior to January 1, 2012, and issue refunds.
3. Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to mitigate the lack of real-time funding fee exemption status updates through system enhancements or procedural changes that minimize inappropriate funding fee charges.
4. Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to conduct periodic reviews to identify exempt veterans charged funding fees from January 1, 2018, forward, and issue refunds in a timely manner.
5. Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to consistently obtain documentation and verify lenders apply funding fee refunds to veterans' loan balances in a timely manner.

VBA Management Comments

The Under Secretary for Benefits concurred with Recommendations 1, 2, and 4, and concurred in part with Recommendations 3 and 5. The Under Secretary provided corrective action plans for all recommendations, with a target completion date of July 31, 2019. VBA has requested a legal opinion from VA's Office of General Counsel to determine whether VA has the authority to issue funding fee refunds directly to veterans in cases where there is a loan balance. The Under Secretary stated having this authority would increase the efficiency in completing refunds timely and would determine the procedural and policy changes implemented going forward. The Under Secretary also stated Loan Guaranty Service has a contingency plan ready for implementation depending on the outcome of General Counsel's legal opinion. In response to Recommendations 1, 2, and 4, VBA plans to identify exempt veterans charged funding fees and issue refunds as appropriate. In response to Recommendation 3, VBA chose to implement procedural changes instead of system enhancements to mitigate control gaps. In response to Recommendation 5, VBA stated that, if the General Counsel's legal opinion permits VBA to issue refunds directly to veterans, this recommendation would become unnecessary. If the legal opinion does not permit issuance of refunds directly to veterans, the OIG will assess whether VBA's contingency plan will adequately address this recommendation. The Under Secretary also included technical comments on the OIG's draft report.

Appendix E provides the full text of the Under Secretary for Benefits' comments.

OIG Response

The Under Secretary for Benefits' comments and corrective action plans for Recommendations 1 through 5 are acceptable and responsive to the intent of the recommendations. The OIG will monitor implementation of planned actions and will close the recommendations when the OIG receives sufficient evidence demonstrating progress in addressing the identified issues.

The Under Secretary's comments noted discrepancies in the analysis conducted by St. Paul Regional Loan Center staff. Based on VBA's response to the draft report, the OIG revised the report to clarify that exempt veterans identified by the St. Paul Regional Loan Center analysis "may" be owed refunds. The OIG stands by the assertion that VBA should issue refunds for any exempt veterans inappropriately charged funding fees.

The Under Secretary indicated that the financial impact to veterans is minimal when amortized over the life of a loan. The OIG stands by the assertion that VBA did not protect these veterans' financial interests and any inappropriate funding fee charges, regardless of the amount, should be refunded. VBA's response indicated staff issued more than 19,700 funding fee refunds during the period from January 1, 2012, through December 31, 2017. However, OIG's review estimated Loan Guaranty Service did not issue funding fee refunds to approximately 72,900 exempt veterans who originated VA-guaranteed home loans during that same period.

The Under Secretary expressed a concern that OIG's categorization of certain inappropriate funding fee charges as avoidable is misleading, indicating that many such charges are the result of lender errors. The OIG stands by the distinction, which is clearly defined in the report. As stated by VBA in their response, Loan Guaranty Service is responsible for lender oversight. In cooperation with lenders, VA should be able to minimize or detect these inappropriate charges and issue refunds when appropriate.

The Under Secretary took exception to the five-year monetary impact estimate reflected in the report. The OIG uses the five-year estimate to emphasize the importance of taking corrective actions and to highlight the potential magnitude of identified issues if such actions are delayed or never implemented. The OIG acknowledges that the actual future monetary impact will vary because events and circumstances change. However, that variance is largely dependent on if, when, and how VBA implements its corrective actions.

Appendix A: Scope and Methodology

Scope

The review team conducted its work from June 2018 through April 2019. The review included approximately 77,800 veterans who were exempt, originated VA-guaranteed home loans, and paid funding fees during the period from January 1, 2012, through December 31, 2017.[18] The loan origination date is the date the borrower signs the final loan application. The review team also obtained VA disability compensation data to determine the appropriate funding fee exemption statuses of the veterans. The review team selected a statistical sample of 100 loans from the universe of approximately 8,900 during the period from January 1 through December 31, 2017. In addition, the review team selected a statistical sample of 100 loans from the universe of approximately 68,900 during the period from January 1, 2012, through December 31, 2016. Of the 200 loans reviewed, the team found VA issued funding fee refunds for 47 exempt veterans.

