

MMC MORTGAGE EXAMINATION MANUAL



MULTI-STATE MORTGAGE COMMITTEE

1129 20th Street, NW, Ninth Floor

Washington, D.C. 20036

Telephone: (202) 728-5756 • Facsimile (202) 728-0000

<http://www.csbs.org>

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General

Introduction

The Multistate Mortgage Committee (MMC) is a representative body of state mortgage regulators appointed by CSBS and AARMR to represent the examination interests of the combined states under the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision. The MMC's primary focus is for nationwide lenders operating in 10 or more states. The MMC has constructed this manual to promote transparency and consistency in its examinations of Multistate Mortgage Entities (MMEs).

Structure and Use of Manual

The Examination Manual is divided into several modules representing broad categories of examination interest. The introductory General module provides fundamental background information and criteria for the overall examination function. Subsequent modules provide guidance on planning and administration; examination of assets, finance, management, compliance, and reports.

The typical module is comprised of several sections which provide information and/or guidance on specific topical areas. Although the format of these sections varies as dictated by each section's content, the general format is as follows:

- Introduction--Provides relevant background information to introduce and support examination of the specific area.
- Examination Objectives--Outlines basic goals that should be of primary interest to the examiner in reviewing the respective area.
- Criteria and/or Guidance--Outlines applicable requirements, standards, or additional criteria relevant to the examination area.
- Examination Procedures--Provides procedural guidance to assist the examiner in evaluating the specific topical area. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution being examined.

Given the inherent diversity among institutions and the dynamic nature of lending issues and concerns, it is not possible for the Examination Manual to cover all potential examination areas. However, the contained sections and their corresponding workpapers provide a solid base of criteria, guidance, and procedures, and they are intended to promote examination quality and consistency.

Generally, the Examination Manual, the examination procedures, and the supporting workpapers, in particular, are not inflexible rules to be followed blindly, but rather they are concepts and tools designed to assist the examiner. Examiners must use their own professional experience and judgment augmented

by Examination Manual guidance to tailor appropriate examination techniques to each individual examination. Only those examination procedures and workpapers (or portions thereof) that are relevant to a given examination should be utilized. Similarly, these examination aids may be modified when necessary, and they should be supplemented with additional examination techniques and workpapers as needed.

The Exam Manual has been assembled by the MMC and state working groups administered by the MMC. Sources consulted and used in forming the text of the manual include existing public documents, guidance, and examination manuals from state regulatory agencies, the FDIC, the FRB, the OTS, the OCC, the FFIEC, FinCEN, the FBI, Fannie Mae, Freddie Mac, and HUD.

Revisions

This manual will be updated as needed, and all changes will be announced and made available to each regulatory jurisdiction by posting [here](#).

All examiners are encouraged to provide suggestions for strengthening the Examination Manual on an ongoing basis. Examiners should also relay institutions' suggestions for improving the manual. Suggestions may be made at the MMC Exam Manual Survey link under the Mortgage Examiners section of the "Regulators Only: Supervisory Tools" page on the CSBS website [here](#).

Cover Letter

The MMC Examination Manual cover letter, which was distributed with the initial release of the Manual can be viewed [here](#). The cover letter serves as a background document and a brief instruction for use of the manual.

Examination Policy

Introduction

In general, states are authorized to conduct routine and special examinations, including investigations, under state statute and/or rule. Examiners should be familiar with the following:

1. Applicable governing law and associated rules.
2. The appropriate naming conventions and codifications of applicable law and rules.
3. The breadth and limits of the authorizing authority.
4. The agency's procedures for conducting examinations.
5. The MMC procedures for conducting examinations.

States participating in multi-state examinations are authorized under unique state specific examination authority. However, common denominators of examination authority make it possible for multiple states to join authorities and efforts in the pursuit of a uniform examination and reporting goal. Many states have adopted specific language authorizing or allowing the state to share information and

resources with other states, effectively creating authority for multi-state examinations.

Participating states should have available the state's citation of authority made available to the EIC if questioned by institution management. Challenges to authority should be addressed and escalated as follows:

1. EIC should present management with copies of the specific state authorities.
2. Questions concerning each authority should be directed to a representative of the state.
3. Challenges to the multi-state authority should be directed to the MMC. Direction can be facilitated by the CSBS staff member assigned to support the examination and/or MMC.

Authority to Examine for State and Federal Laws and Regulations

During a multi-state examination, the multi-state examination team will examine the institution for compliance with applicable State and Federal Laws and Regulations. Most states have specific authority to examine for compliance with Federal Laws and Regulations. In some states, this authority is granted under general provisions. The EIC should be provided with each state's specific or general authority to examine for compliance with Federal Laws and Regulations.

Challenges to the authority to examine for compliance with Federal Laws and Regulations should be escalated as detailed above.

Authority to Examine for Financial Condition and Risk Management

During a multi-state examination, the multi-state examination team will examine the institution for issues, problems or practices related to financial condition, general risk management and quality and performance of management. As with the above areas of authority, states may have specific citations available to the EIC. Many states, however, may rely upon general authorities and requirements commonly referred to as Character and Fitness Standards. Each state should provide the EIC with the authorities relied upon by the state. Challenges to this authority should be escalated as instructed above.

Role of the Examiner-in-Charge State (EIC State)

Each multistate examination is assigned an Examiner-in-Charge State (EIC State) responsible for leading the examination and authoring the report of examination. The EIC State, under advisement from the MMC assigns an Examiner-In-Charge (EIC) as the lead examiner for the multistate examination. The EIC, supported by the [Examination Liaison](#) when assigned (see Supplement 5), is responsible for planning the examination, assignment of work to state examiners, reviewing the work performed, coordinating the work of specialists, identifying financial condition, regulatory compliance, management, and other issues, drafting examination reports and maintaining communication with the

institution as well as the Examination Liaison and the MMC on the progress of the examination.

Once the MMC has established the onsite and offsite state participation team, the EIC is responsible for advising the MMC on the necessary size and makeup of the examination staff based on each state's available resources. Similar to a single state examination, the EIC typically performs the following functions:

1. Assesses the necessary scope of the examination and conducts pre-examination meetings with the examination staff.
2. Acts as point of contact with institution; makes information requests on behalf of the MMC and all states; receives information from institution and distributes information to each state; and controls communication and follow up with the institution.
3. Make examiner assignments; track assignment completion; hold regular examiner meetings; coordinate onsite and offsite responsibilities; coordinate travel arrangements; and facilitate ongoing examiner requests with institution.
4. Make regular progress reports to the MMC.
5. Draft the report of examination based on the multistate findings.
6. Conduct exit reviews and handle examination follow up.

The EIC for a multistate examination operates in much the same manner as an EIC for an individual state examination. The primary differences are the lines of communication and direction from the MMC or Examination Liaison and the complexities of coordinating multiple examiners from independent jurisdictions. The EIC must authoritatively, but delicately lead the multistate examination as directed by the MMC while respecting each state's independent jurisdiction and preference for procedure.

The EIC is not another state's examiners supervisor. The EIC is authorized by the MMC to lead the examination and communicate MMC direction to the participating states. If conflicts or difference in approach arise between the participating state examiners, the EIC must be aware of which situations require MMC intervention. The MMC believes that minor differences in opinion should be resolved by the EIC and the Examination Liaison, however, any differences of opinion that might result in processes different than those approved by the MMC, or situations in which further controversy might arise, should be brought immediately to the MMC's attention.

Institution Responsibilities during Multi-State Examinations

Institutions are expected to have policies and procedures in place to facilitate multi-state examinations and assure that each institution staff person is aware of these procedures as necessary to assist in the examination process. Meritless obstacles or resistance to the multi-state examination should be avoided as such actions or non-compliance may result in additional time, burden and cost to the institution, as well as impede the spirit of cooperation and efficiency between the examination team and the institution. Institutions should note that most state

authorities contain serious sanctions and remedies for failing to comply with examination authorities. In some states, sanctions include criminal penalties for non-compliance.

An institution's cooperation with examinations and investigations is factored into the management component rating. However, if an institution refuses to provide an examiner with applicable documents and company information in a timely manner for exam purposes, examiners may take certain actions against the institution if the issue is detrimental to the conducting of the exam. Institutions that refuse to provide pertinent information may be tampering with the requested information. It is important that examiners not allow an institution extended periods of time to produce important information without a reasonable explanation. If the institution does not provide the examiner with requested information 72 hours after the examiner's request, there are measures the examiner can take, including a demand letter. If the institution continues to withhold or fails to provide the requested information, examiners should report the situation to the MMC's enforcement liaison for a possible enforcement action.

Conclusion

State law generally requires that institutions afford full access to all premises, books, records and information that the examiner deems necessary. The EIC is responsible for assisting the institution in understanding the requirements and obligations associated with a multi-state examination.

MMC Examination Objectives

A full scope examination takes into consideration all significant compliance, operational, and financial factors. The overall objective of the examination process is to:

- Evaluate the institution's financial condition and quality of management.
- Ensure compliance with state and federal laws and regulations.
- Investigate possible consumer protection issues.
- Assess the overall condition and performance of the institution.

Each institution should be examined in sufficient depth to satisfy these objectives.

Given the interrelationship between different types of risk, the program requires examination reports and other products of the supervision process to be meaningful to all stakeholders, including the supervised entities and the MMC.

Examination Scope

In "scoping" the examination, the EIC is directly or indirectly considering what issues the examination will cover, how deep the team will delve into issues, how extensive the time frame will be (how far back), and how many of what type of transactions will be reviewed.

In general, the MMC considers two basic examination scopings:

- **Full Scope Examination:** A full scope examination would typically consist of off-site preparation and meeting, followed by an on-site examination of records and practices, including interviews of staff and possibly borrowers. Follow up to the on-site examination would normally consist of an exit review, a report of examination and a response by institution management where necessary.
- **Limited Scope Examination:** Similar to the full scope examination, the limited scope examination will be narrower in issues covered, time spent or numbers of transactions reviewed. When appropriate, a limited scope examination may be conducted primarily or entirely off-site. Despite the limits of this type of examination, it nevertheless can be a valuable tool for monitoring or in situations where the issues or risk do not merit a full examination of the institution.

The risk-based examination method employed by the MMC is an efficient method of establishing the scope of an examination. Consequently, the resulting Reports of Examination include an assessment of each compliance area, each component of financial condition, and systemic programmatic risk when necessary. Sufficient analysis is performed within each compliance area to ensure risk is adequately identified and addressed. Although any risk that weakens or has the potential to weaken an institution is of interest to the MMC, examination activities will be prioritized to provide cost-effective and efficient examinations within resource constraints. The [Examination Scope Worksheet](#) is a key tool in helping examiners identify key areas regarding regulatory compliance, financial condition, and management and operations that should be assessed during an exam.

Compliance Risk Scoping

There are a number of factors the EIC should consider in determining examination scope for evaluating compliance risk in an institution. Among other types of available information, the EIC should consider prior exams, external audits, and complaints in determining scope. Compliance areas are examined as necessary to achieve and/or maintain a reasonable assurance of the institution's compliance with state laws and federal laws and regulations. Additionally, the MMC provides guidance and direction to the EIC regarding key areas of examination emphasis and priority to assist in making scope determinations.

Financial Risk Scoping

The risk-based examination method requires efficient scoping for financial condition risk. While examiners should reference the [Examination Scope Worksheet](#) for direction on financial risk scoping, the following points reflect some guidelines for financial risk scoping:

-
- Review prior exams/file correspondence for previously identified financial condition issues.
 - Review available data to develop a preliminary assessment of applicable trends and risk. Identify trends or changes in sources and use of funds requiring further analysis.
 - Review available documentation for evidence of oversight, responsibility, management reports, and any identified financial condition concerns.
 - Review/Discuss strategic planning and the financial condition implications of any new changes in direction.

Financial risk scoping requires examiners to gather the following documentation:

- Prior exams/file correspondence regarding financial condition component
- Policies and procedures relating to component and component management
- Any written internal controls regarding financial condition component
- Written audit program related to financial condition component
- External audit reports
- Internal/External reviews of component function
- Internal component monitoring documentation
- Internal reports showing sources and uses of funds
- Internal reports showing liquidity/earnings/capital levels and ability to meet unanticipated needs
- Financial statements for all relevant periods reviewed
- Legal documentation for all company loans – warehousing or working capital
- Internal/External reporting on compliance with loan covenants
- Internal reports showing loan turnover on the warehouse lines
- Internal reports showing the level of management involvement and effectiveness in supervising the component function
- Strategic planning documentation

Once the preliminary review is complete, the examiner can revise the scope of necessary.

The next step is to complete a work program where the following seven questions are answered in detail:

1. Are policies, procedures, and risk limits adequate?
2. Are internal controls adequate?
3. Are the audit or independent review functions adequate?
4. Are information and communication systems adequate and accurate?
5. *Specific to liquidity*: Is the use of wholesale and rate sensitive funding sources reasonable?
6. *Specific to liquidity*: Does the overall assessment of liquidity, including provisions for back-up funding sources, indicate liquidity needs can be met without adversely affecting operations or financial condition?
7. Does the Board/Management effectively supervise financial condition?

Once all of the questions are answered, the examiner would compose a detailed comment regarding all relevant aspects of financial condition. The detailed comment is then pared down to a short one or two paragraph statement conveying the information necessary to support the function's rating

Programmatic Scoping

Additionally, the MMC focuses on systemic programmatic issues when warranted. Scoping for such issues is largely covered in the [Servicing](#) chapter but generally includes reviewing any existing complaints or litigation. Examiners should also review the policies and procedures that management has in place for performing the certain functions. Examiners should foster an open communication with management about the functional procedures. Examiners should survey the actual facilities and observe employees in each area in order to ensure that the institution has adequately trained employees. Additionally, examiners should request that management verbally communicate the institution's policies and procedures even if the examiner already received them, in order to ensure that management is very familiar with the company's own plans for maintaining a successful operation.

Scope Expansion

To the extent practical examiners will utilize the work performed by others, such as, external and internal auditors/reviewers, the degree of reliance on this work is based upon the examiner's judgment of the competence and independence of the individuals involved with the audits or reviews and the overall adequacy of the institution's system of internal controls.

On occasion, the examination scope can be expanded to meet special objectives. This could mean the examination would include an activity in the examination scope even if that particular area does not pose significant risk to the institution being examined.

Examples of these may include completing one or more of the following activities:

- In all examinations if so directed by the MMC for reasons broader than the individual examination being conducted;
- For the benefit of another examination; or
- For the benefit of a state or MMC special project.

Examination Frequency

The MMC will determine the frequency of full, non-cause examinations for certain institutions based on level of risk¹. It is important to note that when NMLS Call Report information will be collected quarterly going forward. On May 2, 2011,

CSBS and AARMR launched the NMLS Mortgage Call Report in accordance with the SAFE Act. Submission of the first NMLS Mortgage Call Report is required by May 15, 2011 for all state-licensed companies and companies employing state-licensed mortgage loan originators. The launch of the NMLS Mortgage Call Report marks the first standardized information collection for the residential mortgage industry. The NMLS Mortgage Call Report will provide timely, comprehensive and uniform information of the non-depository mortgage industry, thereby allowing state mortgage regulators to effectively monitor both licensees and mortgage activities. Data is submitted by companies on a quarterly basis covering the financial condition and mortgage loan volumes by type and state. As companies continue to report critical figures on a quarterly basis going forward, the MMC will be able to utilize the Call Report information as a key tool in determining examination frequency.

It is worth noting that the CSBS Accreditation standard contained within CSBS best practices is at least once every 60 months.

In addition to regular ongoing examination work, special examination activities may occur at any time if there is evidence for good cause. Special examination activities are usually directed toward a specific issue, and they typically result from unique conditions within the individual institution that warrant distinct attention. In such cases, the same risk-based principles are applied in determining the scope and depth of examination activity. Results of special examination activities will be communicated both internally and externally, as appropriate.

Institution Risk Profile

Each institution has a unique risk profile determined by the level and severity of risk within the institution. The MMC has established procedures for determining an institution's individual risk². These procedures establish the criteria for identifying Multi-State Mortgage Entities (MMEs) and assigning a Risk Profile to each MME under the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision (Protocol and Agreement). The [MME Identification Procedures](#) and [Risk Rating Valuation Table](#) will be used by the MMC to set the MME Examination Schedule for all multi-state examinations conducted under the Protocol and Agreement. However, individual states are encouraged to consider using the procedures where appropriate to establish risk profiles for non-MMEs for purposes of examination frequency and scope.

