Mortgage Partnership Finance® PFI Quality Control

October 21, 2013
This presentation is based on changes Effective January 1, 2014 to the MPF® Origination Guide chapter 28. It is not intended to replace the guides. The MPF guides are the governing documents and control the quality control requirements
Agenda

- Participating Financial Institution (PFI) Eligibility
- Purpose
- QC Policy
- Sample Selection
- QC Process
  - Pre-closing
  - Post-closing
  - Post-closing of a pre-closing
- Reporting Requirements
PFI Eligibility
PFI Eligibility

• Quality control is required as a part of the PFI’s eligibility requirements for participation in the MPF Program

• Annual Eligibility Certification (AEC) requires reps and warrants which includes the QC process
  - AEC will require the PFI to submit some level of documentation to support the reps and warrants
Purpose of Quality Control
Purpose

Evaluate the investment quality of the PFI’s mortgage production as well as detect possible fraud and false representation

- To ensure the loan conforms to the policies and guidelines of the PFI’s lending policy, MPF Program, other investors, insurers or guarantors as well as contractual agreements
- Ensure the loan conforms to local, state and federal laws and regulations
Purpose

• QC is the gate keeper to guard against negligence, errors and omissions by officers, employees, contractors, brokers, borrowers, marketing partners and any others involved in the process

• Provides feedback to the organization
  • Using the QC findings the mortgage process can be modified and improved
  • Recognize where staff training is needed
  • Recognize staffing needs
QC Policy
QC Policy

QC procedures must be written and tailored to fit the specifics of each PFI based on the organization’s operating environment, taking into account:

- The size and structure of the organization
- Staff qualifications
- Geographic area of operations and branch structure
- Types of originations:
  - Retail – PFI originated, processed, underwritten and closed
  - Broker – takes app, collects info and delivers to the PFI
  - Correspondent – sells a closed loan to the PFI
- Volume and types of mortgages
- Significant changes may require additional monitoring
QC Policy

- Define the type of QC to be utilized
  - In-house
    - Defines in detail the process for any staff members involved in the process
  - Outsourcing – Use of a third party vendor
    - Define the third party monitoring process
    - Can be all or a portion of loans selected for QC
- MPF expects the same standards of quality regardless of the type of QC utilized by the PFI
- Outsourcing doesn’t replace a QC policy
QC Policy

• Detailed procedures must include
  • An overview of the PFI’s QC philosophy, objectives
  • The risk to be measured and monitored
  • Define the sample size, timing and selection process
  • File review requirements
    • Pre-closing
    • Post-closing
    • Post-closing of a loan that had a pre-closing review
  • Include a process for the re-verification of information
QC Policy

• Credit review process

• Appraisal review procedures for both review appraisals and desk reviews

• Appraiser oversight procedures and monitoring
  • The review appraisal process is not only to determine the quality of the individual appraisal but also the quality of the work of the appraiser
  • PFI QC policy must include procedures for suspending or terminating appraisers as well as referring the appraiser to the state licensing and regulatory board if necessary

• Servicing PFIs
  • Early payment default review
  • High level concern review
QC Policy

• Must include a vendor review process for work provided by any third party vendors
• Include a process to ensure the audit department/staff are following the QC policy
• Reporting requirements
  • Identifies defects
  • Categorizes defects based on severity of findings
  • Highest level of severity must identify mortgages ineligible for deliver to MPF
• Resolution procedures
• Meet file retention requirements
QC Policy

- PFI must establish a target defect rate and continually measure results to the targeted rate and at least on an annual basis adjust the targeted rate based on measured changes i.e. improvements/setbacks
- PFI is responsible for development and maintenance of standards for mortgage quality
- Must establish a process designed to achieve those standards
QC Policy

- QC staff must be knowledgeable in secondary market mortgage lending
- It is the responsibility of the PFI to make training available to QC staff
  - Internal training
  - MPF training – live training, webinars and pre-recorded webinars
  - State and National Mortgage Association training
  - AllRegs Academy classes
  - Private Mortgage Insurance Company training
QC Policy

• QC staff must stay current with changes to the MPF Program
  • PFI Notice
  • Bulletins
  • Advisories
  • MPF Xtra® PFI Notices
  • MPF Xtra Bulletins
  • MPF Xtra Advisories
QC Policy

- Pre-closing review must be performed by someone other than those with a vested interest in the closing of the loan and be independent of the mortgage production staff.
- At a minimum, an individual that had no involvement in the processing or the underwriting decision.
QC Policy

- Post-closing review must be independent of the mortgage origination, processing and underwriting staff
- Exceptions can be made based on the size of the organization and the exception must be documented in the QC policy
QC Sample Selection Procedures
QC Sample Selection