Methodology

To accomplish the review objective, the review team identified and reviewed applicable laws, regulations, VA policies, operating procedures, and guidelines related to VA home loan guaranty funding fees. The review team interviewed and obtained testimonial information related to work processes associated with home loan guaranty funding fees from management and staff at three RLCs; VBA's Central Office, including Loan Guaranty Service; and Loan Systematic Technical Accuracy Review in Nashville, Tennessee.

From June through August 2018, the review team conducted site visits to the following RLCs:

1. Atlanta, Georgia
2. St. Paul, Minnesota
3. Denver, Colorado

The review team interviewed employees including loan guaranty officers, loan production officers, and loan production staff.

In coordination with VA OIG statisticians, the review team reviewed a stratified random statistical sample of 100 loans from the period from January 1 through December 31, 2017. The review team also reviewed a stratified random statistical sample of 100 loans during the period

[18] The OIG sample was selected from a population of 77,824 loans. The review team estimated the population to be 72,892 loans after excluding loans determined to be outside the scope of review. For example, the veteran was no longer exempt from paying the VA funding fee, the veteran was deceased, or the review team did not have access to loan information.

from January 1, 2012, through December 31, 2016. The review team determined whether exempt veterans paid VA home loan funding fees, and if applicable, whether they were refunded the funding fees. Appendix B provides more details on the statistical sampling methodology.

The review team used VBA's electronic systems, including WebLGY and the Veterans Benefits Management System, to review relevant documentation required to assess whether exempt veterans paid VA home loan funding fees. The review team discussed the findings with VBA officials and included their comments where appropriate.

Fraud Assessment

The OIG assessed the risk that fraud, violations of legal and regulatory requirements, and abuse could occur during this review. The OIG exercised due diligence in staying alert to any fraud indicators by taking actions such as

- Soliciting the OIG's Office of Investigations for indicators,
- Reviewing the OIG Hotline complaints and concerns for indicators, and
- Completing the Fraud Indicators and Assessment checklist.

The OIG did not identify any instances of fraud or potential fraud during this review.

Data Reliability

The review team used computer-processed data from LGY Master File and VBA's Corporate Data Warehouse. To test for reliability, the review team determined whether any data were missing from key fields, included any calculation errors, or were outside the time frame requested. The review team also assessed whether the data contained obvious duplication of records, alphabetic or numeric characters in incorrect fields, or illogical relationships among data elements.

Testing disclosed the data were sufficiently reliable for the review objectives. Comparison of data obtained by the review team to information contained in VBA electronic systems did not disclose any problems with data reliability.

Government Standards

The OIG conducted this inspection in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation.*

Appendix B: Statistical Sampling Methodology

Approach

The team selected a statistical sample of 200 loans, including 100 from the period of January 1 through December 31, 2017; and 100 from the period January 1, 2012, through December 31, 2016.[19] The purpose of the sample review was to quantify the extent of loans where exempt veterans were charged a funding fee and had an effective date of entitlement to receive disability compensation prior to loan origination.

Population

The review population included 77,824 loans, during the period from January 1, 2012, through December 31, 2017.

Sampling Design

The review team selected a statistical sample of 100 loans from the universe of 8,912 loans from the period of January 1 through December 31, 2017. The review team also selected a statistical sample of 100 loans from the universe of 68,912 loans from the period of January 1, 2012, through December 31, 2016.

Weights

The OIG calculated estimates in this report using weighted sample data. Sampling weights are computed by taking the product of the inverse of the probabilities of selection at each stage of sampling.

Projections and Margins of Error

The review team used Statistical Analysis System software to calculate the weighted universe estimates and associated sampling errors from the statistically selected loans. The Statistical Analysis System employs replication methodology to calculate margins of error and confidence intervals that correctly account for the complexity of the sample design. The margins of error and confidence intervals are indicators of the precision of the estimates. If the review team repeated this review with multiple samples, the confidence intervals would differ for each sample but would include the true population value 90 percent of the time. For the review results, the team

[19] The OIG reviewed 212 loans to identify a sample of 200. The review team identified 12 loans that did not meet the selection criteria. For example, the veteran was no longer exempt from paying the VA funding fee, the veteran was deceased, or the review team did not have access to loan information. These 12 loans were considered out of scope.

used estimates of the 90 percent confidence interval. The following tables detail the review team's analysis and projected results.