Examination Process

Introduction

The examination process is designed to ensure that each institution receives the level of regulatory review needed on a timely basis so that all issues may be

² See Supplement 1- "MMC MME Identification Procedures" and Supplement 2- "MMC MME Risk Rating Valuation Table."

identified and proactively addressed. The examination process centers on an ongoing oversight approach. It involves risk profiling as well as off-site and on-site review activities. This ongoing oversight may be accomplished through formal and informal contacts with institutions by examiners who monitor and analyze conditions in their assigned institutions.

Efficient use of resources is a primary goal of the examination process. This goal is accomplished by utilizing the risk-based examination approach. Risk-based examinations permit judgment in determining the scope and depth of work to be performed for an examination; as well as, the specific examination areas. For example, a high-risk institution would command greater resources than a low-risk institution. Likewise, high-risk examination areas would require greater resources.

Additionally, institutions are expected to have an internal program to identify, measure, monitor and control risk as a first line of defense in managing and addressing risk.

Examination Functions

The flowchart in [Supplement 3](#) details typical activities that may take place during the examination process. These activities can be broken down into the four general examination functions previously discussed (institution examination planning, off-site activities, on-site activities, and reporting). There are extensive interrelationships among these functions. For example, planning provides the foundation for examination activity and vice versa. Examination activities result in reporting, which provides a basis for institution examination planning, and so on. These examination functions are described below.

Institution Examination Planning

Institution examination planning is the process of adequately planning for the examination and its related activities occurring with each institution. The planning should cover all facets of the process, including both off-site activities and on-site activities.

The key point is that the examination process must be adequately planned to ensure effective and efficient use of resources. In general, this involves scoping the examination, establishing objectives and strategies to address those areas of significant risk, and allocating sufficient resources to accomplish these objectives.

Off-Site Activities

Off-site activities include both monitoring and off-site examination. The primary objectives are to provide timely recognition of risks associated with an institution and to gain efficiencies by performing examination functions while off-site.

Monitoring activities consist of the activities associated with ongoing oversight of

institutions to keep abreast of significant changes in risk. Examples of such activities include review of an institution's correspondence, board minutes, financial reports, business plans, etc. Examiners should also review an institution's policies and procedures to ensure that they are up to date and adequate. Through the use of technology and examination software, monitoring may also include an electronic review of all or a portion of the institution's loan portfolio.

Monitoring activities often progress into an off-site examination. For example, reviewing a business plan is illustrative of a monitoring activity, but analyzing and concluding on the adequacy of the plan constitutes an examination activity.

The type, frequency, and documentation required for off-site activities should be tailored to the degree of risk present in the institution and the type of activity being performed.

On-Site Activities

On-site examination work should focus on what cannot be effectively analyzed and concluded off-site. What is critical in on-site work is the examiner's interaction with company personnel, including the personnel that complete applicable tasks and not just their supervisors. For example, examiners should talk to processors outside the presence of management. Valuable information can be gained through human interaction. On-site visits to the institution are really an extension of off-site activities, and these activities may be used in a number of ways, such as:

- To examine areas which cannot be practically examined off-site;
- To test and reach (or reaffirm) a conclusion about the reliability of the institution's systems, controls, and reports so that off-site examination and analysis techniques may be used with confidence;
- To investigate changes or anomalies disclosed by off-site activities and analysis;
- To conduct more comprehensive or full scope examinations; and
- To meet with boards of directors and management.

Reporting

This phase of the examination process communicates results and findings to parties internal and/or external to the MMC and the states. When completing any report, the EIC should address issues of concern and analyze the interrelationship of findings. Results are communicated in several ways, including:

- Reports of Examination--Completed subsequent to the "as of" date of the examination and conclusion of all necessary examination work. The purpose of the Report of Examination is to provide the institution's

management and the MMC with a clear, concise evaluation of the institution's overall condition and to provide recommendations for any improvement needed. The nature and depth of the Report of Examination reflects the level of identified risk. It is important to ensure that management understands the conclusions and recommendations included and are committed to enacting appropriate corrective measures. This may be accomplished by a presentation of the report to management, or through other methods of contact as suitable to the circumstances.

Note: The MMC and most states consider all Reports of Examination to be Confidential Supervisory Information as covered under the Nationwide Cooperative Agreement for Mortgage Supervision. Examiners and institution management should take great care to protect the confidentiality of these documents. Any accidental release of a Report of Examination should be reported immediately to the MMC for communication to the supervising states.

- MMC Rating System Summaries--Completed as part of the internal reporting function. The primary objective of the rating system is to ensure a uniform evaluation of the main characteristics of all institutions.

General Examination Procedures

The risk-based examination approach provides examiners with flexibility in how examination work is completed. However, certain activities tend to be applicable regardless of the institution or area being examined, including the following:

- Conducting discussions with management as needed to obtain information applicable to the area being examined. These discussions are utilized for identifying and evaluating internal controls governing the area being examined to ensure the adequacy of management direction and guidance. This procedure also includes review of applicable policies and procedures to identify any potential weaknesses/deficiencies.
- Identifying the cause and effect of weaknesses. Determining the underlying cause of weaknesses helps ensure that the appropriate corrective action will be taken. Identifying the effect of weaknesses assists the examiner in determining materiality of findings, and the impact these findings have on the institution's financial condition and risk management, the institution's compliance with laws and regulations, and its consumer protection practices.
- Conducting discussions with management to resolve concerns, discuss findings, and/or obtain commitment to correct weaknesses, as appropriate.
- Summarizing and documenting the scope and depth of testing, findings, conclusions, management responses, and recommended actions are accomplished by preparing a lead sheet, as discussed in the workpapers section of this manual.

-
- Reviewing institutions based on the [MMC Exam Rating System](#), which provides guidance on the various aspects of the examination process and the method for evaluating institutions.

These activities promote consistency in the MMC's examination process and should be completed as applicable during examination work.

Workpapers

Introduction

Workpapers are the primary documentation for the examination process. They include printed and electronically stored information prepared or obtained during the process, and they are useful for the following purposes:

- Identifying and documenting the condition and trends of an institution;
- Providing evidence of work performed, findings, and conclusions;
- Supporting information, comments, and conclusions in the Report of Examination;
- Assuring examination objectives and agency standards are achieved;
- Supporting agency positions during litigation;
- Evaluating quality of work performed and examiner performance; and
- Planning and conducting future examination activities.

This section provides general guidance on workpaper preparation, organization, and retention.

Workpaper Preparation

Workpapers prepared during the examination process typically include many different types of documents. Emphasis tends to be on workpapers drafted by examiners, such as, planning documents, completed pro forma workpapers, violation summary sheets, and referenced Reports of Examination. However, useful workpapers can also be obtained from many other sources to provide support for examination conclusions. Most commonly, this information will consist of correspondence and reports from the institution, and photocopies of institution's documents.

At this time, each individual state will maintain its workpapers.

The extent of workpaper documentation should vary based on factors, for example, examination scope, risk present in the institution, and experience level of examiners. At a minimum, workpapers should demonstrate completion of each examination objective and substantiate all conclusions reached in the Report of Examination.

Examiners should analyze and summarize pertinent information gathered during

the examination process. These tasks are often best achieved through a violation summary sheet. A [violation summary sheet](#) may be prepared for each violation identified although several violations may be addressed together. Typically, the violation summary sheet is prepared by the examiner assigned overall responsibility for accomplishing the objective, thus ensuring accountability for the work being performed. Violation summary sheets promote examination effectiveness by simplifying the report writing process and ensuring a logical, systematic, and organized documentation process. Refer to [Supplement 4](#) of this module for an example of a standard violation summary sheet.

Examination efficiency can be enhanced by the use of pro forma workpapers. Pro forma workpapers are especially beneficial to examiners in completing repetitive or process-oriented tasks in the loan review and compliance areas. Individual examiners may also develop pro forma workpapers as needed to meet examination needs.

Workpapers should be clear and accurate; thus, providing a reliable representation of the examiner's analysis, findings, and conclusions regarding conditions existing in the institution. The examiner should also take care to ensure workpapers are legible and neat. Whenever possible, workpapers should be prepared on standard-size (8-1/2" x 11") paper. Only one side of the paper should be used, and all temporarily-affixed notes should be permanently attached. The preparer and completion date must be listed on all workpapers prepared by the examiner.

Workpaper File Organization

Workpapers should be logically organized, numbered, and bound upon completion of examination work to facilitate quality assurance processes and future use. Because examinations typically produce sizable quantities of information, the examiner should take care to file only those documents that are relevant to the work performed. As a general rule, if a workpaper is needed to support work performed within an examination objective or to support a conclusion in the Report of Examination, it should be maintained in the workpaper files. Additionally, documents resulting from the quality assurance process should be retained in the workpaper file. Files should not be overburdened with irrelevant material.

The method and sophistication of the numbering and bundling system used is at the discretion of the EIC. The system will usually correspond to the complexity of the examination and volume of workpapers accumulated. A typical method of numbering and bundling workpapers includes separation by the violation number sequence listed in the Report of Examination. Whatever method is used, examiners should ensure information is readily accessible for internal or, in the event of an enforcement action, external review.

The cover of each workpaper file should be clearly labeled. Each label should contain at least the following information:

- Name of institution examined

-
- Institution number
 - File type (i.e. Exam)

Workpaper Security and Retention

Examination workpapers maintained in workpaper files should be safeguarded and retained to satisfy legal and administrative time requirements. For examinations conducted under the MMC's authority and oversight, workpapers should be maintained by the EIC state for no less than the longest retention requirement of each state participating in the multi-state examination.

Electronic workpapers require additional measures to alleviate safekeeping concerns. To minimize risk, electronic workpapers should be stored on the EIC state's shared drive. Hard copies of electronic workpapers can be generated for further risk control.

Workpapers are the property of the participating states and should be safeguarded at all times to prevent unauthorized access. It is the responsibility of the EIC to ensure workpapers are secured at all times during the course of on-site work.

The EIC state is responsible for providing copies of workpapers upon request by participating states at the participating state's cost.

Examination Quality Assurance

Introduction

Quality controls over examination work products represent a fundamental element of generally accepted auditing standards and are crucial to the integrity of the examination process. The accuracy of any process involving evaluation of conditions and operations to identify and measure risk in an institution is itself vulnerable to risk. This risk, referred to as examination risk, is the risk of not identifying or incorrectly diagnosing conditions that threaten the level of compliance of the institution that can lead to errors or omissions in Reports of Examination. Examination risk can be reduced by having an effective quality assurance program.

An essential precursor to effective quality assurance is clear and appropriate delegation of examination authorities. The MMC's objective is to delegate authority to the lowest practical level based on institution risk and examiner expertise. This necessitates formal establishment of authorities at all operational levels. These authorities are typically accomplished by state directives, operating plans, or memoranda.³

There are numerous levels and types of quality assurances that can be utilized to

³ Such authorities may be promulgated by the MMC, however, at all times these authorities are derived and controlled from individual state law or rule.

control examination risk. It is important; however, to ensure that the cost of quality assurance does not exceed the expected benefits. As such, the resources devoted to quality assurance should vary based on factors such as institution risk, derived from elements of portfolio composition, past exam results, complaint activity, enforcement actions, possibility of litigation, and the expertise of the EIC and examiners assigned to the institution.

Regardless of risk levels, there are three basic activities that must be performed:

- Supervision of the examination process;
- Cross-referencing of examination documents; and
- Review of examination documents.

Requirements and guidelines in each of the above areas are further discussed in this section. Additionally, the MMC may provide supplemental direction as it deems necessary. It is the responsibility of each EIC to establish a quality assurance program that meets established requirements, ensures efficient resource use, and is best suited to the states' organizational structure and staff experience levels.

Supervision of the Examination Process

Supervision should occur early on and continue throughout the examination process. Various methods of supervision; such as, planning conferences, workpaper review, on-site visits by the EIC's supervisor, and report drafting conferences can be used to ensure that appropriate communication takes place between the EIC, his/her supervisor, and participating examiners. These communication tools assist the EIC in establishing appropriate examination objectives; determining the proper focus, tone, and balance of the report; and ensuring that the findings are accurate and adequately supported. The extent of supervision should be differentiated based on factors of institution risk.

Workpaper review is an important part of supervision. Completed workpapers must be reviewed to determine that the intended scope of the examination was carried out, that adequate evidential material was gathered to support the work performed, and to validate that the conclusions and opinions are accurate and adequately supported. This review should occur as early in the examination process as practical, but always before examination report issuance. The EIC is responsible for the completion of workpaper review; although, in some cases it may be appropriate to delegate review to other team members (for example, review of individual loan workpapers). Additionally, review of workpapers by the EIC's supervisor may be utilized as deemed appropriate. To ensure efficient resource use, the depth of workpaper reviews should be based on factors, such as:

- Nature of the work and its relative importance to the overall examination objectives;

-
- Extent to which the EIC was involved with the area during the examination;
 - Experience of the EIC and examiners who carried out the various activities and/or performed initial review of the work; and
 - Examination and institution risk involved.

In a multi-state examination, first line supervision of the EIC and examination product should occur with the EIC's state supervisor, with second line supervision occurring at the MMC level. However, situations and immediate need may dictate flexibility in this arrangement. In general, the MMC will not interfere with the EIC's supervisor's responsibilities; however, supervisors should be aware and sensitive to the national needs and MMC direction of a multi-state examination. Communication between the exam teams and the MMC is facilitated by the MMC Examination Liaison Team. Generally issues at the examination level will first be reviewed by the Examination Liaison Team before the MMC. There also exists an Enforcement Liaison Team which performs a similar function to the Examination Liaison Team from the enforcement context. Refer to [Supplement 5](#) for the functions of the Examination Liaison Team.

Cross-Referencing of Examination Documents

The primary objective of cross-referencing is to ensure the Report of Examination is substantiated by adequate, accurate, and relevant documented evidence. The Report of Examination is the states' official finding of the examination. As such, it is imperative that the report be checked, verified and censored for every word, date or number included. Additional benefits of cross-referencing activities include verifying achievement of examination objectives and ensuring supporting evidence can be easily located and reviewed.

Examiners should use sound judgment to ensure that the extent of cross-referencing activities is consistent with examination risk. At a minimum, however, the following cross-referencing must be completed:

- Report of Examination (including the transmittal letter) to supporting workpapers;
- Violation summary sheet or other summary type workpapers (directly supporting Report of Examination comments and figures) to any significant underlying workpapers; and
- Each examination objective in the examination plan to the supporting workpapers which evidence completion of the objective.

Workpapers which do not directly support Report of Examination comments and figures may also be cross-referenced to supporting workpapers at the discretion of the EIC. Such cross-referencing is often beneficial for ensuring easy location and review of supporting evidence. However, supporting workpapers should not be copied and/or maintained in the workpaper files simply for cross-referencing purposes. Examination risk is the primary criteria to consider when making a

determination of the extent of underlying support that is maintained in the workpaper files.

When cross-referencing, it is important to ensure consistency between comments and figures within documents. For example, when cross-referencing a Report of Examination, it is important to ensure consistency among the body of the report, and the appendices. If a comment or figure occurs more than once, it is appropriate to cross-reference the comment or figure to another part of the report which has in turn been cross-referenced to the supporting documentation. This will commonly occur in the case of figures in an appendix. Typically, an appendix would be cross-referenced to supporting workpapers, and the body of the report would then be cross-referenced to the appendix as appropriate. Likewise, comments in a transmittal letter may be cross-referenced to the body of the report that in turn would be cross-referenced to supporting workpapers or appendices. The EIC is responsible for ensuring cross-referencing is accurate, sufficient, and completed in a timely manner. Cross-referencing should be completed prior to review of examination documents.

Review of Examination Documents

Reviews should provide for an objective assessment of examination documents to ensure examination risk is minimized and desired quality is achieved. The following discussion expands on the aspects of review previously addressed under supervision by focusing on review of the accuracy and quality of the end examination documents.

The review function must ensure:

- Facts, figures, and calculations are correct;
- Comments are adequately supported by the workpapers;
- Comments are consistent with agency standards, directives, and regulations;
- Comments and conclusions are adequately developed and stated, commensurate with the risks identified, and consistent within each document and between all documents; and
- Focus, balance, tone, and clarity are appropriate.