- The sample selection process must target areas having a higher potential for errors, misrepresentations or fraud
- Include loans with characteristics of previous QC findings for both pre-closing and post-closing
- Any loan excluded from the selection process is not eligible for sale to MPF
QC Sample Selection

- For each 12 month period the PFI must represent and warrant that both pre- and post-closing samples are representative of the full scope of the PFI’s mortgage production
  - All product lines
  - All states
  - Each branch
  - Each third party
  - Mortgages with higher risk attributes
QC Sample Selection

• Selection methodology should include:
  • Loans with multiple layers of risk such as:
    • LTV > 90%
    • Primary FICO Score <660
    • Self employed borrower
    • Cash out refines
    • Higher total debt ratio
    • Loans originated by brokers or correspondents
    • Multiple unit properties
    • Condos or manufactured housing
    • New staff
    • Loans with complex income scenario
QC Sample Selection

• Pre-closing selection process
  • Timed so every mortgage within the selected population has the chance of being selected for review
  • Timed to be after final loan approval and before closing
  • Allowing sufficient time to complete the review process and notify origination personnel to make necessary corrections prior to closing
  • The audit department/staff should have the authority to prevent loans from closing until all deficiencies are cured
QC Sample Selection

Pre-closing continued

- There is no set percentage
- Pre-closing QC reviews are in addition to the requirements for post closing
- Methodology for file selection must be re-evaluated from time-to-time taking into account:
  - Changes to products
  - Staff changes
  - Source of loan origination
QC Sample Selection

- Post-closing sample selection
  - Must have written documentation to support the sampling methodology
- Must be made available to the MPF Bank upon request
- MPF Bank can request the PFI change the methodology
  - Must include both random and targeted sampling
  - Can be either statistical or a 10 percent random sampling of closed loans
QC Sample Selection

Post Closing continued

- PFI using the 10 percent random sampling must review one of the following:
  - 10% of annual 1-4 residential mortgages
  - 10% of secondary market production
  - 10% of MPF loans
QC Sample Selection

- If PFI closes 10 or more loans in a month:
  - The selection of 10% of the mortgages closed must be made before the end of the next month
QC Sample Selection

• If PFI closes less than 10 loans in a month:
  – PFI may delay the sample selection until the month following the month where the combined number would reach 10
    • The PFI would be required to do at least one QC quarterly even if the loan count does not reach 10 in the three month period
• PFI must notify the MPF Bank when the QC cycle is in arrears for any reason
QC Sample Selection

- Third Party Originations (TPO)
  - PFI must monitor third party originations
  - The file selection process must include a sampling of TPO that is representative of the loans received from TPOs
  - The review cycle must include at least one file from every TPO annually
QC Sample Selection

- A loan that was selected for a pre-closing review cannot be excluded from the sample population for a post-closing review
QC Review Procedures
Pre-closing Requirements
Pre-Closing QC Review Process

• Auditor to review the file for accuracy of information

• For any discrepancies between verified information and the information used in the approval process
  - Full review
  - Targeted review – a supplement of the full review process that focuses on a specific element of the loan file
    • Documentation
    • Employment and income documentation/calculation
    • Regulatory disclosures
Pre-Closing QC Review Process

Full review to include

- Review of the loan data reported to MPF for accuracy and consistency
  - Loan presentment data for Portfolio
  - XML upload for the MPF Xtra Product
- Automated Underwriting System (AUS)
  - Accuracy of AUS data entry
  - File documents that comply with the AUS feedback requirements
Pre-Closing QC Review Process

- Review the application (1003) for completeness
- The information in the final 1003 must match the verified information
- Review the underwriting transmittal summary
- Review the sales contract
- Borrower identity
  - Office of Foreign Asset Control (OFAC)
  - Social security number validation
- Employment Documentation
  - Income calculation
  - VVOE – if not yet in file auditor should do the VVOE
  - Any red flags (i.e. re-verification needed)
Pre-Closing QC Review Process

- Source of funds
  - Proper documentation
  - Calculation of sufficient funds to close
  - Meets any reserve requirements
  - Any red flags (i.e. re-verification needed)
- Desk review of the appraisal
- Adequate private mortgage insurance from an eligible insurer for loans >80% LTV
Pre-Closing QC Review Process

- If applicable, condominium project documentation must meet MPF guidelines
- Sound underwriting decision
- Review closing docs for accuracy
- Loan conditions met or will be met prior to closing
- Auditor should have the right to stop a closing until the pre-closing findings are resolved
Post-Closing Review Requirements
Post-Closing QC Review Process

Post-closing review process

- Requires a review of all the loan file documentation as required in the pre-closing review

- If tax transcripts were not obtained prior to closing they must be obtained for the post-closing review regardless of the source of income
  