Table B.1 shows the projections of the estimated number of veterans and associated dollars included in this report.

Table B.1. Summary of Projections and Confidence Intervals for Estimated Avoidable Funding Fee Charges and Refunds Calendar Year 2017

Category	Projection	Margin of error	Lower limit 90% confidence interval	Upper limit 90% confidence interval	Total sample size	Count from sample
Veterans affected	3,225	697	2,528	3,922	100	38
Dollars charged	$14,931,895	$4,736,005	$10,195,890	$19,667,899	100	38
Veterans due refunds	2,461	648	1,813	3,110	100	29
Refunds due	$9,886,472	$3,762,272	$6,124,200	$13,648,744	100	29

Source: VA OIG analysis of statistically sampled loans from January 1, 2017, through December 31, 2017.
Note: The dollar figures and numbers are rounded for reporting purposes.

Table B.2 shows the projections of the estimated number of veterans and associated dollars included in this report.

Table B.2. Summary of Projections and Confidence Intervals for Estimated Avoidable Funding Fee Charges and Refunds Calendar Years 2012–2016

Category	Projection	Margin of error	Lower limit 90% confidence interval	Upper limit 90% confidence interval	Total sample size	Count from sample
Veterans affected	15,457	4,633	10,824	20,090	100	24
Dollars charged	$50,915,283	$22,674,055	$28,241,228	$73,589,339	100	24
Veterans due refunds	11,593	4,155	7,438	15,747	100	18
Refunds due	$31,624,354	$17,525,707	$14,098,648	$49,150,061	100	18

Source: VA OIG analysis of statistically sampled loans from January 1, 2012, through December 31, 2016.
Note: The dollar figures and numbers are rounded for reporting purposes.

Table B.3 shows the projections of the estimated number of veterans and associated dollars included in this report.

Table B.3. Summary of Projections and Confidence Intervals for Estimated Unavoidable Funding Fee Charges and Refunds Calendar Year 2017

Category	Projection	Margin of error	Lower limit 90% confidence interval	Upper limit 90% confidence interval	Total sample size	Count from sample
Veterans affected	5,262	713	4,549	5,976	100	62
Dollars charged	$29,236,363	$5,929,316	$23,307,046	$35,165,679	100	62
Veterans due refunds	4,414	725	3,688	5,139	100	52
Refunds due	$22,833,407	$5,280,884	$17,552,523	$28,114,291	100	52

Source: VA OIG analysis of statistically sampled loans from January 1, 2017, through December 31, 2017.
Note: The dollar figures and numbers are rounded for reporting purposes.

Table B.4 shows the projections of the estimated number of veterans and associated dollars included in this report.

Table B.4. Summary of Projections and Confidence Intervals for Estimated Unavoidable Funding Fee Charges and Refunds Calendar Years 2012-2016

Category	Projection	Margin of error	Lower limit 90% confidence interval	Upper limit 90% confidence interval	Total sample size	Count from sample
Veterans affected	48,947	5,038	43,909	53,985	100	76
Dollars charged	$191,333,138	$32,746,076	$158,587,061	$224,079,214	100	76
Veterans due refunds	34,778	5,553	29,225	40,331	100	54
Refunds due	$124,720,299	$28,880,556	$95,839,744	$153,600,855	100	54

Source: VA OIG analysis of statistically sampled loans from January 1, 2012, through December 31, 2016.
Note: The dollar figures and numbers are rounded for reporting purposes.

Appendix C: Monetary Benefits in Accordance with Inspector General Act Amendments

Recommendation	Explanation of benefits	Better use of funds	Questioned costs
1	The OIG estimated that during the period from January 1, 2012, through December 31, 2016, VA failed to issue over $156.3 million in home loan funding fee refunds to exempt veterans.	$0	$156.3 million
1	The OIG estimated that during the period from January 1 through December 31, 2017, VA failed to issue nearly $32.7 million in home loan funding fee refunds to exempt veterans.	$0	$32.7 million
2–3	The OIG estimated that VA would owe exempt veterans home loan funding fee refunds of $163.6 million over the next five years if VBA does not implement controls to minimize or detect inappropriate charges.[20]	$0	$163.6 million
	Total	**$0**	**$352.6 million**

[20] The OIG team added the calendar year 2017 estimates that veterans were owed $9.9 million in avoidable refunds and $22.8 million in unavoidable refunds, for a total of $32.7 million in refunds. The OIG team then multiplied those totals by 5 to estimate the refunds due for calendar years 2018 through 2022. This resulted in a five-year value of approximately $163.6 million ($32.7 million x 5). (Variance due to rounding.)