Each EIC must establish an effective and efficient means for completing reviews, ensuring appropriate independence and objectivity, and avoiding duplication of effort where possible. Due to the importance of the review function, all reviewers should possess sufficient knowledge, skills, and abilities with respect to the examination process and be familiar with MMC and state agency standards. Documentation which evidences completion of reviews should be placed in the workpaper files.

Upon approval and immediately prior to dissemination, the EIC should review the final copy of the examination report as a last quality assurance check

Supplement 1 – MME Identification Procedures

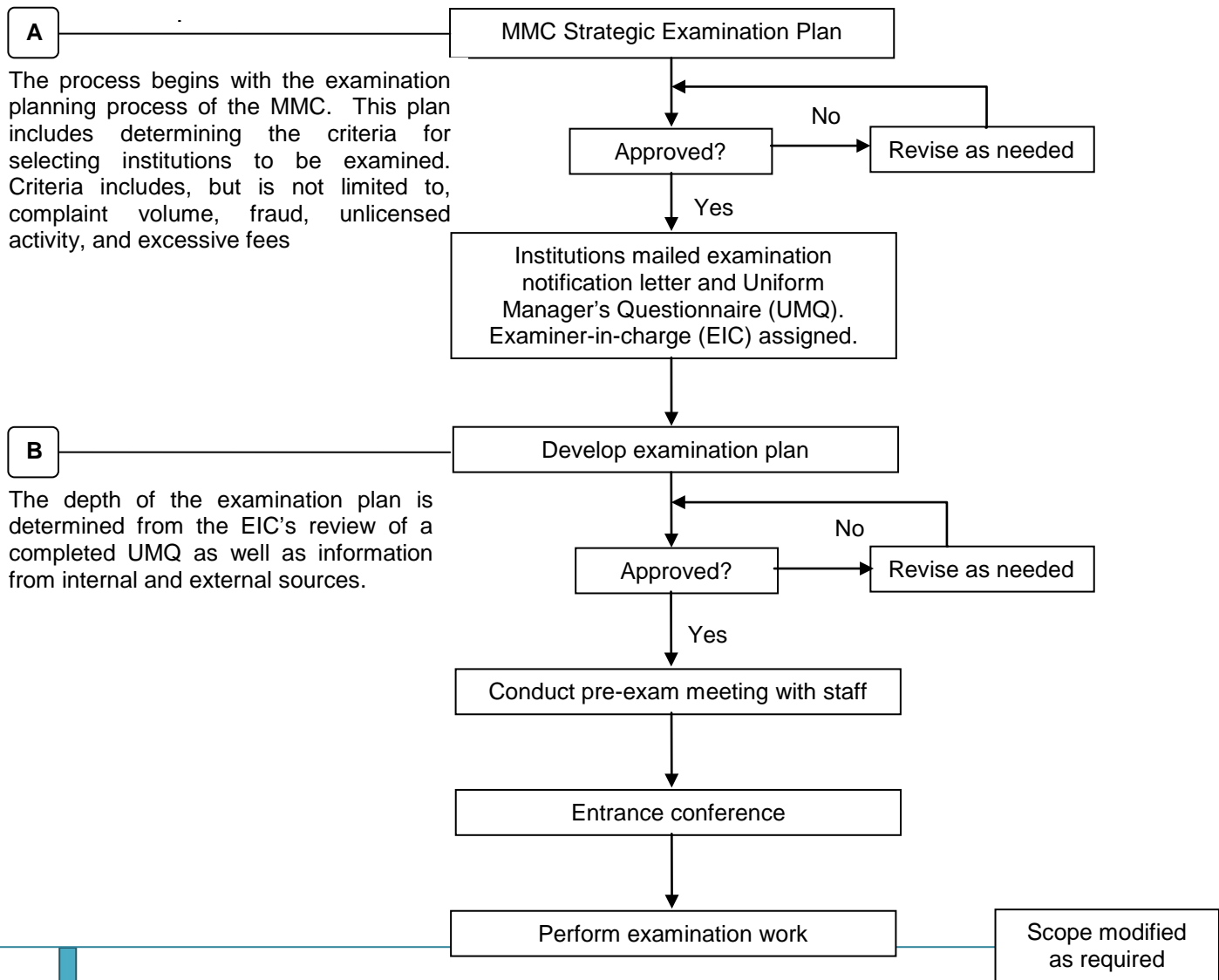
- [MMC MME Identification Procedures](#)

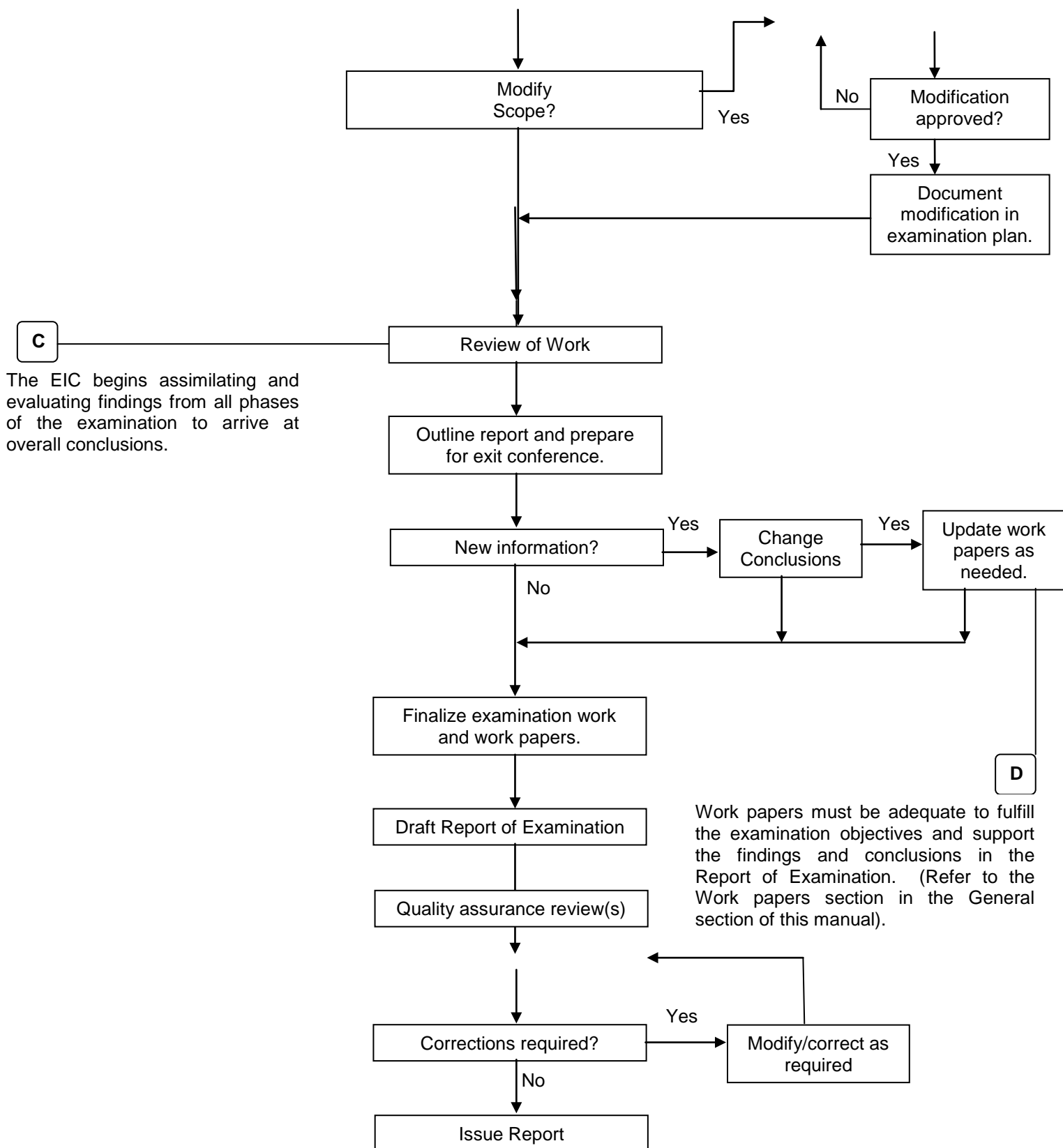
Supplement 2 – MME Risk Rating Valuation Table

The risk rating valuation table is currently under construction.

Supplement 3 - Flowchart of the MMC Examination Process

The following flowchart details various activities that may take place during the examination process. The chart is not all inclusive, examiners may not perform all tasks listed, or they may not do them in the specific order of the chart. However, it provides an example of a typical multi-state examination process and is therefore a useful guide. To enable the reader to more easily follow the process, brief narrative descriptions of various steps in the examination process are provided.





Supplement 4 - Violation Summary Sheet

Institution Name
Violation Summary Sheet
Exam Report Dated:

Violation 1: cite statute and list brief description

	<u>Name</u>	<u>Loan Number</u>	<u>Settlement Date</u>	<u>add columns as needed</u>	<u>Exhibit Number</u>	<u>Amount Refund</u>
1						
2						
3						
4						
5						
6						
7						
8						

Violations found in XX% of
sample

Prepared
by:

Page x of x

Date
Prepared:

- [MMC Violation Summary Sheet](#)

Supplement 5 – Duties of the Examination Liaison Team

1. Individually, as assigned, act as the Liaison for a specific multistate examination. In this role, the Liaison is a combination of mentor/adviser to the examiner in charge, and the communication portal between the MMC and the examination team. The EIC and team carry the work load with the Liaison observing, advising and reporting as necessary.
2. As a team, the collective Liaisons act as a resource or problem solving consortium where a single good mind is simply not enough to solve complex or sensitive issues. The Team holds meetings to vet issues and direct new courses for examination related matters. The MMC also looks to the Team to give a high level review of each MMC examination report as it is completed.
3. The Examination Liaison Team provides the subject matter expertise for the construction of the MMC Mortgage Examination Manual.
4. The Examination Liaison Team administers a mentoring program for junior level examiners.

Planning & Administration

Mortgage Pre-Examination Planning

Institution examination planning is the process of adequately planning for all examination and related activities. The principal objectives of planning are to identify and prioritize high-risk areas in an institution's operation in order to facilitate a more efficient and effective allocation of examination resources. This planning is accomplished by identifying those areas that require examination coverage and determining the depth of that coverage. Refer to the Examination Policy section of this manual for a discussion on the use of risk-based examination concepts in establishing scope and depth of testing in an examination.

Failure to adequately plan for examination work constitutes examination risk--the risk of not identifying or incorrectly diagnosing conditions which threaten the safety and soundness of the institution. However, the need to minimize examination risk must be balanced with the cost involved in performing the examination. This balance is partially achieved through effective examination planning and the development of a planning document (Examination Plan) prior to the commitment of resources. The Examination Plan provides a framework for monitoring and controlling this balance. This preliminary decision does not mean that once a plan is approved it cannot be changed. Plans are continually assessed and reevaluated throughout the examination process to optimize the balance between examination risk and the related costs to complete the examination.

This [Conducting the Multistate Exam](#) chapter provides guidance on the overall examination planning process including development and content of the resulting Examination Plan and supporting planning documents.

Planning Process

Institution examination planning is the process used to formulate institution-specific plans that focus on areas of significant or emerging risk. The planning process should identify specific high-concern areas affecting the institution, prioritize concerns according to risk, and determine how high-concern areas should be addressed. Institution examination planning must, at a minimum, address financial condition, management effectiveness, and compliance with laws and regulations. In order to ensure adequate examination coverage, it may be necessary to include examination issues other than the above broad categories, which may or may not reflect currently identified areas of concern.

The factors involved in the examination planning process and the development of institution-specific planning documents are detailed below:

- Survey--The more that is known about an institution, the easier it will be to develop a plan that minimizes examination risk. An effective monitoring program is the primary method of maintaining a general awareness of an

institution's operations. Nevertheless, the knowledge gained from prior monitoring and examination activities will oftentimes not provide, by itself, the comprehensive understanding of an institution's condition necessary to develop a plan and justify the commitment of resources. In these cases, this understanding can be enhanced and/or achieved through survey activities. The survey's purpose is to gather additional information that will aid the examiner in identifying risk and determining areas warranting investigation.

Survey-type activities include evaluating internal controls, reviewing pertinent files, and interviewing institution management and institution personnel. Evaluating an institution's overall internal control environment and internal controls can provide the examiner with the perspective needed to effectively plan an examination. Reviewing institution file information, complaints, investigation reports, and prior years' examination reports and workpapers provides the initial framework to identify areas of significant risk. After license file review, the examiner should consider interviewing institution management to clarify and expand upon this information and knowledge. Discussion with institution personnel may provide insight into changes in policies and procedures, in organization and staffing, and in operational trends. In addition, personnel may alert the examiner to issues which might not surface during file review. Additionally, interviews can clarify misunderstandings or resolve questions that institution management may have concerning the examination effort.

The examiner should also hold discussions with prior state examination personnel as appropriate. The EIC for the preceding examination should be able to provide perspective on the institution's operations and weaknesses. If the institution is operating under an enforcement action, the EIC should contact appropriate enforcement personnel to discuss the approach for evaluating compliance with any enforcement order or other action.

At the conclusion of the survey, the examiner should have the information and analyses needed to develop examination objectives, justify resources, and determine timeframes necessary to accomplish the examination. The [Examination Scope Worksheet](#) (ESW)⁴ is a tool to assist the EIC in the development and documentation of the results of survey efforts. The ESW is designed to help examiners manage examination risk by identifying compliance examination areas, financial condition areas, and management areas that may be evaluated during a given examination activity or period, identifying the high-risk areas to be examined in an institution's operations, and ensuring consistent consideration is given to examination issues across the participating states. In addition to being a planning tool, when incorporated into the planning documents, the ESW effectively documents and communicates examination guidance to multi-state examiners.

- **Objectives**--Objectives are statements of what is to be accomplished. They should be focused and tailored based on ongoing monitoring activities, prior

⁴ Refer to Supplement 1.

examination findings, the information obtained in discussions with institution management, the adequacy of the institution's audit and review program, additional information discovered during survey activities, etc. Objectives are evaluative in nature, and when achieved, they result in a conclusion about a specific area of an institution's operation.

- Scope--The scope addresses what is to be done to accomplish the examination objectives while ensuring effective and efficient resource utilization. This is typically accomplished by providing appropriate scope guidance via the ESWs to assigned examiners. Once completed, the ESWs define the scope of examination work to be performed, including examination issues which pose the greatest institutional and examination risk, as well as minimal risk issues requiring periodic evaluation. The ESWs also identify the extent of the planned examination activities required to complete each issue. Additionally, *Compliance Analyzer* is an effective tool for scoping compliance risk.
- Evaluative Criteria--Evaluative criteria outlines the requirements, standards, and additional criteria to be applied when performing the examination activities. Specific evaluative criteria that cite the particular regulation, institution policy or practice, or other performance measure to be used as the basis for evaluation, are preferred wherever possible.
- Strategies/Procedures--The strategies/procedures provide guidance that may range from general guidelines to specific procedures to be completed. Strategies offer examiners considerable latitude in determining how to examine a given topic. Conversely, specific procedures typically identify the nature and extent of analysis expected, including the preliminary depth of testing in an examination area. Examination Manual procedures, however, should be supplemented and modified as needed to meet the objectives and specifications of the specific examination activity in question. The EIC has the discretion to develop alternative strategies for completing examination activities. The MMC should be notified of any significant departures from established examination guidelines.

The examination team can develop targeted loan samples to test each applicable examination area, as appropriate. Targeted loan samples typically consist of several smaller samples of specific loans tailored to fit the particular concerns being investigated. Targeted sampling is generally more efficient and effective than random sampling because examiners are reviewing for only one or two pertinent factors on a smaller targeted sample instead of examining several generic items on every loan in a larger random sample. The depth of testing is continually reevaluated based on examination results. When sufficient work has been done to reach a conclusion, no further testing is needed. If a conclusion cannot be reached, then the targeted sample should be expanded or refocused on those areas of significant risk.

In addition to targeted sampling, examiners have the option of using statistical sampling techniques. [Supplement 2](#) contains MMC statistical sampling guidelines.

Both targeted and statistical sampling methods work in concert with electronic or software portfolio reviews covered in the [Technology for Portfolio Review](#) chapter of the MMC Exam Manual. The results of a software review of the portfolio are used to further define the population of files to be sampled under one of these two methods.