  • Transcripts in the post-closing QC process is not optional and must be for the same years used to underwrite the loan

  • Transcripts are required for post-closing reviews for both random and targeted reviews if the targeted element of the review is employment/income
Post-Closing QC Review Process

Additional post-closing requirements

- Post-closing review requires all documentation used in the underwriting process be re-verified/validated

- For targeted sampling only re-verify the information for the targeted element

- If the information obtained through the re-verification/validation process differs from the information used in the approval process the loan must be re-underwritten to determine if the loan remains MPF eligible
Post-Closing QC Review Process

- Written re-verification/validation is obtained by the PFI by sending a copy of the original document to the source, with a cover letter, requesting the source validate the information at the point in time that the information was provided.
  - The auditor may supplement the re-verification process with alternative sources for gathering information if the source doesn’t respond.
  - If the PFI is unable to validate the documentation due to the lack of response by the source, the file must be documented with a copy of the written request, with a notation of the date it was sent and that it was not returned by the source.
Post-Closing QC Review Process

Re-verification/validation process

- Re-verifications should be in writing
  - Verbal is acceptable if the verbal contains the following information:
    - Name of staff member making the verbal contact
    - Date of the conversation
    - Source that provided the information i.e. borrower’s employer, financial institution etc...
    - Name and title of the person being contacted at
    - States whether or not the information is accurate and discloses the nature of any inaccuracies
Sovereign Mortgage Services, as Quality Control Agent for the MPF® Program
420 W Bethel Rd. - Coppell, TX 75019

January 1, 2002

Attention: Personnel (CONFIDENTIAL)
Re: Borrower's Name - MPF Loan Quality Control Review

Sovereign Mortgage Services is a quality control agent engaged by the investor that provided funds in connection with this recently closed mortgage loan. As part of the ongoing quality control system for the MPF Program, a percentage of loans are selected on a random basis for review. This review is performed in accordance with Government and investor regulations or requirements, and in no way represents a question of the efficiency of your organization.

This review is intended to reaffirm that appropriate procedures were followed in obtaining the information for completion of this loan by the lender that originated the loan. Please check the appropriate answers to the questions below and return this cover letter attached to the verification in the enclosed stamped envelope. It is only through this contact that we can identify whether the lender, which has agreed to provide certain services, is providing reasonable service in accordance with the MPF Program requirements.

Thank you for your assistance and time. If you have any questions, please feel free to call our operations manager at (800) 348-2781.

Sincerely,

Operations Manager
Sovereign Mortgage Services
Quality Control Agent for the MPF Program

Enclosure: Verification

<table>
<thead>
<tr>
<th>COMPLETE THIS SECTION</th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>Was the information correct as reported on the date completed?</td>
<td></td>
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<tr>
<td>Is the signature on the attached document authentic and that of the personnel authorized to provide this information?</td>
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<tr>
<td>Do individuals other than those listed on the attached document have signatory authorization on these account(s)?</td>
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</tbody>
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SIGNATURE/TITLE:

COMMENTS:

NOTICE: The MPF Program structure allows a participating financial institutions to originate mortgage loans, as agent, for a Federal Home Loan Bank.
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420 W Bethel Rd. - Coppell, TX 75019

January 1, 2002

Company Name
Address
City,

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Sincerely,

Operations Manager
Sovereign Mortgage Services
Quality Control Agent for the MPF Program

Enclosure:

COMPLETE THIS SECTION

Was the information correct as reported on the attached bank statement? Yes No

SIGNATURE/TITLE:

COMMENTS:

NOTICE: The MPF Program structure allows a participating financial institution to originate mortgage loans, as agent, for a Federal Home Loan Bank.
Post-Closing QC Review Process

Re-verification of employment and income

- All documentation for employment and income used in the approval decision must be validated
- Such as, but limited to:
  - Verification of Employment (VOE)
  - Paystubs
  - Salary vouchers
  - W-2 forms
  - Tax returns
  - Financial statements
  - Compensation award letters
  - VVOE - a mandatory requirement of every loan file
- The VVOE must be obtained before loan closing
Post-Closing QC Review Process

Re-verification of source of funds

- All documentation for source of funds used in the approval decision must be validated
- Such as, but limited to:
  - Verification of deposit (VOD)
  - Depository account statements
  - Stocks or security account statements
  - Gift letters
  - Signed settlement statement or other evidence of conveyance and transfer of funds if the sale of an asset was involved
- Auditor must verify the occupancy status of a subject property secured by a primary residence
Post-Closing QC Review Process