Appendix D: VA Loan Guaranty Program Funding Fees Tables

The VA Loan Guaranty Program funding fees, effective as of November 21, 2011, are shown in the tables below.

Table D.1. Funding Fees for Purchase and Construction Loans

Type of veteran	Down payment amount	Percentage for first time use	Percentage for subsequent use
Regular military	None	2.15 percent	3.3 percent
	5 percent or more	1.5 percent	1.5 percent
	10 percent or more	1.25 percent	1.25 percent
Reserve/National Guard	None	2.4 percent	3.3 percent
	5 percent or more	1.75 percent	1.75 percent
	10 percent or more	1.5 percent	1.5 percent

Source: VA Pamphlet 26-7 and §38 U.S.C. 3729

Table D.2. Funding Fees for Cash-Out Refinancing Loans

Type of veteran	Percentage for first time use	Percentage for subsequent use
Regular military	2.15 percent	3.3 percent
Reserve/National Guard	2.4 percent	3.3 percent

Source: VA Pamphlet 26-7 and §38 U.S.C. 3729

Table D.3. Funding Fees for Other Loans

Type of loan	Percentage for either type of veteran whether first time or subsequent use
Interest rate reduction refinance loans	.5 percent
Manufactured home loans	1 percent
Loan assumptions	.5 percent

Source: VA Pamphlet 26-7 and §38 U.S.C. 3729

Appendix E: Management Comments

Department of Veterans Affairs Memorandum

Date: May 15, 2019

From: Under Secretary for Benefits (20)

Subj: OIG Draft Report – Exempt Veterans Charged VA Home Loan Funding Fees [Project No. 2018-03250-BI-0116]

To: Assistant Inspector General for Audits and Evaluations (52)

1. Attached is VBA's response to the OIG Draft Report: Exempt Veterans Charged VA Home Loan Funding Fees.
2. OIG's report assumes that VBA would not make any improvements over the next five years, including those from implementing OIG's recommendations, and then proceeds to identify a corresponding estimated monetary impact. VBA takes exception to this practice as this assumption is incorrect and misleading to the reader. Furthermore, the methodology/reasoning for the practice is not clearly documented or explained in the report. Generally, agencies are required to complete final action on OIG recommendations within 12 months of publication. Assuming current practices will go unchanged is false, as VBA values OIG's vital oversight role and works diligently to implement recommendations to improve service to Veterans.
3. Questions may be referred to R. Mitchum, Program Analyst, at (202) 632-8987.

(Original signed by)

Paul R. Lawrence, Ph.D.

Attachment

For accessibility, the original format of this appendix has been modified to comply with Section 508 of the Rehabilitation Act of 1973, as amended.

Attachment

Veterans Benefits Administration
Comments on OIG Draft Report
Exempt Veterans Charged VA Home Loan Funding Fees

VBA provides the following general comments:

The Veterans Benefits Administration (VBA) Loan Guaranty Service (LGY) appreciates the Office of the Inspector General's (OIG) review of Exempt Veterans Charged VA Home Loan Funding Fees. VBA acknowledges this report highlights areas for improvement and generally agrees with the OIG recommendations. However, LGY does not agree with some of the findings and conclusions of OIG regarding operational practices, historical context, and leadership decisions.

Historically, VA has notified Veterans and lenders that if Veterans are rated for VA disability compensation before closing on a VA loan, they are eligible for a waiver of the funding fee. Further, VA guidance notes that if a Veteran's disability compensation award date is made retroactive prior to a previous VA home loan closing, the Veteran may be entitled to a funding fee refund. VA has communicated this in its Lenders Handbook and Internal Operations Manual (M26-1). In considering the historical practices of LGY, Veterans were notified to contact LGY once they were awarded compensation for a service connected disability to request a funding fee refund so that LGY could review their case considering the date of loan origination and the compensation award date to determine if a funding fee refund was warranted. This operational precedent is further supported by the design of many of LGY's oversight controls, which were operationalized to ensure a proper determination was made regarding the funding fee refund decision once a Veteran requested a refund.