- Resource Allocation--The staffing and scheduling of resources in a multi-state examination are made by the MMC based on the EIC's evaluation of the areas being examined, the identification of skill sets needed to examine the areas, and an estimation of how much time should be allocated to the examined areas.

The MMC's assignment of examiners to the multi-state examination is covered under the [Conducting the Multistate Exam](#) chapter. The assignment of examination team members to program activities is influenced by skill sets, training needs, experience, examination risk, and availability. The EIC, in concert with the MMC, is responsible for ensuring a reasonable balance between examination risk exposure and staff development. Also, the EIC must monitor the workload throughout the examination and permit timely release of staff not required for the entire examination.

- Examination Notification Letter--Institution management should be notified of planned examination activities. An examination notification letter is used to inform institution's management of the upcoming activity and to advise them of the examination team's administrative and information requirements. The letter should be followed up by a telephone call to confirm these arrangements. Refer to [Supplement 3](#) for an example [Examination Notification Letter](#).
- Initial Information Request—The MMC's [Initial Information Request](#) ([Supplement 4](#)), is a comprehensive request of information and data required in order to begin conducting a multi-state examination. The Initial Information Request is equally useful for single state examinations. Sufficient lead time prior to the on-site portion of the exam should be provided in order for the institution to complete request. However, the EIC may set completion dates for sections of the request to be fulfilled after the on-site examination begins. The Initial Information Request carries crucial instructions and directions to institution management that are necessary for a successful examination. The EIC should be in frequent contact with institution management to monitor progress and guide the completion of the request.
- Supplemental Information Request—It is sometimes necessary for the EIC to use one or more supplemental requests to obtain additional information from the institution.
- Examination Plan Documents--There are two typical planning documents that comprise the MMC Examination Plan: a Monitoring/Oversight Plan and an On-site Activity Plan. The Monitoring/Oversight Plan may range from being very broad in its approach, such as when monitoring is the primary activity, to substantially more specific if significant off-site examination activities are to be performed. The On-site Activity Plan should be focused on directing only

those activities to be completed on-site. Examples of the Examination Plan documents are provided in the [Conducting the Multistate Exam](#) chapter.

While planning documents should be specific, their content and detail will depend on the circumstances and risk unique to each institution. Accordingly, plans are tailored to specific institutions and no two plans will be identical. These planning documents are not standardized documents, even though similar approaches to examining issues may be employed. The purpose of the planning documents is to communicate **what** needs to be done, **why** it should be done, **how** it will be done, **who** will do it, and **where** and **when** it will be done. To answer these questions, the components of a plan would typically include: objectives, scope (with sufficient justification), evaluative criteria, strategies/procedures, and resource allocation. These components should be present in the Monitoring/Oversight Plan, the On-site Activity Plan, or both. In addition to a scope selection tool, the ESWs are designed to assist in the documentation of these components by incorporating the ESWs into the planning document(s). Proposed changes to an approved plan should be discussed with the EIC's supervisor and the examination team. Actual changes to the plan must be documented in the workpapers. The EIC ensures all examination objectives are met by cross-referencing each objective in the plan with its corresponding workpaper.

The Examination Plan should be provided to the MMC at the outset and updated as necessary during the course of the examination. Any substantive changes to the plan documents should be discussed with the MMC during scheduled EIC/MMC update meetings. While it may not be necessary to provide the MMC with the actual amended plan documents, the EIC should apprise the MMC of the substantive changes in the EIC's regular report to the MMC, as discussed further in [Conducting the Multistate Exam](#).

Communication

Communication between examiners and supervisors throughout the examination process is essential and will aid in avoiding misunderstandings that might occur during report preparation and supervisory review activities. There is a balancing act performed between the EIC's and each examiner's state supervisor and the oversight function of the MMC.

The EIC is expected to hold regular meetings with the Examination Liaison Team and the MMC (as discussed in [Conducting the Multistate Exam](#)) to apprise the oversight body of progress and problems and receive additional direction as appropriate. The Examination Liaison Team serves as the intermediary between the exam team and the MMC. As such, issues and progress should first be discussed with the Liaison Team before the MMC. Since the EIC is typically agreed upon as a representative of the lead state and then assigned or allocated by that state, the EIC's state supervisors are encouraged to attend EIC/Liaison/MMC meetings.

To the extent possible, the entire multi-state examination team should participate in planning examination activities. To the extent practical, individual state examiner supervisors may wish to participate in the planning process as well. The purposes of the multi-state process are to foster inclusion and participation and are never intended as an exclusion of any participating state.

Communication of on-site examination activities and objectives is especially important, and it is best accomplished through a pre-examination meeting with the examination team. During the meeting, the EIC covers all aspects of the planning documents to ensure full understanding of examination guidelines and scheduled completion dates. The meeting also affords examiners the chance to ask questions about their assignments and the overall examination activity. Relevant issues pertaining to the MMC or institution are also discussed so examiners are in the most knowledgeable position prior to commencing on-site activities. Again, inclusion and participation by each state is preferred whenever possible.

Examination Objectives

- Identify and prioritize high-risk areas in an institution's operations in order to permit a more efficient and effective allocation of examination resources.

Examination Procedures

The following procedures are provided to facilitate the identification and prioritization of high-risk areas in an institution's operations. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

Each participating state should assign an examiner to complete the Pre-Examination Planning sections for the individual state.

MMC Pre-Examination Planning Exam Procedures

Examination Procedures		Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	EIC Note: Each state must provide a response to the following questions. The EIC may compile individual responses into a single response.			
1	Did the state licensing file and NMLS extraction data reviews identify any areas of concern within the institution's operations?			
2	Did review of prior examination reports and workpapers identify any areas of concern within the institution's operations?			
3	Did state complaint file review identify any areas			

MMC Pre-Examination Planning Exam Procedures

Examination Procedures		Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
EIC Note: Each state must provide a response to the following questions. The EIC may compile individual responses into a single response.				
	of concern within the institution's operations? <i>Examiner note: Additionally, review complaints that have been received but have not been entered in the agency's complaint tracking system.</i>			
4	Did the FTC Consumer Sentinel complaint database review identify any areas of concern within the institution's operations?			
5	Did enforcement actions, reports or information identify any areas of concern within the institution's operations?			
6	Did board of director meeting minutes identify any areas of concern within the institution's operations?			
7	Do "in-process" investigations identify any areas of concern within the institution's operations? <i>Examiner note: Interview investigator to determine areas of concern.</i>			
8	Has the institution been examined by a federal agency? <i>Examiner note: Obtain a copy of the examination report(s) and discuss the findings with the federal agency where necessary.</i>			
10	Did the institution provide all information requested by the Uniform Managers' Questionnaire (Supplement 5)?			

- [MMC Pre-Exam Planning Exam Procedures](#)

Information Security

Introduction

To protect unencrypted information from unauthorized access, the MMC does not send, receive, or request transmission of unencrypted electronic non-public sensitive information. When transmitting non-public sensitive information, the examiner should follow data encryption procedures. The sender should make certain that the encrypted files are "self-extracting." "Self-extracting" means that the file(s) can be opened without proprietary software. It should be noted that different states have different policies on encrypted files. Examiners should work with the various states and policies in coordinating the transfer of sensitive information.

Encrypting and Decrypting Files

Before transmitting unencrypted information, the examiner should create encrypted file(s) using MMC approved software.

When creating encrypted file(s), be careful to note the password used (do not include in the e-mail, just keep this information available for when the recipient calls for it). Include in the e-mail the name and phone number of the representative the recipient will need to call to obtain the password.

Before receiving unencrypted information, the examiner should request encrypted file(s) using the transmitters own data encryption procedures.

In the absence of such procedures, MMC suggests using a free utility called "IZArc."

Instruct the transmitter to follow this link to download a free copy of the ZIP Genius Software: <http://www.izarc.org>

Sending and receiving Information via E-mail

Encrypted files require a password to decrypt them after sending or receiving them via e-mail.

When creating encrypted file(s), be careful to note the password used (do not include in the e-mail, just keep this information available for when the recipient calls for it). Include in the e-mail the name and phone number of the representative the recipient will need to call to obtain the password.

Sending Information via Computer FAX

Computer FAX services convert incoming facsimile transmissions to Adobe® PDF files and delivers them directly to the recipients e-mail.

MMC has no way to secure information sent via computer fax; therefore, examiners should not send sensitive information to a computer fax.

Sending Information via CD

For those companies that prefer to send CDs of sensitive information, the examiner should request that the file(s) be encrypted before saving them to CD.

When creating encrypted file(s), be careful to note the password used (do not include in the e-mail, just keep this information available for when the recipient calls for it). Include in the e-mail the name and phone number of the MMC representative the recipient will need to call to obtain the password.

When CDs containing non-encrypted sensitive information are received, the examiner should immediately copy the information to their laptop hard drive and destroy the CD.

The Examination Supervisor shall be notified if the examiner is aware that non-encrypted sensitive information CDs are being sent. Upon receipt, the Examination Supervisor will copy file(s) to MMC shared drive (S:) and destroy the CDs.

USB Thumb Drives and CD Data Security

An examiner who uses a USB Thumb Drive (Thumb Drive) or CD to transfer sensitive information to their laptop hard drive could potentially lose either device.

There are two primary ways to mitigate the risk of losing sensitive information contained on a Thumb Drive or CD-- avoidance and encryption.

With an avoidance strategy, no sensitive information is stored on a Thumb Drive or CD. This is MMC's preferred strategy.

An encryption strategy allows sensitive information to be stored on a Thumb Drive or CD but renders the information useless without the required encryption key. Examiners are prohibited from storing sensitive information on Thumb Drives or CDs without encrypting.

Laptop Security

Laptops are especially vulnerable to loss and theft. Opportunistic and organized thieves will target laptops when examiners are away from their "duty station."

This section describes policies and procedures designed to prevent the loss of sensitive information through laptop theft.

Passwords

MMC laptops are password protected. Do not write passwords on the laptop or on paper stored with the laptop.

Examiners should create a strong password. A combination of at least eight numbers and upper- and lower-case letters is most effective.

Off-site

Laptop security should be maintained while working away from examiner's "duty station."

Telecommuter

Sensitive information on home computers can be just as vulnerable to compromise. Examiners should maintain up-to-date firewall, anti-virus, and anti-spyware protection and the latest security patches on home computers used even occasionally for business.

Examination Location

Never leave your laptop unattended when conducting an examination at institution's office.

Always log off when leaving sight of your laptop.

Always take your laptop with you when leaving the examination location.

Supplement 1- MMC Examination Scope Worksheet

- [MMC Examination Scope Worksheet](#)

Supplement 2 - Statistical Loan Sampling

Definition: A method of selecting a portion of a population, by means of mathematical calculations and probabilities, for the purpose of making scientifically and mathematically sound inferences regarding the characteristics of the entire population.

The EIC first ascertains the institution's total loan population from which to select samples.⁵ Next, the EIC sorts the total population by lien position such as (1) First Lien Real Estate Mortgages; (2) Junior Lien (Second, third lien, etc) Real Estate Mortgages.

To maintain statistical validity, each item in the population should have an equal chance of being selected for the sample. The MMC uses the following chart to determine the total number of sample loans to select from any given population.

TOTAL UNIVERSE TABLE			
Number in Universe	Minimum	Plus:	Maximum ⁶
Under 99	20	Total universe if smaller	20
100-299	20	10% of number above 100	40
300-499	40	7% of number above 300	54
500-749	54	6% of number above 500	69
750-999	69	5% of number above 750	82
1000-1999	82	4% of number above 1000	122
2000-2999	122	3% of number above 2000	152
3000-4999	152	2% of number above 3000	192
5000-9999	192	1.5% of number above 5000	267
10000 or more	267	1% of number above 10000	

⁵ Or uses a predetermined portfolio subset identified through electronic analysis discussed in *Technology for Portfolio Review*.

⁶ Maximum for the initial request. The examiner for each state may request additional documents if they deem necessary.

Note: The [Technology for Portfolio Review](#) chapter outlines loan sampling through the *ComplianceAnalyzer®* tool. This supplement should be used in concert with *ComplianceAnalyzer®*. If institutions can successfully and accurately submit data through *ComplianceAnalyzer®*, this supplement may be less useful than *ComplianceAnalyzer®*.

- [MMC Statistical Loan Sampling Supplement](#)

Supplement 3 – Example of an Exam Notification Letter

- [MMC Exam Notification Letter](#)

Supplement 4 – Initial Information Request

- [MMC Initial Information Request](#)

Supplement 5 – Uniform Manager’s Questionnaire

- [MMC Uniform Manager's Questionnaire](#)

MMC Rating System

Introduction

The MMC Exam Rating System is incorporated into the examination work program to provide a seamless and continuous evaluation of the three components the MMC assesses when determining the overall rating of examined MMEs. When an examination is complete, the MMC recommends a rating for the institution to the lead examination state based on the criteria outlined below. The lead examination state, supplied with the MMC’s rating recommendation, may choose to issue a confidential rating to the institution. The rating, if issued, will be contained in the Report of Examination. The areas of analysis that govern the MMC’s rating recommendation include:

- [Financial Condition](#)
- [Management](#)
- [Regulatory Compliance](#)

Also described in the manual is a [Consumer Protection](#) component. Consumer protection is not incorporated in the rating system.

An examiner's evaluation of the three components serves as the guide for the composite rating that the MMC recommends to the state for the institution. Each of these components will receive an individual rating of 1-5, 1 being the best rating and 5 the worst. Examiners should consider the individual strength of each component as well as the interconnectedness of the components in determining the overall condition of the institution. Composite and component ratings will be shared with the institution.

The composite rating is not an average of the component ratings. Assigning composite ratings is not an exact science and as such the examiner should be mindful of the severity of findings in the various examination components.

The remainder of this section outlines the various aspects of the components that examiners should investigate as well as the guidelines for assigning a composite rating to an institution. The guidelines and exam procedures for a significant number of the aspects of each component are detailed elsewhere in the manual. In these cases, hyperlinks will direct readers to the applicable section.

Safety and Soundness

In its simplest form, safety and soundness means: free from danger or injury. For financial institution purposes, safety and soundness describes the condition of an institution's financial health, the reliability and accountability of its operations, and its prospect for the future financial stability. Generally considered a depository examination term, an examination for safety and soundness is an examination of the institution's strength and operating policies and procedures to determine whether the institution is being run in a safe and sound manner. This manual covers safety and soundness in two primary areas: financial condition and management. Safety and soundness is not incorporated as a single concept in the MMC Exam Manual. This explanation is included to clarify that the concept is not structured in the same manner in the MMC Manual as it is in institution examination manuals.

Components

[Financial Condition:](#)

Liquidity, earnings, asset quality, capital, and sensitivity to market risk are all key indicators of the stability and soundness of a financial institution and potential for risk of loss to both the institution and consumers. Without funds to operate (is "liquid") and earn a profit, an institution ultimately will not be able to meet its obligations to consumers or sustain a viable program of legal and regulatory compliance. Either situation jeopardizes the institution's ability to maintain its license. If it has low quality assets, the institution may experience losses that detract from earnings and limit its liquidity. If an institution is not well capitalized, investors and commercial lending institutions will be hesitant to invest in the institution or lend it money. Extreme sensitivity to market risks in an institution's portfolio can be particularly dangerous and has the capacity to dismantle an

institution overnight. Therefore, the assessment of the Financial Condition component will consider the adequacy of liquidity, earnings, asset quality, capital, and sensitivity to market risk. Since mortgage institutions generally have limited regulatory capital requirements, much of the assessment of financial condition will be based on liquidity. The adequacy of earnings, asset quality and capital will be determined based on their potential as sources of liquidity. However, examiners should also thoroughly investigate the overall solvency of the institution and the future prospects for remaining solvent.

The financial strength of an institution is largely determined by its ability to fund loans that are in the pipeline. Because the typical nondepository institution does not portfolio loans and depends on quick turnaround on the sale of originated loans, liquidity is very crucial when analyzing the financial condition of an institution. In the context of analyzing the institution's liquidity, the examiner should verify the level of capital. An institution with strong capital positions and earnings fundamentals that are trending up is likely to be able to sustain ongoing operations and have less difficulty raising funds for even unforeseen events. Conversely, institutions with low levels of capital, weak earnings that are not growing or trending low or whose assets are deteriorating, may find financing to be more expensive or borrowing adequate line amounts difficult or maturities reduced.