Credit Report verification

- Credit history must be re-verified for all QC’d loans for both random and targeted sampling if the targeted element is credit related
- A new tri-merged credit report is required for all loans selected for a post purchase review
- The new and the original credit reports must be compared for any debt that is on the new report that should have been on the original
- DU findings should be reviewed for credit related issues to be sure the findings were addressed
- All sources of the non-traditional credit must be re-verified
Post-Closing QC Review Process

Appraisals

- The quality of appraisals must be continually evaluated through normal underwriting procedures
- The QC process requires the use of both review appraisals and desk reviews
- Review appraisals must be performed by a qualified licensed or certified appraiser, independent of the original appraiser or appraisal firm
- Desk reviews may be performed by PFI staff with appraisal review knowledge - license or certification is not required
- PFI should also use third party tools, public records, automated valuation model appraisals to identify areas of inaccuracies or inconsistencies that may indicate a deficient appraisal
QC Review Process

Appraisals

- A field review appraisal must be obtained for every one out of 10 files selected for the random sampling for post-closing reviews
- A desk review is required for the remaining files in the random sampling
- A field review appraisal for the targeted sample is only required if the appraisal is the element of the targeted review
- Review appraisals must be on the appropriate forms
  - One-unit dwelling FNMA 2000/FHLMC 1032
  - Two- to four-unit dwelling FNMA 2000A/FHLMC 1072
QC Review Process

Appraisals

- Automated valuation model appraisals do not replace the review appraisal or desk review
- Review appraisal must include photo of the subject property (front, back and street), the comps used in the subject property as well as any new comps
- The photos must be clear, detailed copies, digital or electronically imaged
- The review appraisal must include any addendums, explanations, location map showing the subject property and all of the comps from the original appraisal and any new comps
- The review appraisal must include a review of the factual data in the original report
QC Review Process

Appraisals

- The auditor must determine if there are defects in the appraisal and recommend appropriate action
QC Review Process

- Auditor must review the closing documents for accuracy, completeness and to ensure the loan was closed using the correct documentation and disclosures such as, but not limited to:
  - Government loans include a review of the insurance certificate
  - Title binder, title insurance policy, title opinion or title guaranty
  - HUD 1
  - Life of loan flood certification
  - Homeowners insurance documentation
  - Flood insurance documentation
  - Loan approval and conditions
  - Closing instructions
Post-closing review process for mortgage that had a pre-closing review
QC Review Process

• Post-closing review of a loan that had a pre-closing review
  - Auditor must review the pre-closing findings
  - Verify that all pre-closing finds were cured
  - Re-verify or validate only the items required in a post closing review that were not previously verified
QC Reporting Process
QC Reporting Process

- Documenting QC reviews
  - Maintain complete records for each file selected for QC review
    - All audit related forms, check lists and documentation must be maintained
    - Audit documentation may be maintained in the mortgage loan file or with the PFIs QC records
  - Records must include explanation and documentation of any disparities or inconsistencies found in the file that impacts the investment quality or MPF eligibility
  - Explanation and documentation for curing any defects
QC Reporting Process

- Loans deemed ineligible for the MPF Program must be reported to the MPF Bank within 30 days of determining the loan is not investment quality or MPF eligible
- Any incident of suspected fraud or false representation must be immediately reported to the MPF Provider
- MPF may demand immediate repurchase of any loan when the borrower or any other party to the transaction has been found to have made false representations relating to the transaction
- MPF reserves the right to increase the sampling size or impose other QC requirements on a case-by-case basis
QC Reporting Process

• QC timing
  • QC review reporting requirements
  • The entire QC process must be completed within 120 days from the first day of the month in which the sampled loans closed
  • The outcome of the QC review must be reported to senior management within 30 days of completion of the QC reviews
    • Loan closes: March
    • File selection must be complete: April 30
    • QC review and rebuttal must be complete: June 30
    • QC reports are due to management: July 31
QC Reporting Process

- Final defect rate and trends need to be identified in the QC process and reported to senior management
- PFI must establish an action plan for specific corrective action including resolution and time frames for implementation
QC Reporting Process

- Pre-closing QC reporting requirements
  - PFI must have a process for reporting defects found in the pre-closing QC process
  - Must be reported to senior management on a monthly basis
  - Include a process for reporting the defects to parties responsible for curing the defects prior to the closing of the loan
  - Document the resolution of all QC finding
  - Describe the sample selection process
  - Report QC defect trends
QC Reporting Process

Record retention

- PFI must retain records of all QC findings (pre-closing and post-closing) together with action taken for a minimum of three years
  - Include a listing, by year, of all pre-closing, post-closing, post-closing of a pre-closing and EPD and HLC reviews
- Records must be made available to the MPF Bank or MPF Provider upon request
- The records shall be provided to a new servicer if a transfer of servicing occurs
Thank you
Enjoy the Conference