In the draft report, OIG acknowledges the legal complexities of this operational precedent by observing, "VA's Chief Counsel, Loan Guaranty National Practice Group, Office of General Council, stated that whether an application is required depends on how VA classifies funding fee refunds. If VA classifies these refunds as a benefit, then an application form is required. Conversely, if VA classifies these refunds as overpayments received by VA, then VA should return the amounts overpaid" (p.10). While LGY has opted not to pursue this line of inquiry with the Office of General Counsel (OGC), and has instead decided to re-evaluate the historical precedent guiding its operational practices by contacting the Veterans affected and initiating funding fee refunds, OIG's statements on this issue illuminate the fact that there are many unanswered questions regarding the legalities of LGY's historical practices and assumptions regarding VA's classification of funding fee refunds.

OIG reviewed LGY's funding fee activity from calendar years (CYs) 2012 through 2017. This is a time when the program was experiencing unprecedented growth. LGY was contending with workload considerations due to record loan volume from CY 2012 through CY 2018. For example, VA guaranteed almost 540,000 loans in fiscal year (FY) 2012 (a record at the time) only to be followed by subsequent fiscal years of record loan volume of approximately 629,000, 631,000, 705,000, and 740,000 in 2013, 2015, 2016, and 2017, respectively, as well as record purchase loan volume in FY 2015 – FY 2018. It is also important to note that the program experienced a 300 percent increase in loan volume from FY 2008 (i.e. around the time of the housing crisis) to FY 2017, which included loan volume that had more than doubled from FY 2011 to FY 2017. During this same timeframe, certificates of eligibility (COEs) were being processed at only one Regional Loan Center (RLC) (Atlanta). By having only 35 dedicated LGY staff members at one RLC responsible for issuing all COEs nationally during a time of unprecedented growth in VA loan volume, timeliness was beginning to suffer, inhibiting Veterans' access to their home loan benefit and delaying loan closings which could result in lost contracts. At one point, COEs were being processed in 26 days on average, and many cases were taking even longer. For this reason, LGY leadership decided to prioritize nationalization by distributing COE requests across staff at VBA's eight RLCs. Because of the efficiencies from nationalization, COE's are now processed in 1.9 days on average, allowing more Veterans to take advantage of their home loan benefit in a timely manner.

Along with the record increases in loan volume, LGY also experienced a parallel increase in phone call volume. In FY 2015, annual call volume was near 1,000,000 calls annually with a 40-50 percent blocked call rate and 20-30-minute wait times during peak periods. Because the largest grouping of phone calls received were inquiries on COEs, the statistics in Atlanta (which was the sole processor of LGY COEs at the time) were far worse. LGY moved to redistribute the call queue (based on callers' area codes) so that the staff in Atlanta could work to process COE requests while LGY worked to nationalize COE processing to all RLCs. However, these initiatives did not provide the full degree of improvement sought, and LGY still lacked in customer service to our stakeholders. Swift action was needed to serve Veterans who were closing on loans and needed to have their telephone calls answered promptly. LGY leadership was forced to respond to the changing market conditions by diverting additional staff and resources in an effort to keep pace with demand and ensure Veterans had access to their home loan benefit. This effort resulted in the implementation of a nationwide telephone system with average wait times under 30 seconds and no blocked calls.

At the same time, LGY was focused on addressing the burgeoning number of unassigned and untimely appraisals. In the first quarter of FY 2017, LGY posted an astounding Appraisal Assignments Pending figure of over 4,000 cases. The appraisal timeliness figure was 17.8 days at the end of FY 2016, and 18.8 days at end of FY 2017. Worse yet, in several troublesome counties in the US, appraisal timeliness was significantly higher; in some areas we saw appraisal delays of up to 32 days in FY 2016; and 54 days in FY 2017. Numerous Veteran and Congressional complaints were being received, and in April 2017, the House Committee on Veteran's Affairs, Subcommittee on Economic Opportunity, summoned LGY's Director to testify on this issue in an oversight hearing. Fortunately, actions taken to address the situation were largely successful in decreasing the number of pending appraisals and increasing appraisal timeliness. Following the hearing, staff were directed to continue their tight focus on ensuring appropriate appraiser roster numbers that were in-line with demand, and on monitoring and triaging the weekly unassigned cases list to ensure Veterans were getting their appraisals in timely fashion. In addition to the noted challenges, LGY was working to resolve competing priorities. This included the redesign/re-platforming of the VA Loan Electronic Reporting Interface (VALERI) system to assist Veterans in default on their loans and prevent foreclosures. LGY was also addressing serial refinancing and predatory refinancing, which was an increasingly complex issue that impacted numerous stakeholders including Veterans, lenders, and mortgage investors, and led to an oversight hearing. This work was done in the backdrop of record level volume in loans, Specially Adapted Housing (SAH) grants, and foreclosure assistance.