To review the guidelines and examination procedures for evaluating the various aspects of the Financial Condition component, follow the links below:

- [Liquidity](#)
- [Earnings](#)
- [Capital](#)
- [Asset Quality](#)
- [Sensitivity to Market Risk](#)

When determining the financial condition of an institution, the examiner should take into consideration the level of capital, liquidity and funds management practices, the trend and level of earnings, the quality of the institution's assets, and also the institution's mechanisms for controlling interest rate risk. While MMC examinations do not assign numerical ratings to the individual subcomponents of the Financial Condition Component, examiners should rate the overall condition of the institution's financial condition taking into consideration the following:

The examiner should assign a risk rating taking into consideration the level of capital, liquidity and funds management practices, the trend and level of earnings, the asset quality and interest rate risk management.

A rating of "1" indicates strong liquidity levels, excellent earnings and well-developed and practiced funds management policy. Such institutions demonstrate reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs. Capital levels and asset quality are

strong. Additionally, such institutions have strong mechanisms for controlling sensitivity to market risk.

A rating of “2” indicates satisfactory sources of funds on acceptable terms to meet present and anticipated liquidity needs; satisfactory capital and earnings, modest weaknesses from funds management practices, satisfactory asset quality, and sufficient interest rate risk mechanisms.

A rating of “3” indicates less than satisfactory liquidity management, relatively low levels of capital or decreasing earnings. Such an institution may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices. Asset quality needs improvement. Additionally, interest rate risk mechanisms may be subpar.

A rating of “4” indicates the institution is operating at a loss in an accelerated basis, liquidity levels are deficient or capital is inadequate. The institution may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs. Asset quality is deficient. Sensitivity to market risk may be high and uncontrolled.

A rating of “5” indicates the institution has serious liquidity practices. Liquidity is critically deficient, capital has deteriorated to a critical level or earnings are non-existent. The continued viability of the institution is threatened, and requires immediate external financial assistance to meet funding obligations. Asset quality is poor. The potential for a break down in operations due to extreme sensitivity to market risk may also be present.

[Management:](#)

The foundation of strong management in any institution is an effective, rational organizational structure, exhibited by sound and clear policies and procedures and effective internal routine and control processes. There must also be a culture of accountability which is demonstrated by clearly delineated operational controls by various officials and employees over specific spheres of influence. The Board of Directors and senior management must demonstrate their commitments to maintaining an effective compliance management system and to set a positive climate for compliance. The quality of management is reflected in its ability to create and implement reasonable and effective plans for the activities of the organization, monitor and enforce the organization’s execution of its plans, and modify its plans in light of operating results and changes in its operating environment. In evaluating management, the examiner should consider the knowledge, skills, and abilities of the executive officers, their track record, regulatory compliance, and financial performance of the institution.

To review the guidelines and examination procedures for evaluating the various aspects of the Management component, follow the links below:

- [Adequacy of Institution Policies:](#)
 - Financial Condition

-
- Liquidity
 - Earnings
 - Capital
 - Asset Quality
 - Sensitivity to Market Risk
 - Operations
 - General Function
 - Personnel
 - Third Party Risk
 - Underwriting
 - Employee Training Program
 - Business Plan
 - Investment Lending
 - Secondary Market Risks
 - General Risk Management
 - Consumer Complaints
 - Regulatory Compliance
 - Applicable State Laws
 - Equal Credit Opportunity Act; Regulation B
 - Home Mortgage Disclosure Act; Regulation C
 - Truth-in-Lending Act; Regulation Z
 - Fair Credit Reporting Act
 - Fair Housing Act
 - Real Estate Settlement Procedures Act; Regulation X
 - USA Patriot Act of 2001
 - Gramm-Leach-Bliley Act
 - Home Ownership Protection Act
 - SAFE Act
 - Dodd-Frank Bill
 - Consumer Contact/Direct Origination
 - [Adherence to Policies and Effectiveness, Policy Enforcement System, and Policy Modification System](#)
 - [Cooperation with Examinations and Investigations](#)

Examiners should rate the overall condition of the institution's operations and management taking into consideration the following:

A rating of "1" indicates strong performance by management and the board of directors and strong risk management practices relative to the institution's size, complexity, and risk profile. Management has strong policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination, and management adheres to those policies and controls. Systems for modification of policies and cooperation with examinations and investigations are strong.

A rating of "2" indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk

profile. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination may demonstrate some weaknesses. Adherence to those policies and controls is satisfactory. Systems for modification of policies and cooperation with examinations and investigations are satisfactory.

A rating of “3” indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution’s activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination may be inadequate. Systems for modification of policies and cooperation with examinations and investigations are less than satisfactory.

A rating of “4” indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution’s activities. The level of problems and risk exposure is excessive. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination are deficient. Adherence to those policies and controls is weak. Systems for modification of policies and cooperation with examinations and investigations are deficient.

A rating of “5” indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination are critically deficient or nonexistent. Adherence to those policies and controls is also critically deficient or nonexistent. Systems for modification of policies and cooperation with examinations and investigations are unacceptable.

[Regulatory Compliance:](#)

Sound compliance management is a major consideration when evaluating the quality and effectiveness of an institution. An effective compliance management function should include a process for assessing and monitoring compliance performance, training, and for implementing corrective action based on identified deficiencies.

Examiners should strongly consider the severity and level of violations incurred by institutions and making evaluations. Additionally, examiners should consider repeat violations and the institution’s success in address outstanding violations.

To review the guidelines and examination procedures for evaluating the various aspects of the Regulatory Compliance component, follow the links below:

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- [Applicable State Laws](#)
 - [Equal Credit Opportunity Act; Regulation B](#)
 - [Home Mortgage Disclosure Act; Regulation C](#)
 - [Truth-in-Lending Act; Regulation Z](#)
 - [Fair Credit Reporting Act](#)
 - [Fair Housing Act](#)
 - [Real Estate Settlement Procedures Act; Regulation X](#)
 - [USA Patriot Act of 2001](#)
 - [Gramm-Leach-Bliley Act](#)
 - [Home Ownership Protection Act](#)
 - [Dodd-Frank Bill](#)

Examiners should rate the overall condition of the institution's compliance mechanisms taking into consideration the following characterizations:

A rating of "1" indicates that compliance with federal laws and regulations is strong. Management has strong internal controls and monitoring for regulatory compliance. Policies are in writing, determined to be effective, and operations are tested for compliance. Management is pro-active in addressing areas of weakness.

A rating of "2" indicates that compliance with federal laws and regulations is satisfactory. Management has satisfactory internal controls and monitoring for regulatory compliance. Some areas of weakness may be noted but are not material in nature and are easily corrected.

A rating of "3" indicates that compliance with federal laws and regulations needs improvement. Management has less than satisfactory internal controls and monitoring for regulatory compliance. The situation presents an undue risk to the institution's operations if not corrected.

A rating of "4" indicates that compliance with federal laws and regulations is deficient. Management has a less than satisfactory level of internal control and monitoring in place for regulatory compliance. Material areas of operations do not have written policies and procedures or have ineffective policies and procedures. Immediate actions must be taken to preserve the viability of the institution.

A rating of "5" indicates that compliance with federal laws and regulations is critically deficient. Management has poor or no internal controls and monitoring in place for regulatory compliance. The risks present are to the degree that the institution may cease operations.

[Consumer Protection](#)

Although the Consumer Protection Component outlines some key issues that may be present in institutions, the Consumer Protection Component **is not** part of the MMC rating system. Means for measuring consumer protection beyond

regulatory compliance are largely undeveloped. Thus, the Consumer Protection Component is worked into the manual to provide information regarding the meaning and detection of unfair and deceptive acts or practices. Given the relatively subjective nature of consumer protection, it is not reasonable to incorporate it into an exam rating. However, the component does provide some insight on unfair and deceptive acts or practices that might go undetected through strict regulatory compliance inspection. The Consumer Protection Component is written like the other components, and gives instruction on rating an institution in this area. However, examiners do not need to arrive at a consumer protection rating to complete an exam. Certainly resources often demand full attention to areas for which an examiner is strictly responsible. Thus, the MMC does not endorse or require examining an institution based on these principles. Simply, if an examiner is familiar with the principles in this component, he or she may use them at their disposal during the work process.

Consumer protection standards are largely based on the practices that have been deemed unfair and deceptive by the FTC and state and federal regulatory bodies. Under standards endorsed by all of the federal financial institution regulatory agencies and the FTC, an act or practice is unfair where it:

- Causes or is likely to cause substantial injury (usually monetary) to consumers;
- Cannot be reasonably avoided by consumers; and
- Is not outweighed by countervailing benefits to consumers or to competition.

Under standards endorsed by all of the federal financial institution regulatory agencies and the FTC, an act or practice is deceptive in the following circumstances:

- There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.
- The act or practice must be considered from the perspective of the reasonable consumer.
- The representation, omission, or practice must be material.

To review the guidelines and examination procedures for evaluating the various aspects of the Consumer Protection Component, follow the links below:

- [FTC Act, Section 5](#)
- [UDAP Procedures](#)

Examiners should rate the overall condition of the institution's consumer protection taking into consideration the following:

A rating of “1” indicates that the institution has strong consumer protection controls in every regard. Evidence of unfair or deceptive acts or practices is nonexistent.

A rating of “2” indicates that the institution has satisfactory consumer protection controls. Evidence of unfair or deceptive acts or practices is minimal.

A rating of “3” indicates that the institution has less than satisfactory controls over consumer protection. Evidence of unfair or deceptive acts or practices is present.

A rating of “4” indicates that the institution’s controls over consumer protection are deficient. Evidence of unfair or deceptive acts or practices is prevalent.

A rating of “5” indicates that the institution’s controls over consumer protection are critically deficient. Evidence of unfair or deceptive acts or practices is pervasive.

Application of the Manual to non-MMEs

While this manual represents the MMC’s focus as a body that examines MMEs, states are free to look to this manual as guidance for their own examinations as they deem appropriate.

If states wish to apply the manual to non-MMEs, it is clear the exact same principles and examination methods cannot apply to all institutions which are not part of the MMC’s core mission. Individual states typically examine smaller institutions than does the MMC. Smaller lenders and other much smaller operations, such as a pure mortgage broker who does not originate mortgage loans, while subject to the same principles, require modified examination procedures which reflect the size and complexity of the institution. Examiners should modify the scope of the examination and procedures to be used based upon the institution’s size and complexity. Additionally, when rating the institution, the weight given to each rating component can be varied based on the activities performed by the institution, the volume of activity, and other such characteristics.

While the financial review of much smaller operations, and in particular, individuals or companies that do not originate mortgage loans, should be adjusted, many of the same principles used to evaluate MMEs still apply. Examiners should always look at capital levels to determine an institution’s capacity for absorbing losses. Similarly, examiners should evaluate earnings to ensure that the institution is running a viable business. For institutions that do not originate loans, liquidity should be reviewed for its adequacy in funding day to day operations and meeting payroll.

Examiners should still conduct a complete compliance review on loans for non-MMEs. Also, examiners should evaluate and comment on legal requirements like licensing, LOs, locations, and other such matters. Management policies and

procedures, in so far as they apply to the functions of the institution should be thoroughly reviewed, just as they should in MMEs. Additionally, consumer protection practices should be evaluated as well.

Composite Rating

A rating of “1” indicates that financial condition is strong in all areas. Management has strong controls and policies in all areas of operation. Compliance with federal consumer laws and regulations is strong and no violations are present.

A rating of “2” indicates that institution maintains a satisfactory state of financial condition. Management has satisfactory controls and policies in place in areas of operation. Compliance with federal consumer laws and regulations is satisfactory as few or no violations are present.

A rating of “3” indicates that financial condition is less than satisfactory. Management has less than satisfactory controls and policies in place in areas of operation. Compliance with federal consumer laws and regulations is less than satisfactory as violations may be numerous.

A rating of “4” indicates that financial condition is deficient. Management has marginal controls and policies in place in areas of operation. Controls and monitoring of all institution personnel are such that abusive lending practices are likely to develop. Compliance with federal consumer laws and regulations is deficient as numerous violations are present.

A rating of “5” indicates financial condition is critically deficient. Management has failed to develop policies and procedures necessary to ensure operation. Controls and monitoring of all institution personnel do not exist and abusive lending practices are evident. Compliance with federal consumer laws and regulations is ignored and violations are pervasive.

The Composite Rating assigned to this institution is

Financial Condition

Introduction

The Financial Condition module provides general information, objectives, criteria, guidance, and procedures for examining specific topical areas related to the financial condition of institutions. The purpose of this section is to introduce the Finance module and financial examination in general. The remaining sections of this module correlate to the five key financial areas presented below:

- [Liquidity](#)

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- [Earnings](#)
 - [Capital](#)
 - [Asset Quality](#)
 - [Sensitivity to Market Risk](#)

These five financial areas have been combined into one module due to their strong operational and functional interrelationships. From an operational perspective, capital, earnings, liquidity, asset quality, and sensitivity to market risk typically represent the key responsibilities of the institution's chief financial officer. This interrelationship, in turn, facilitates the grouping of these functional areas for the purpose of examination review.

Additionally, examiners should be cognizant of the potential negative impact instances of fraud may have on an institution's financial condition. Refer to the chapter on [Fraud](#) for direction on detecting fraud.

Examination Tools

There are a variety of tools examiners can use to assess the five financial areas in determining an institution's financial condition. These include audited financial statements, institution books and records including interim financial statements, tax filings, SEC filings, annual regulatory reports (including reports filed with other regulatory agencies), statements prepared for borrowings, lines of credit, or approval of lending relationships, and for publicly traded institutions, ratings analysis and reports. Note that NMLS Call Report data is being collected and when made available, ratio analysis will be more readily available.

Examiners should inquire of management, in writing, as to the existence of available statements, documents and reports, but should not limit the review to only records provided by management in response to the request.

Examination Objectives

- Determine the adequacy of an institution's liquidity, earnings, capital, asset quality, and level of sensitivity to market risk.
- Utilize the five financial condition modules and respective exam procedures to determine the overall Financial Condition Rating.

Interrelationships

As mentioned above, extensive interrelationships exist between the key financial areas. Additionally, the quality and characteristics of the asset portfolio have a substantial affect upon the adequacy evaluations of the financial areas.

Examples of these interrelationships are listed below:

- The evaluation of capital adequacy is, in part, dependent upon portfolio risk exposure; the level, quality, and stability of the institution's earnings; and the degree of interest rate risk exposure;

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- The assessment of earnings performance is, in part, dependent upon capitalization sufficiency, portfolio risk exposure, and interest rate risk sensitivity;
 - The assessment of liquidity primarily revolves around the continued access to funding at a reasonable cost, which, in turn, is primarily dependent on asset quality, capital adequacy, earnings performance, and the quality of management; and
 - The evaluation of asset quality appropriateness must consider the strength of the institution's capital position and earnings performance.

Although the accurate assessment of each individual area includes numerous evaluative factors, as discussed in each respective section, consideration to the above-type of relationships is a critical aspect of the overall evaluative process. These and other interrelationships are presented and further described within the remaining sections of this module.

Prospective View

When evaluating the key financial areas, it is not enough to review only past and present performance -- consideration must also be given to anticipated future performance. The examiner must look beyond the basic performance numbers and also assess other more subjective factors to gain insight into the likelihood and strength of continuing performance. Such factors typically include:

- Trends--In which direction is performance trending and why?
- Threats--What factors exist that may threaten future performance? For example, does excessive interest rate risk jeopardize future earnings?
- Stability--What is the likelihood that the current level of performance will continue? For example, is current performance due to ongoing operations or extraordinary events? What is the composition or quality of capital and earnings? What internal and external factors will likely impact future performance?
- Projections--Are the institution's projections of future performance reasonable and adequately supported?
- Quality of Management--What is the quality and soundness of underlying management systems, processes, programs, plans, internal controls, etc? For example, how sound and effective is the institution's loan pricing program? Does the management have a documented, well-thought out, and germane capital plan?

Collectively, these and other similar factors provide insight into likely future performance levels and conditions. This prospective view, in combination with the analysis of past and present performance, provides the examiner a sufficient basis upon which to draw conclusions regarding the adequacy of each functional area, and, ultimately, the overall condition of the institution.