As OIG documented, around October 2014, VBA's St. Paul RLC elevated a concern to LGY leadership indicating their belief that approximately 48,000 Veterans may be eligible for funding fee refunds totaling approximately $151 million based on funding fees collected between October 2006 and May 2014. According to the analysis presented to LGY leadership, most of these cases were the result of a retroactive award of compensation for a service connected disability, meaning that at the time of loan origination, the Veterans were correctly charged the funding fee. At the time, the St. Paul RLC estimated that it would take eight VA staff members (approximately 50 percent of their loan production staff) one year to refund the funding fees identified. LGY noted several discrepancies with St. Paul's data, including that their estimate did not consider the fact that many of the loans on which funding fees were collected had since been paid in full, refinanced, transferred, and/or terminated, adding additional complexities to locating the loan holder and documenting the principal balance reduction. At the time, LGY leadership estimated that it would take, at a minimum, 12 VA staff members devoted to this process for an entire year to complete this undertaking. According to more recent data, LGY estimates that it would take at least 30 full-time employees more than a year to research and process the refunds.

In the draft report, OIG states they find “it troubling that senior VBA management was aware that thousands of veterans were owed over $150 million yet did not take adequate actions to ensure that refunds were issued” (p. i). Between CY 2012 and CY 2017, LGY issued over 19,700 funding fee refunds totaling approximately $97 million. OIG’s statement does not consider the historical context within which these decisions were being made. Both the current and former LGY leadership were working within the operational framework they inherited. When viewed through this context, it is clear that the unprecedented market conditions, demand on LGY resources required to deliver benefits to Veterans, and the historical operational precedent relying on Veterans (or lenders on the Veteran’s behalf) to contact LGY once Veterans were awarded compensation for a service connected disability weighed heavily on the decisions made to focus resources on system and process enhancements to improve the accuracy of COE determinations and benefits delivery.

Furthermore, the VA Home Loan allows Veterans to minimize out-of-pocket expenses. As such, many VA loans close with no down payment at 100 percent loan-to-value (LTV). Between FY 2014 and FY 2018, approximately 81 percent of all VA purchase loans originated with no down payment, with similar activity for refinance loans. All closing costs, including the funding fees, are rolled into the loan and funded by the lender. For loans that close with a down payment, funding fee costs are significantly reduced. Funding fees have a very minimal effect on the Veteran’s monthly payment. Using OIG’s average funding fee noted in the report of $4,483, amortized over 30 years, with an average interest rate of four percent, the actual financial impact to the Veteran would be approximately $21.40 per month. Hence, the total amount of funding fees collected by VA and reported by the St. Paul RLC does not necessarily correlate to the actual financial impact to Veterans.

Despite the historical context and operational precedent delineated above, current GY leadership has determined that the most appropriate course of action is to re-evaluate operational practices and to develop processes for actively identifying Veterans who are: (a) funding fee exempt at the time of loan origination, and (b) become funding fee exempt after loan origination as the result of a retroactive award and proactively issue refunds.

VBA provides the following technical comments:

Section: Executive Summary Page i, paragraph 3 - Avoidable vs. Unavoidable

> “To refine the analysis of the inappropriate charges, the review team drew a distinction between “avoidable” charges and “unavoidable” charges. Avoidable charges are those instances where the veterans were exempt from fees at the time of the loan origination.2 Unavoidable charges occur when a veteran was correctly charged a fee at loan origination, but the veteran became retroactively exempt. These inappropriate charges included approximately $65.8 million in avoidable and approximately $220.6 million in unavoidable funding fees, which occurred on loans that closed during the period of January 1, 2012, through December 31, 2017. During the same period, Loan Guaranty Service staff issued approximately 19,700 of these veterans’ refunds totaling approximately $97 million.”

VBA Comment: OIG’s draft report drew a distinction between “avoidable” and “unavoidable” charges, with (a) unavoidable charges being instances in which the Veteran was not exempt at the time of closing, but later received a funding fee exempt status as the result of a retroactive compensation award, and (b) avoidable charges being those instances where the Veteran was exempt at the time of loan origination. LGY contends that this categorization, particularly the avoidable, is misleading since it gives the reader the false impression that these charges can be prevented altogether rather than being corrected through oversight processes and controls. It also gives the impression that avoidable charges are attributed to VA, when in fact, almost all were due to lender errors.

LGY believes that much of the avoidable category should be listed as unavoidable. This category includes cases where: (a) the COE correctly indicated a funding fee status of non-exempt when issued, but Veterans subsequently received an award of service connected compensation prior to the loan closing (20 of 62 loans), (b) the COE incorrectly indicated a funding fee status of non-exempt despite the Veteran receiving VA compensation for service-connected disabilities (16 of 62 loans), and (c) the COE correctly indicated a funding fee status of exempt; however, these Veterans were incorrectly charged a funding fee in error by the lender.

(a) **The COE correctly indicated a funding fee status of non-exempt when issued –** There is a timing issue between when a Veteran is rated eligible, when Compensation Service systems update the record, and when that information is updated to LGY systems to reflect the correct exempt status. Since most VA loans close within 30 days of application, there is a very low likelihood that obtaining a second COE prior to closing would reflect a revised exempt status. OIG presumes that requiring lenders to update COEs prior to closing could have reduced the occurrence of COEs reflecting the incorrect status. However, this is all contingent upon the timing of the award regarding the loan closing and would therefore be unavoidable based on the information available to LGY at the time of closing.

(b) **The COE incorrectly indicated a funding fee status of non-exempt despite the Veteran receiving VA compensation for service-connected disabilities –** This issue is a bit more complex. Much of this is contingent upon the accuracy of data being reconciled between LGY, Compensation Service, and Department of Defense (DOD) systems. If the Veteran's name is misspelled, date of birth is incorrect, social security number (SSN), service number, or other identifying information is not correct, the COE may not accurately reflect receipt of compensation since it relies on the ability of two different VA systems and one DOD system reconciling data to identify the Veteran. In many instances, the Veteran does not have an SSN on file with VA, but rather a service number which might be duplicated.

Another common cause of reconciliation failure is the use of a full middle name vs a middle initial. This difference can prevent the system from accurately recognizing the Veteran and the correct exempt status. If, for example, the Veteran updates their name with LGY, but not Compensation Service or DOD, the systems cannot reconcile this data to make a correct determination of exempt status.

Marriage and/or name changes are also a contributing factor. If a Veteran does not notify LGY, Compensation Service, and/or DOD of a name change, the record will not reconcile to show the correct exempt status due to a mismatch with the SSN.

(c) **The COE correctly indicated a funding fee status of exempt; however, these Veterans were incorrectly charged a funding fee –** The majority of these cases were Interest Rate Reduction Refinance Loans (IRRRLs), which historically did not require a new COE. Furthermore, LGY is not aware of the funding fee payment or the Veterans exempt status until after the lender requests guaranty for the loan. Thus, for lender errors, LGY cannot prevent these charges from occurring, but can only correct errors once LGY conducts quality oversight of the lenders work.

<u>Section: Exempt Veterans were Charged Funding Fees, Page 5, paragraph 2:</u>

"If Loan Guaranty Service management does not implement processes to prevent or timely detect inappropriate funding fee charges, the review team estimated that VA could owe another 34,400 exempt veterans refunds of approximately $164 million over the next five years."

VBA Comment: OIG's report assumes that VBA would not make any improvements over the next five years, including those from implementing OIG's recommendations, and then proceeds to identify a corresponding estimated monetary impact. VBA takes exception to this practice as this assumption is incorrect and misleading to the reader. Furthermore, the methodology/reasoning for the practice is not clearly documented or explained in the report. Generally, agencies are required to complete final action on OIG recommendations within 12 months of publication. Assuming current practices will go unchanged is false, as VBA values OIG's vital oversight role and works diligently to implement recommendations to improve service to Veterans.

Section: Appendix D: VA Loan Guaranty Program Funding Fees Tables, Table 10. Funding Fees for Cash-Out Refinancing Loans, Page 19

Reserve/National Guard first time use Funding Fee percent is listed as 4.2 percent.

VBA Comment: Reserve/National Guard first time Funding Fee should be listed as 2.4 percent.

The following comments are submitted in response to the recommendations in the OIG draft report:

Recommendation 1: Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to identify exempt veterans who were charged funding fees during the period January 1, 2012 through December 31, 2017, and issue refunds.