Liquidity

The financial strength of a lending institution is largely determined by its ability to fund loans that are in the pipeline. Liquidity risk is the risk of not being able to obtain funds at a reasonable price within a reasonable time period to meet obligations as they become due. Because the typical institution does not portfolio loans and depends on quick turnaround on the sale of originated loans, liquidity is very crucial when analyzing the financial condition of an institution. In the context of analyzing the institution's liquidity, the examiner should verify the level of capital. An institution with a strong capital positions and earnings fundamentals that are trending up is likely to be able to easily fund ongoing operations and have no difficulty raising liquidity for even unforeseen events from other money center financial institutions. Conversely, institutions with low levels of capital, weak earnings that are not growing or trending low or whose assets are deteriorating, may find financing to be more expensive or borrowing line maturities reduced. The examiner should also inspect for the quality of the assets the institution works with and their potential impact on liquidity sources.

To provide funds to satisfy liquidity needs, one or a combination of the following must occur:

- Disposal of assets.
- Increase in short-term borrowings.
- Increase in long-term liabilities.
- Increase in capital through earnings, capital injection, stock issuance, or issuance of other capital instruments.

Liquidity is also necessary to fund daily activities. Cash is necessary to pay workers, pay third party service providers, pay for the acquisition of assets (including leasing or buying equipment or premises), pay for supplies and pay creditors. For a lending institution, it is important that the business have cash reserves to cover loan commitments and to fund loans that are going to closing but have not been funded. Trends in cash reserves can be observed through the NMLS Mortgage Call Report Cash Flow Statement. Sources of liquidity for a residential mortgage institution include retained earnings, sales of assets, warehouse lines of credit, other loans and paid in capital.

It is important that examiners determine if sources of liquidity (i.e. lines of credit) are viable and likely to continue to support operations; not just availability. The viability of any credit line rests on the viability of the creditor. Since most creditors are banks these days, it is good practice to either visit the appropriate federal regulator's web site and obtain financial information and review the condition of the crediting bank or ask the mortgage institution for its analysis and mitigation of this risk. Examiners should make a distinction between loans to support operations (Working Capital LOCs, revolving LOCs, and Term Loans) and warehouse lines of credit meant to support the lending function. Loans supporting operations have a distinct and separate use than do the warehouse lines. Each loan type has a specific lifecycle and if the sources are mixed up, a

situation may arise where short money supports long-term loans or long money supports short-term loans and liquidity and earnings are negatively affected.

In evaluating the adequacy of an institution's liquidity position, the examiner should take into account the current level funds being used to fund the loan pipeline, and prospective sources of liquidity compared to funding needs. An institution that is aggressively originating loans requires a stable, ample source of funding either from earnings, money center institutions or a strong combination of both. A misstep in such an aggressive posture, such as poor quality control leading to inadequate documentation of files, can quickly lead to funding sources drying out. Examiners should also verify an institution's compliance with loan covenants to ensure the institution's ability to fund loans.

Institution management must ensure funds management practices are congruent with the institution's size, complexity, and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner. As mentioned, the formality and sophistication of liquidity management depends on the size and sophistication of the institution, as well as the nature and complexity of its activities. Good management information systems, strong analysis of funding requirements under alternative scenarios, diversification of funding sources, and contingency planning are crucial elements of strong liquidity management.

Ratio Analysis

Examiners should calculate the ratios listed below and consider them in the liquidity evaluation. Where possible, ratio analysis should consider trends and unusual sources for the numerator or denominator (such as cash from the sale of an asset that was considered plant and equipment). For those institutions that fund loans, consider the volume of loan commitments outstanding versus available funding sources when determining the evaluation for the liquidity portion of the Financial Condition component. Calculations will be facilitated as the NMLS Mortgage Call report develops an increasingly robust database.

Current Ratio:

- Current Assets / Current Liabilities
- The Current Ratio is a good gauge of an institution's capacity to meet short-term debt obligations. A higher Current Ratio indicates a more liquid institution.
- Generally, a satisfactory Current Ratio is above 1.8%, while an above average Current Ratio is 1.3-1.8%, a below average Current Ratio is 1.0 to 1.2%, and an Unsatisfactory Current Ratio is below 1.0%.

Quick Ratio:

- Current Assets – Inventory (ie. Loans Held for Sale) / Current Liabilities

- The Quick Ratio is good indicator of an institution's short-term liquidity. It gauges an institution's capacity to meet short-term debt obligations with its most liquid assets.
- Generally, a satisfactory Quick Ratio is above 1.3%, while an above average Quick Ratio is 1.0-1.3%, a below average Quick Ratio is 0.1 to 0.9%, and an Unsatisfactory Quick Ratio is below 0.1%.

Turnover Rate:

- Measures about how many times in a month the warehouse line is drawn upon and paid-off. In looking at the data for this ratio it also becomes quickly evident whether the institution is constantly hitting the ceiling on its borrowing capacity on any particular line.
- This analysis should answer two questions:
 - How often the line is paid out every month - If the institution gets close to drawing the full amount twice a month then it has effectively doubled the volume it can push through. Most operations aren't good enough to get a group of loans closed, sold, and transferred much quicker than a two week window.
 - How close to full usage the line is - Examiners should verify that if a particular line is constantly being fully used or exceeded that there are alternate sources for liquidity. In this situation it becomes important to check the agings of the loans on the line.

Other Ratios:

- Acid-Test Ratio: $(\text{Cash} + \text{Accounts Receivable} + \text{Short Term Investments}) / \text{Current Liabilities}$
 - The Acid Test Ratio depicts whether an institution has enough short-term assets to cover its immediate liabilities without selling inventory.
 - A ratio less than 1 indicates that an institution cannot pay its current liabilities and should be scrutinized.
- Operating Cash Flow Ratio: $\text{Cash Flow from Operations} / \text{Current Liabilities}$
 - Indicates how well current liabilities are covered by operations cash flow.

Exam Objectives:

Examiners should consider:

- Ability to fund daily activities.
- Ability to fund loans in the pipeline.
- Ability to meet debt-obligations.
- Levels of capital and earnings to support liquidity.
- Quality of assets and their possible effect of liquidity.

MMC Liquidity Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Are policies, procedures, and risk limits related to liquidity adequate?			
2	Are internal liquidity controls adequate?			
3	Are the audit or independent review functions related to liquidity adequate?			
4	Are information communication systems related to liquidity adequate and accurate?			
5	Is the use of wholesale and rate sensitive funding sources reasonable?			
6	Does the overall assessment of liquidity, including provisions for back-up funding sources, indicate liquidity needs can be met without adversely affecting operations or financial condition?			
7	Do the board and senior management effectively supervise liquidity related functions?			
8	Review prior examination reports and file correspondence for an overview of any previously identified liquidity concerns.			
9	Review board or committee minutes for evidence of oversight, responsibility, routine management reports, and any identified liquidity concerns.			
10	Determine if there are any recent or planned changes in strategic direction and discuss with management the implications for liquidity risks.			
11	Review liquidity and funds management policies. Policies should provide sufficient			

	<p>guidance to management with regard to the board's risk tolerances and oversight responsibilities. Liquidity guidelines may also be found in other policies, such as the Investment Policy or Loan Policy, but taken together should:</p> <ul style="list-style-type: none"> • Provide authorization to an individual(s) or committee, delineating responsibilities for planning, executing, and reporting. • Describe acceptable funding sources and an acceptable mix of uses, by type and maturities (e.g., investment securities, loan mix, other assets). • Define and place limits upon certain types of funding sources and uses of funds, including significant off-balance-sheet positions. Some common limits include: <ul style="list-style-type: none"> • Reliance on less stable funding of longer-term assets. • Individual and aggregate limits on borrowed funds by type and source. • Minimum level of short-term investments. • Provide contingency liquidity plans for use in emergency funding situations, including periods when credit sensitive funding is unavailable or cost prohibitive. 			
12	Review the funds management			

	process with management. Consider attending an ALCO meeting to evaluate the process.			
13	Determine if policies, procedures, and risk limits related to liquidity are reasonable in relation to management abilities, current economic conditions, the nature and complexity, and the overall condition of the institution.			
14	Evaluate the frequency and timeliness of liquidity policy reviews and updates by the board of directors.			
15	Determine if sufficient separation of duties (or comparable controls) exists over the preparation of reports used in managing the liquidity function.			
16	Determine that internal management reports concerning liquidity needs and available sources of funds are prepared with the appropriate frequency and reviewed by senior management and the board of directors.			
17	Determine if management complies with liquidity policy guidelines and documents the reasons for any variance.			
18	Determine that the scope of the audit or independent review is sufficient to identify policy, reporting, internal control, and compliance deficiencies related to liquidity.			
19	Determine that liquidity independent review results are properly reported to the board.			
20	If recent reviews disclosed any deficiencies, determine if management responses are reasonable.			
21	Determine if internal			

	management reports provide sufficient information for ongoing liquidity management decisions and for monitoring the results of those decisions.			
22	Determine if board and senior management reports provide sufficient information to monitor compliance with board policies and guidelines related to liquidity.			
23	Determine if liquidity needs and risks are effectively communicated to all areas affected.			
24	Consider testing liquidity reports for accuracy by comparing data with regulatory reporting schedules and subsidiary records.			
25	Assess the potential impact on liquidity of asset sales that include recourse provisions.			
26	Determine the extent of liquidity provided by the loan portfolio.			
27	Determine the impact of any related asset pledging and other off-balance sheet arrangements.			
28	Review recent asset sales or unusual borrowings prompted by unplanned liquidity needs and determine if there were any adverse affects on operations or financial performance.			
29	Explore and assess the impact of any other significant trends or changes in sources and uses of funds identified during the preliminary review process.			
30	Review contingency funding arrangements and determine if they are adequate given the institution's past, present, and prospective liquidity position, strategic plans, and overall financial condition. Consider:			

	<ul style="list-style-type: none"> • Sources of contingency funding; • Reliability of contingency funding (eg. Revocable, irrevocable vs. "as available"); and • Terms and conditions of alternative or contingency funding arrangements. 			
31	Calculate the applicable ratios under the ratio analysis sections and determine the institution's adequacy relative to those ratios.			
32	Appropriately identify differences in funding viability for purposes of operations and availability and ensure those sources are stable.			

- [MMC Liquidity Exam Procedures](#)

Earnings

From a regulator's standpoint, the essential purpose of earnings, both current and accumulated, is to absorb losses and augment capital. Additionally, earnings are an immediate source of liquidity generated primarily from the normal operations of the business. Earnings are also a short-term indicator of the adequacy of operations.

Earnings are the initial safeguard against the risks of engaging in the mortgage business, and represent the first line of defense against capital depletion resulting from shrinkage in asset value. Earnings performance should also allow the institution to remain competitive by providing the resources required to implement management's strategic initiatives.

Earnings quality is the ability of an institution to continue to realize strong earnings performance. It is quite possible for an institution to register impressive profitability ratios and high dollar volumes of income by assuming an unacceptable degree of risk. An inordinately high ROA may be an indicator that the institution is engaged in higher risk activities relative to peers.

Ratio Analysis:

Several ratios are important for determining an institution's earnings performance. Several applicable ratios are described below. The most important ratios for evaluating earnings in mortgage institutions are Return on Assets (ROA), Return on Equity (ROE), and the Debt to Equity Ratio. Examiners should calculate the applicable ratios listed below to help guide the earnings evaluation. Where possible, ratio analysis should consider levels and trends and unusual sources for the numerator or denominator (such as profit or loss from the sale of plant and equipment).

Return on Assets:

- $\text{Net Income} / \text{Total Assets}$
- The ROA is a common starting point for analyzing earnings because it gives an indication of the return on the institution's overall activities. Traditionally, return on assets is the primary measure of an association's profitability. Examiners should review the level, trend, and peer comparison of this ratio since it is a critical determinant of long-term viability.
- Generally, an adequate ROA in mortgage institutions is above 10%, while a moderate ROA is 0-10%, and an inadequate ROA is below 0%.

Return on Equity:

- $\text{Net Income} / \text{Shareholder's Equity}$
- $\text{Shareholder's Equity: Total Assets} - \text{Total Liabilities}$
- Return on equity indicates a corporation's profitability by depicting how much profit an institution creates with the money shareholders have invested. Investors and capital markets use the return on equity ratio to determine investment options.
- Generally, an adequate ROE in mortgage institutions is above 32%, while a moderate ROE is 0-32%, and an inadequate ROE is below 0%.

Debt to Equity Ratio:

- $\text{Total Liabilities} / \text{Shareholder's Equity}$
- The debt to equity ratio is included as an indicator of the volatility of return on equity because a small change in net income can have a large effect of ROE if there is little equity.
- Generally, an adequate Debt to Equity Ratio in mortgage institutions is below 1.4%, while a moderate Debt to Equity Ratio is 8.8-1.5%, and an inadequate debt to equity ratio is above 8.8%.

Other Ratios:

- $\text{Debt Ratio: Total Debt} / \text{Total Assets}$
- $\text{Earnings Retention Rate: (Net Income} - \text{Dividends)} / \text{Net Income}$
- $\text{Net Interest Margin: (Interest Income} - \text{Interest Expense)} / \text{Average Earning Assets}$

Exam Objectives:

Examiners should consider:

- Ability to cover losses and provide for adequate capital
- Earnings trends and stability
- Quality and composition of net income
- Degree of reliance on interest-sensitive funds
- Interrelationships between the dividend payout ratio
- Rate of growth of retained earnings and the adequacy of capital
- Adequacy of transfers to the valuation reserve, and the
- Extent to which extraordinary items, securities transactions and tax effects contribute to net income, are also assessed.
- Extent to which income may be enhanced through junk fees and higher service charges to consumers and by offering riskier loan products.

MMC Earnings Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Are profit, planning, and budget practices adequate?			
2	Are internal controls related to earnings adequate?			
3	Are the auditor or independent review functions for earnings adequate?			
4	Are earnings information communication systems adequate and accurate?			
5	Are earnings at a level appropriate for the institution's risk profile?			
6	Are earnings sustainable?			
7	Do the board and senior management effectively supervise this area?			
8	Review previous reports of examination, prior examination workpapers, and file correspondence for an overview of any previously identified earnings concerns.			
9	Review the most recent audits and independent reviews and identify deficiencies concerning reliability of			

	information systems that may affect quality and reliability of reported earnings.			
10	Review management's remedial actions to correct examination and audit deficiencies related to earnings.			
11	Discuss with management any recent or planned changes in strategic objectives and their implications for profit plans.			
12	Review board and committee minutes and management reports to determine the level and quality of management information systems related to earnings.			
13	Review the recent balance sheets to determine if there have been and significant changes in balance sheet structure that could materially affect earnings performance.			
14	<p>Review strategic plans, profit plans and budgets to determine if the underlying assumptions are realistic. Determine the sources of input for profit plans and budgets. Profit plans and budgets should address the following areas with detail appropriate for the size and complexity of the institution:</p> <ul style="list-style-type: none"> • Anticipated level and volatility of interest rates; • Local and national economic conditions; • Funding Strategies; Asset and liability mix and pricing; • Growth objectives; and • Interest rate and maturity mismatches. 			
15	Compare earnings performance to budget			

	forecasts. Determine if management compares budgeted performance to actual performance on a periodic basis and modifies projections when interim circumstances change significantly.			
16	Review management's procedures to prevent, detect, and correct earnings errors.			
17	<p>Determine if the income and expense posting, reconciliation, and review functions are independent of each other. Consider testing selected income and expense items to observe the operational flow of transactions. Areas commonly selected for review are:</p> <ul style="list-style-type: none"> • Large Volumes of other income (miscellaneous, service fees, or any other unusual accounts) • Proper treatment of loan origination fees per SFAS 91. • Insider expense accounts. • Management fees or other payments to affiliates. • Significant legal fees. 			
18	Determine if significant income, expenses, and capital charges are reviewed and authorized.			
19	Determine if insider related items are routinely reviewed for authorization and appropriateness.			
20	Determine that the audit or independent review program provides sufficient review of earnings relative to the institution's size, complexity, and risk profile. These			

	<p>activities should:</p> <ul style="list-style-type: none"> • Recommend corrective action when related to earnings warranted; • Verify implementation and effectiveness of corrective action related to earnings; • Assess separation of duties and internal controls related to earnings; • Determine compliance with profit planning objectives and accounting standards. • Assess the adequacy, accuracy, and timeliness of earnings reports to senior management and the board; • Include sufficient transaction testing to assure income and expenses are accurately recorded. 			
21	Determine if managerial earnings reports provide sufficient information relative to the size and risk profile of the institution.			
22	<p>Evaluate the accuracy and timeliness of the earnings reports produced for the board and executive management. These may include:</p> <ul style="list-style-type: none"> • Periodic earnings results; • Budget variance analyses; • Income projections; • Large item reviews; • Insider related transaction disclosures; • Tax planning analyses. 			
23	Validate the accuracy of Reports of Income where			

	necessary.			
24	Assess the level, trend, and sustainability of return on average assets relative to historical performance, peer comparisons, the organization's risk profile, and local economic conditions. Determine areas needing further investigation.			
25	Evaluate the level and stability of the institution's net interest margin.			
26	Evaluate the level and trend of overhead expenses.			
27	Evaluate the level, trend, and sources of non-interest income.			
28	Review the level and trend of provisions for loan and lease losses and the relationship to actual loan losses to determine the impact of asset quality on earnings.			
29	Review the level and trend of non-operating gains and losses and their impact on the earnings.			
30	Determine whether there have been any nonrecurring events that have affected earnings performance. Consider adjusting earnings on a tax-equivalent basis for comparison purposes.			
31	Evaluate the level and trend of income tax payments recognizing the institution's basis for filing taxes.			
32	Assess the ability of earnings to support capital growth. Review the earnings retention rate in comparison to the institution's potential growth rate.			
33	Evaluate the earnings impact of activities with affiliated organizations.			
34	Determine if board records			

	document routine attention to institution earnings and timely responses to significant budget deviations.			
35	Assess compliance with institution policies, applicable regulations, and governing accounting standards related to earnings.			
36	Calculate the applicable ratios under the ratio analysis section and determine the institution's adequacy relative to those ratios.			

- [MMC Earnings Exam Procedures](#)

Capital

Capital is the ownership interest in the business. It represents the ownership's "stake" in the business and, through retained earnings, is a long-term indicator of the adequacy of operations. Capital performs several very important functions. It absorbs losses, promotes public confidence, and when employed with capital ratio limitations, helps restrict excessive asset growth. In depository examinations capital is broken into specific risk components. Your state may have specific capital adequacy requirements, which should be followed in a review of the institution's capital.

For a residential mortgage institution, capital can affect liquidity through capital requirements (by lenders, regulatory agencies and business partners) and the institution's access to capital markets. Capital requirements will affect an institution's liquidity by limiting the portion of liquidity that can be borrowed versus that provided by paid in capital and retained earnings.

Capital requirements are considered when a lender is contemplating a business loan to a residential mortgage institution. Furthermore, lender capital requirements can affect liquidity long after a loan is made. A lender may decide, based upon a capital ratio review, to exercise a demand feature in a loan to an institution or prohibit an institution from drawing on a line of credit (such as a warehouse line).

A regulatory agency may require that capital ratios be maintained in order that a business may remain licensed to operate. A regulatory enforcement action may dictate an increase in capital to be brought about by the retention of earnings (no or reduced use of cash to pay dividends) and/or through a sale of stock (increase in cash through paid in capital).

Business partners may also require that certain capital ratios be maintained. Large volume providers of services may require that capital ratios be maintained in order to allow an institution to pay for services monthly. An institution that is hired as a sub-contractor to service or process loans may be required to maintain capital ratios as well.

When an institution cannot or chooses not to borrow funds, it may still provide liquidity through access to capital markets. Access to capital markets is generally easier for larger institutions and can be hindered by regulations governing acceptable ownership of regulated institutions.

When assessing capital, the examiner should be careful to consider contingent liabilities. Contingent liabilities affect the adequacy of capital through both their volume and the likelihood that they will become true liabilities. Contingent liabilities can arise through lawsuits and contractual agreements (retention of some liability for loans sold in the secondary market).

Additionally, especially in large institutions that hold loans long-term, the adequacy of loan loss reserves is critical. Inadequate loan loss reserves have the capacity to erode capital in the event of asset classification or loan losses. In general, examiners must ask the question, "Considering existing and potential liabilities and risks, does this institution have sufficient capital to sustain operations?" If not, examiners may choose to criticize management and recommend that the institution increase its capital to a sufficient level. Following are some of the ways in which a financial institution may increase its capital:

- **Increased Earnings Retention** through higher earnings, lower cash dividends, tighter controls over expenses, and upgrading credit standards to reduce loan losses. Note, however, that retained earnings only improve capital ratios when the increase exceeds asset growth.
- **Sale of Additional Capital Stock.**
- **Reduce Asset Growth** below that of capital formation. Note, this reduction results in a relatively higher capital-to-assets ratio, but may leave the institution with a strained liquidity posture further deteriorating the institution's Safety and Soundness.

The examiner should also consider contingent liabilities such as significant lawsuits or repurchase agreements when determining an institution's capital adequacy.

Ratio Analysis:

Prolonged Negative Earnings:

- Tangible Net Worth / Average Losses
- When an institution is experiencing negative and prolonged earnings it is important to know how long it can survive before capital disappears. To

- calculate the capital burn rate, examiners would essentially average out the loss experience and then divide tangible net worth by the average losses. Average losses can be calculated based on how thorough the data is. Examiners could make it weekly, monthly, or quarterly depending on the severity of the losses. The resultant figure will reveal how many periods you have left as a regulator before regulatory capital minimums are breached, how long you've got until insolvency, and how quickly you need to react as a regulator with orders, information requests, etc.
- It is important to keep in mind an appropriate time frame (weekly, monthly, quarterly) for losses.

Exam Objectives:

Examiners should consider:

- Capital levels in relation to the volume of risk assets
- Volume of marginal and inferior quality assets
- Growth experience, plans and prospects
- Strength of management
- Capital ratios relative to peer group if applicable
- Earnings retention and access to capital markets or other appropriate sources of financial assistance.

MMC Capital Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Are the institution's operating policies, procedures, and risk limits regarding capital preservation adequate?			
2	Are internal controls adequate with regard to capital?			
3	Are the auditor or independent review functions related to capital adequate?			
4	Are information communication systems related to capital adequate and accurate?			
5	Is earnings retention sufficient to provide for future growth, capital maintenance, and potential losses?			
6	Is the capital level sufficient in relation to the risk profile of the			

	institution?			
7	Do the Board and senior management effectively supervise capital amounts?			
8	Review prior examination reports, prior examination work papers, pre-examination memorandum, and file correspondence for an overview of any previously-identified capital deficiencies.			
9	Review internal and external audits for capital concerns.			
10	Review remedial action taken by management to correct prior audit and examination findings related to capital.			
11	Review the institution's dividend policy and historical and planned dividend payout/distribution ratios.			
12	Assess any other potential risks to capital, e.g., a growing trend in nonperforming loans, rapid growth, new products, etc.			
13	<p>Determine whether management's policies and practices promote capital preservation. Consider the following issues:</p> <ul style="list-style-type: none"> • The strategic plan and its underlying assumptions, projected asset growth dividend plans, asset quality, income, liquidity, funds management, parent institution relationship, contingent liabilities, expansion plans, competition, economic conditions, etc. <p>(Coordinate with the examiner(s) completing the Management and Internal Control Evaluation Module);</p>			

	<ul style="list-style-type: none"> • Interviews with institution management regarding the strategic planning process; • Management's risk monitoring procedures; and • The availability of additional capital sources. (Consider funding provided by insiders, external sources, or additional debt at the parent level.) • The adequacy of loan loss reserves, especially in institutions that hold loans long-term. 			
14	Determine if entries to capital accounts are appropriate and properly authorized.			
15	Determine if controls exist over off-balance sheet items. Consult with those examiners completing the Loan Portfolio, Securities, and Interest Rate Risk Reviews.			
16	Review board and management's procedures to prevent, detect, and respond to policy exceptions related to capital.			
17	Determine if the audit function verifies the accuracy of the capital accounts and regulatory reporting, the appropriateness, accuracy, and timeliness of reports produced for the board and executive management, and the reasonableness of capital budgeting.			
18	Determine if the audit or independent review program provides sufficient capital coverage relative to the institution's size and risk profile. The program should: <ul style="list-style-type: none"> • Substantiate the 			

	<p>effectiveness of internal controls related to management</p> <ul style="list-style-type: none"> • Recommend corrective action related to capital when warranted • Verify the implementation of corrective action commitments related to capital; and • Determine compliance with policies and procedures related to capital issues 			
19	<p>Determine if board and management reports provide sufficient information. Evaluate the accuracy and timeliness of these reports.</p>			
20	<p>Determine if earnings performance enables the institution to fund its growth, remain competitive in the marketplace, and support the overall risk profile. Consider the level and trend of equity capital to total assets as well as asset and equity growth rates.</p> <ul style="list-style-type: none"> • Review the level of the provision for loan and lease losses and the adequacy of the allowance for loan and lease losses. • Review whether the institution is relying on core earnings or income from non-recurring events. • Determine if dividends are excessive compared to current earnings. (Consider applicable state and federal guidance). 			
21	Determine if the existing capital			

	<p>level is adequate for the institution's risk profile when considering the following items:</p> <ul style="list-style-type: none"> • The level and trend of adversely classified assets; • The adequacy of the allowance for loan and lease losses; • The volume of charged off loans and recoveries; • The balance sheet structure and liquidity needs; • The level and type of concentrations; • The volume of unrealized gains or losses on available-for-sale securities; • The degree of interest rate risk exposure assumed by the institution; • The reasonableness of booked future tax benefits; • The accounting treatment and valuation of intangible assets; • The extent of contingent liabilities associated with trust or other activities; • The extent of any other liabilities not shown on the institution's books, including contingent liabilities; • The letters from the institution's attorney as to the existence of pending litigation against the institution and its subsidiaries and the potential and estimated loss exposure (This information should 			
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	be disclosed on the Officer's Questionnaire or First Day Letter); <ul style="list-style-type: none"> • The volume and risk characteristics of new business initiatives, and higher risk investment or lending strategies, e.g., subprime lending, • Compliance with state and federal capital level requirements if applicable; • The level of operational and reputational risk as it may affect capital. • The level, trend, and quality of assets as they influence capital preservation. 			
22	Assess the adequacy of management's actions to correct criticisms related to capital in previous examination reports as well as recent internal and external audits.			
23	Evaluate management's effectiveness at reacting to changes in economic, industry, and regulatory environments.			
24	Where necessary, assess management's ability to raise additional capital and the reasonableness of capital plans.			

- [MMC Capital Exam Procedures](#)

Asset Quality

Asset quality reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned, and other assets, as well as off-balance sheet transactions. The quality of the assets that a mortgage institution brings in has a significant impact on its ability to market its assets, and when an institution does hold assets on its books, the quality of those assets has a significant effect on balance sheet health. In evaluating asset quality, examiners should consider exposure to counter-party, issuer, or borrower

default under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including, but not limited to, operating, market, reputation, strategic, or compliance risks, should also be considered. Furthermore, in evaluating asset quality, examiners should be cognizant of the level of earning vs. non-earning assets and the level of current vs. past due loans.

For mortgage institutions, asset quality often determines the ease with which an asset can be converted, in the normal course of business, to cash to provide liquidity and the likelihood that converting the asset to cash will result in a loss (thus affecting earnings and ultimately capital). In addition, asset quality is another indicator of the adequacy of operations and can be either a short-term or a long-term indicator depending on the type of asset.

Some assets are held and used in the daily operations of a business, assisting in providing liquidity by assisting in earnings. In most cases, these assets will not actually be sold to provide liquidity unless they are being replaced, the business is changing its operations (i.e. abandoning a product line or process) or the business is being liquidated.

Other assets are generated by normal operations such as account receivables, inventory or investment assets. Account receivables assets are amounts of money due to a business by customers or clients. Inventory assets are assets created or purchased to be sold in order to provide liquidity. Investment assets are assets that:

1. Can be sold in the short term to provide liquidity:
 - a. Loans in the secondary market
 - b. Bonds sold before maturity
 - c. Stocks
2. Will provide liquidity over a longer period of time while retained:
 - a. Loans through payments
 - b. Bonds through interest payments
 - c. Stocks through dividends
3. Will be held to maturity to provide liquidity at a later date:
 - a. Loans that do not fully amortize by their maturity date
 - b. Bonds at maturity

The primary factor affecting overall asset quality is the quality of the loan portfolio and the credit administration program. If the institution portfolios its originated loans (or a significant portion), versus selling the originated loans into the secondary market or to investors, this will likely be the largest of the asset items and can also carry the greatest amount of potential risk to the institution's capital account. Securities can often be a large portion of the assets and also have identifiable risks. Other items which impact a comprehensive review of asset quality are other real estate, other assets, off-balance sheet items and, to a lesser extent, cash and due from accounts, and premises and fixed assets. Additionally, examiners should consider an institution's Mortgage Servicing Rights (MSR) in evaluating asset quality.

Evidence of Fraudulent Loans will have a negative impact on asset quality.

Exam Objectives:

When evaluating asset quality, the examiner should consider the following:

- The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices.
- The level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance sheet transactions.
- Management's demonstrated ability to administer and collect problem credits
- The credit risk arising from or reduced by off-balance sheet transactions, such as unfunded loan commitments.
- The diversification and quality of the loan and investment portfolios.
- The extent and quality of hedging activities.
- The adequacy of loan and investment policies, procedures, and practices.
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal controls and management information systems.
- The volume and nature of credit documentation exceptions.

Examiners should note how the current level or status of each factor relates to previous and expected future performance and the performance of other similar institutions.

MMC Asset Quality Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Are policies, procedures, and risk limits related to asset quality adequate?			
2	Are internal controls related to asset quality adequate?			
3	Are the audit or independent review functions related to asset quality adequate?			
4	Are information communication systems related to asset quality adequate and accurate?			
5	Do the board and senior management effectively supervise controls related to asset quality?			

6	Review prior examination reports and file correspondence for an overview of any previously identified asset quality.			
7	Review board or committee minutes for evidence of asset quality and oversight, routine asset quality reports, and any identified asset quality concerns.			
8	Determine if there are any recent or planned changes in strategic direction and discuss with management the implications for asset quality.			
9	Review asset quality policies. Policies should provide sufficient guidance to management with regard to the board's asset quality risk tolerances and oversight responsibilities.			
10	Determine if policies, procedures, and risk limits related to asset quality are reasonable in relation to management abilities, current economic conditions, the nature and complexity, and the overall condition of the institution.			
11	Evaluate the frequency and timeliness of asset quality policy reviews and updates by the board of directors.			
12	Determine if sufficient separation of duties (or comparable controls) exists over the preparation of reports used in managing asset quality.			
13	Determine if management complies with asset quality policy guidelines and documents the reasons for any variance.			
14	Determine that the scope of the audit or independent			

	review is sufficient to identify policy, reporting, internal control, and compliance deficiencies related to asset quality.			
15	Determine that asset quality independent review results are properly reported to the board.			
16	If recent reviews disclosed any asset quality deficiencies, determine if management responses are reasonable.			
17	Determine if board and senior management reports related to asset quality provide sufficient information to monitor compliance with board policies and guidelines.			

- [MMC Asset Quality Exam Procedures](#)

Sensitivity to Market Risk

An institution's sensitivity to market risk is usually measured by its *interest rate risk* or IRR. IRR is the sensitivity of an institution's earnings and net portfolio value (NPV) to changes in interest rates. IRR results from the differences in the way interest rate changes affect the values of assets, liabilities, and off-balance-sheet instruments.

IRR poses repricing risk, yield curve risk, basis risk, and options risk. The interest rate sensitivity of an institution's portfolio depends on the characteristics of the financial instruments that make up the portfolio. The price of liabilities affect the return on the assets (loans) being funded by those liabilities. If the liabilities funding mortgage loans reprice "faster" than the mortgage loans themselves, then rising interest rates will have an adverse impact on the institution's earnings. Conversely in such a scenario, falling interest rates would have a positive effect on earnings.

The interest rate sensitivity of a financial instrument depends on many factors including the following:

- Maturity (generally, of two otherwise identical instruments, the one with the longer maturity will be more interest rate sensitive).
- Repricing characteristics (instruments such as adjustable-rate loans that reprice frequently to market interest rates are typically less interest rate sensitive than fixed-rate instruments).

- The presence of embedded options, such as loan prepayments and interest rate caps that affect the timing of the cash flows generated by the instruments.