VBA Response: Concur. A major issue under review is how VA handles refunding funding fees to borrowers who were made exempt from when they received a VA disability compensation rating. LGY is currently seeking an OGC opinion on refunding funding fee payments directly to the Veteran rather than applying the refund to the principal balance of the loan. This would increase the efficiency in completing the refunds timely and will determine the procedural and policy changes implemented going forward.

LGY has drafted a plan with contingencies ready for implementation depending on the OGC opinion. The plan will identify exempt Veterans who were charged funding fees during the period January 1, 2012 through December 31, 2017, and issue refunds.

LGY expects to implement the plan by the end of July 2019.

Target Completion Date: July 31, 2019

Recommendation 2: Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to identify exempt veterans who were charged funding fees prior to January 1, 2012 and issue refunds.

VBA Response: Concur. LGY has drafted a plan with contingencies ready for implementation depending on the OGC opinion. The plan will identify exempt Veterans who were charged funding fees prior to January 1, 2012 and issue refunds. LGY expects to implement the plan by the end of July 2019.

Target Completion Date: July 31, 2019

Recommendation 3: Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to mitigate the lack of real-time funding fee exemption status updates through system enhancements or procedural changes that prevent or timely detect inappropriate funding fee charges."

VBA Response: Concur in part. LGY disagrees with mitigating the lack of real-time funding fee exemption status updates through system enhancements. While LGY has made numerous systems enhancements and continues to work to improve efficiency in automation technology, automation efforts to date have yielded mixed results given the complexities of reconciling data between LGY, Compensation Service, and DOD systems.

VBA agrees with the impetus of this recommendation regarding procedural changes. LGY has drafted new procedures to identify Veterans' exempt status by requiring lenders to obtain an updated COE prior to closing, providing a monthly list of Veterans entitled to a funding fee refund based on retroactive ratings, and enhanced oversight to ensure Veterans are notified and funding fees are properly refunded. Lenders will be required to obtain a new COE before closing on an Interest Rate Reduction Refinance Loan (IRRRL). In the past, this step had not been required in streamlining the processing of these loans. Lenders will also be advised to ask Veterans who are not exempt from paying the funding fee if they have a claim pending, and if so, to obtain another COE within 3 days of closing.

LGY has drafted a plan with contingencies ready for implementation depending on the OGC opinion. The plan will prevent or timely detect inappropriate funding fee charges.

LGY expects to implement the plan by the end of July 2019.

Target Completion Date: July 31, 2019

Recommendation 4: Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to conduct periodic reviews to identify exempt veterans charged funding fees from January 1, 2018 forward, and issue refunds in a timely manner.

VBA Response: Concur. LGY has drafted a plan with contingencies ready for implementation depending on the OGC opinion. The plan includes guidance for conducting periodic reviews to identify exempt Veterans charged funding fees going forward, and issue refunds in a timely manner. LGY expects to implement the plan by the end of July 2019.

Target Completion Date: July 31, 2019

Recommendation 5: Under Secretary for Benefits ensures Loan Guaranty Service implements a plan to consistently obtain documentation and verify lenders apply funding fee refunds to veterans' loan balances in a timely manner.

VBA Response: Concur in part. LGY disagrees with obtaining documentation to verify lenders apply funding fee refunds to Veterans' loans balances. While lenders are providing verification to VA that a funding fee refund has been applied to the principal balance of the loan, lender errors in applying the refund correctly are very rare. This requirement is outdated as Veterans with home loans now have access to real-time information from their mortgage servicer about their home loan. Consequently, Veterans will be asked in refund notification letters to confirm that their funding fee was applied to their principal balance and contact the RLC for assistance if needed. This process parallels the current LGY procedure where Veterans oversee the mortgage servicers' processing of escrow accounts for property taxes and insurance and call VA when questions arise.

VBA agrees with Veteran funding fee refunds being processed in a timely manner. LGY is currently seeking an OGC opinion on refunding funding fee payments directly to the Veteran rather than applying the refund to the principal balance of the loan. This would increase the efficiency in completing the refunds timely and will determine the procedural and policy changes implemented going forward.

LGY has drafted a plan with contingencies ready for implementation depending on the OGC opinion. The plan will ensure Veteran funding fee refunds are processed in a timely manner. LGY expects to implement the plan by the end of July 2019. Please note that if the determination is made that LGY can begin refunding funding fee payments directly to the Veteran, this recommendation will become unnecessary.

Target Completion Date: July 31, 2019

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