When evaluating the institution's market risk, examiners must consider both qualitative and quantitative factors. While taking into consideration the institution's size and the nature and complexity of its activities, the assessment should focus on the risk management process, especially management's ability to measure, monitor, and control market risk. In addition to adequate systems and controls, examiners should evaluate the potential for market risk to adversely affect earnings and capital. Consideration should also be given to the trend in the institution's recent risk measurements, the overall accuracy of the available measurements, and the presence of items with particularly volatile or uncertain interest rate sensitivity.

Well-run insured depository institutions should have an interest rate risk measurement system appropriate to the composition of the institution's balance sheet and risk profile. The measurement system should capture all material sources of interest rate risk, and be capable of generating meaningful reports for senior management and the board of directors. Institution management should ensure that risk is measured over a probable range of potential interest rate changes, including meaningful stress situations. Further, the measurement system must be subject to appropriate internal controls and periodic independent review. The institution's IRR measurement process should be well documented and administered by individuals with sufficient technical knowledge.

Exam Objectives:

Examiners should consider:

- Whether IRR is commensurate with the size and complexity of the institution.
- The nature of repricing risk, yield curve risk, basis risk, and options risk in the context of the institution's operations.

MMC Sensitivity to Market Risk Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Are policies, procedures, and risk limits related to IRR adequate?			
2	Are internal controls related to IRR adequate?			
3	Are the audit or independent IRR review functions adequate?			
4	Are information communication systems related to IRR			

	adequate and accurate?			
5	Do the characteristics of the institution's assets, funding sources, and financial derivative contracts indicate a low Interest Rate Risk (IRR) profile?			
6	Is the level of risk reasonable relative to capital and earnings levels?			
7	Do the board and senior management effectively supervise IRR?			
8	Review prior examination reports, file correspondence for an overview of any previously identified rate sensitivity concerns, as well as the institution's independent review for any recommendations or suggestions.			
9	Review board or committee minutes for evidence of oversight, responsibility, routine management reports, and any identified rate sensitivity concerns.			
10	Determine if there are any recent or planned changes in strategic direction and discuss with management the implications for rate sensitivity risks.			
11	Review Rate Sensitivity policies. Policy guidance may be incorporated within Liquidity, Loan, Investment, Interest Rate Risk (IRR) or other policies, but taken as a whole, should provide sufficient guidance to management relative to the board's risk tolerances and oversight responsibilities. Policy formality and sophistication will vary, depending upon the level of the institution's risk and the			

	<p>complexity of its holdings and activities, but should:</p> <ul style="list-style-type: none"> • Provide authority and responsibility to an individual(s) or committee for establishing and maintaining an effective IRR management program which identifies, measures, monitors, and controls IRR; • Identify the types of instruments and activities that may be used to manage IRR exposure; • Provide for a measurement system that is commensurate with the size and complexity of the institution; • Establish earnings and capital exposure limitations commensurate with the risk tolerance; and • Provide responsibility for authorizing policy exceptions. 			
12	Determine that the board approves and periodically reviews policies and procedures related to IRR.			
13	<p>Discuss IRR management processes and practices with management. Consider attending an ALCO meeting to evaluate the process. Potential topics for discussion include:</p> <ul style="list-style-type: none"> • Development of IRR policies and practices; • Development or choice of IRR measurement systems; 			

	<ul style="list-style-type: none"> Assumptions used by the IRR measurement system; and Technical expertise of staff relative to the complexity of products used and the complexity of the IRR measurement system. 			
14	Determine whether the potential IRR impact is considered for all new strategic initiatives or products.			
15	Determine if procedures and risk limits are reasonable relative to management abilities, current economic conditions, and the overall condition of the institution.			
16	Determine if sufficient separation of duties or comparable controls exist over the development and use of IRR measurement systems and monitoring tools.			
17	Determine that internal management reports used as a basis for IRR management decisions are prepared regularly and reviewed by senior management and the board of directors, at least quarterly.			
18	Determine if management complies with IRR policy parameters and documents the reasons for variances.			
19	Determine that the scope of the audit or independent review is sufficient to identify policy, reporting, internal control, and compliance deficiencies.			
20	Determine that the scope includes a review and validation of risk measurement calculations and tests for reasonableness and accuracy			

	of assumptions and data inputs. The scope and formality of the review and validation should reflect the size and complexity of the institution.			
21	Determine that results are reported to the board on a timely basis.			
22	If recent reviews disclosed any deficiencies, determine if management responses are reasonable.			
23	<p>Determine if internal management reports provide sufficient information for ongoing interest rate risk management decisions and for monitoring the results of those decisions. Reports should contain sufficient detail for the board or committee and senior management to:</p> <ul style="list-style-type: none"> Analyze IRR levels and trends and measure effects on earnings and capital; Identify material risk exposures and sources; Evaluate key assumptions, including interest rate forecasts, and loan prepayments; Assist management in pricing decisions; and Verify compliance with risk limits and policy guidelines, including exception reporting. 			
24	Determine if interest rate risks are effectively communicated to all areas affected.			
25	Consider testing IRR reports for accuracy by comparing with regulatory reporting schedules and subsidiary records.			
26	Determine whether recent or anticipated structural changes			

	<p>or trends in balance sheet composition alter the IRR profile relative to historical data. When significant structural changes have or are expected to occur, de-emphasize historical analysis and focus on current and forecasted balance sheet composition. Significant structural changes may include:</p> <ul style="list-style-type: none"> • Major shift in the maturity (repricing) characteristics of the investment portfolio, loans or borrowings; • Increased holdings of financial instruments such as mortgage securities, callable securities, fixed-rate residential loans, and structured notes; • Fundamental change in liability mix; and/or • Unexpected change in level or trend of securities appreciation and depreciation. 			
27	<p>Analyze the historical volatility of the net interest margin (NIM) and net operating income (NOI) relative to:</p> <ul style="list-style-type: none"> • Correlation with market interest rate fluctuations; • Management strategies to minimize the effect on earnings and capital; • Ability of earnings to absorb reductions in net interest margin resulting from market volatility. 			
28	Determine the level of IRR from the results of the internal measurement system.			
29	Determine whether the board			

	provides adequate IRR management resources. Consider the following items: <ul style="list-style-type: none"> • Sufficient staff to operate measurement systems, including back-up personnel; • Technical expertise consistent with the institution's complexity, risk profile, and measurement system; and • Adequate training and staff development. 			
30	Determine if historical performance related to IRR indicates adequate board and senior management oversight.			
31	Determine if the board and senior management can effectively oversee planned initiatives related to IRR.			
32	Determine what actions management has taken or plans to take if IRR policy limitations are breached.			

- [MMC Sensitivity to Market Risk Exam Procedures](#)

Financial Condition Component Rating

Examiners should review the Financial Condition modules and follow the respective exam procedures to determine the overall financial condition of the institution. After reviewing each aspect of the Financial Condition component, examiners should rate the component based on the following characteristics:

A rating of “1” indicates strong liquidity levels, excellent earnings and well-developed and practiced funds management policy. Such institutions demonstrate reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs. Capital levels and asset quality are strong. Additionally, such institutions have strong mechanisms for controlling sensitivity to market risk.

A rating of “2” indicates satisfactory sources of funds on acceptable terms to meet present and anticipated liquidity needs; satisfactory capital and earnings,

modest weaknesses from funds management practices, satisfactory asset quality, and sufficient interest rate risk mechanisms.

A rating of “3” indicates less than satisfactory liquidity management, relatively low levels of capital or decreasing earnings. Such an institution may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices. Asset quality needs improvement. Additionally, interest rate risk mechanisms may be subpar.

A rating of “4” indicates the institution is operating at a loss in an accelerated basis, liquidity levels are deficient or capital is inadequate. The institution may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs. Asset quality is deficient. Sensitivity to market risk may be high and uncontrolled.

A rating of “5” indicates the institution has serious liquidity practices. Liquidity is critically deficient, capital has deteriorated to a critical level or earnings are non-existent. The continued viability of the institution is threatened, and requires immediate external financial assistance to meet funding obligations. Asset quality is poor. The potential for a break down in operations due to extreme sensitivity to market risk may also be present.

Management

Introduction

The Management module provides information, objectives, and procedures for examining the management of institutions. The purpose of this section is to discuss the Management component and the examination of management, in general.

The quality of management is a key component affecting the operating results of any business. The quality of management is reflected in its ability to create and implement reasonable and effective plans for the activities of the organization, monitor and enforce the organization’s execution of its plans, and modify its plans in light of operating results and changes in operating environment.

Management is used throughout the module in reference to both the board of directors and executive officers, except where stated otherwise to emphasize a key responsibility or duty. While they have different responsibilities and roles, the board of directors and the executive officers collectively constitute the managing body of the institution, and they are examined concurrently.

The capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of the institution’s activities and to ensure a safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in the management rating. Generally, directors need not be actively involved in day-to-day operations;

however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Senior management is responsible for developing and implementing policies, procedures, and practices that translate the board's goals, objectives, and risk limits into prudent operating standards.

Management should be evaluated and rated based on its ability to perform the following functions:

- Create and Implement Reasonable and Effective Plans related to:
 - Financial Condition
 - Operations
 - Regulatory Compliance
 - Consumer Contact/Direct Origination
- Monitor Adherence to Plans, Enforce the Execution of Plans, and Modify Plans When Appropriate
- Cooperate with Exams and Investigations.

Create and Implement Reasonable and Effective Plans

A vital part of the responsibilities of directors is to set the future direction of the institution. Planning, organizing, and controlling are three fundamental dimensions of management. Sound planning is indispensable in dealing with this uncertainty and rapid change. In order to be effective, planning must be dynamic, carefully attended to, and well supported. Projections must be revised periodically as circumstances change and new strategies devised to meet stated objectives. An increasingly competitive marketplace suggests that an inadequate or ill-conceived planning process may pose a significant threat to the institution.

The adequacy of an institution's planning process may be judged by considering questions such as:

- How formal is the planning process?
- Who is involved? The board? Middle management?
- Is the plan based on realistic assumptions regarding present and future market area(s) and nontraditional competitive factors?
- Does the institution monitor actual performance against its plan?
- Does the institution consider alternative plans in response to changing conditions?

Although the focus must be on an evaluation of the process, the plan itself cannot be ignored if, in the examiner's judgment, the plan is predicated on assumptions which are inappropriate or unrealistic. This assessment must take into account the personnel and financial resources and operating circumstances and conditions unique to the institution being examined. It is emphasized that plotting the future direction of the institution is, properly, the responsibility of the board of directors and not examiners. However, when the goals and objectives chosen by directors are likely to result in significant harm to the institution, examiners must identify the deficiencies in the plan in order to protect

consumers. Absence of a satisfactory planning process or glaring weaknesses in the plan itself must be considered in the appraisal of institution management.

Management should be evaluated based on its ability to formulate an effective Risk Management Program. Such a program subjects every part of the business to the four principals of risk management: Identify, Measure, Monitor, and Control.

Many policies govern the operations of a residential mortgage institution. Management should have established robust internal policies for controlling risks related to financial condition and operations and complying with regulatory laws and consumer protection standards. Policies and procedures should be in writing, so that management and examiners can easily refer back to the plans. Management's internal plans and policies should cover the following areas:

- Financial Condition
- Operations
- Regulatory Compliance
- Consumer Contact/Direct Origination

Financial Condition:

Management should have in place and examiners should consider the adequacy of policies and procedures related to the following aspects of financial condition:

- [Liquidity](#)
- [Earnings](#)
- [Capital](#)
- [Asset Quality](#)
- [Sensitivity to Market Risk](#)

Operations:

Management should have in place and examiners should consider the adequacy of policies and procedures related to the following operations:

- General Function
- Personnel
- Third Party Risk
- Underwriting
- Employee Training Program
- Business Plan
- Investment Lending
- Secondary Market Risks
- General Risk Management
- Consumer Complaints

General Function:

General Functioning policies should provide for:

- Procedures to efficiently carry out all activities of the institution
- Accounting checks and balances to avoid fraud against the institution
- Strong policies to prevent fraud of any kind should be in place; instances of fraud can have a significant negative impact on an institution. Refer to the chapter on [Fraud](#) for a better understanding of detecting and deterring fraud.
- Independent audit of the institution to detect fraud and improve operations
- Internal Audit
- Information Technology Plans

Personnel:

Personnel policies should include:

- Processes for hiring and terminating employees in compliance with labor law
- The qualifications job candidates must possess for the different types of jobs available in the organization
- Procedures to protect data from employees that have been terminated
- Guidance for paying terminated employees for loans that are “in the pipeline”
- Compensation guidelines to attract and retain well qualified individuals
- Compensation guidelines to avoid incentives for employees to “sell” higher priced loans to consumers who qualify for lower priced loans.

Third Party Risk:

Third party risk policies should provide for:

- Due diligence in selecting software and other vendors, indirect originators, financial institutions to provide warehouse lines of credit, and contractors to provide loan processing and other types of services
- Periodic review of the performance and financial strength of third party providers
- Lists of approved third party providers for the use of employees

Examiners should consider the following when evaluating third party risk policies:

- Does the institution conduct appropriate due diligence of third-party originators including pre-relationship review, transaction underwriting review and post-closing reviews?
- Does the institution have adequate criteria for entering into and maintaining relationships with third-party originators?

- Has the institution established criteria for third-party compensation that is designed to avoid providing incentives for higher risk loan products?
- Does the institution regularly review a reasonable sample of third-party originations to determine compliance with the institution's underwriting standards?
- Does the institution monitor third parties for appraisal problems, loan documentation, credit problems and consumer complaints?
- Does the institution monitor third-party originations for delinquency or default within 1 to 3 payments after funding?
- When deficiencies are noted in any of the above areas, does the institution take immediate action? If so, what action does the institution take to alleviate these deficiencies?
- Are strong risk management standards present when using third-party originators?
- Examiners

Underwriting:

Underwriting policies should address:

- Standards for qualifying borrowers including ranges for debt-to-income ratios, credit scores and loan-to-value ratios for the different loan products offered by the institution
- Methods for approval of exceptions to underwriting standards
- Does the institution rely on credit scores or property value as a substitute for capacity to repay based upon income?
- Does the institution consider the borrower's overall ability to handle financial obligations? For example, for high DTI loans does the institution counsel borrowers on the level of general living expenses and commitments that may be impacted by the borrower's decision to accept a covered transaction with an unpredictable future payment stream?
- Does the institution analyze and limit debt to income (DTI) ratios? Are the limits reasonable in relation to the apparent risk?
- Does the institution use credible market rate to qualify borrower and determine repayment capacity?
- Does underwriting include reasonable limitation on potential payment shock at expected payment change dates?
- Offering nontraditional and subprime loan products⁷
 - If offered, is risk layering⁸ allowed? Risk layering is present if the loan has 2 or more of the following characteristics:

⁷ Refer to Supplements 2 and 3: "Final Guidance on Nontraditional Mortgage Product Risks" and "Nontraditional Mortgage Products Risks and Subprime Lending Model Examination Guidelines"

⁸ **Risk Layering**—Providers that originate or purchase mortgage loans that combine nontraditional features, such as interest only loans with reduced documentation or a simultaneous second-lien loan, face increased risk. When features are layered, a provider should demonstrate that mitigating factors support the underwriting decision and the borrower's repayment capacity. Mitigating factors could include higher credit scores, lower LTV and DTI ratios, significant

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- Limited documentation of income
 - Simultaneous second lien
 - Negative amortization with no or little equity
 - Introductory rate 300 basis points or more below fully-indexed rate
 - Borrowers with subprime characteristics
 - No escrow for property taxes and homeowner's insurance
 - Extended amortization period or extended loan terms
 - If risk layering is allowed, what mitigating factors are required for approval?
 - If risk layering is allowed, does the institution substitute higher prices in lieu of sound repayment determinations?

A variety of environmental issues may overload staff and challenge the quality and effectiveness of underwriting as a gatekeeper function. Some of these environmental issues that create or contribute to underwriting ineffectiveness include the following:

- Consumer loan demand driven by low rates and escalating home prices.
 - Investor loan demand driven by high returns and the belief that collateral value will compensate adequately for any added risk.
 - Management overriding the underwriting department in order to allow a greater volume of loans into the pipeline.
 - Lack of independence between the underwriting and sales or origination functions.
 - Inadequate policies, procedures and underwriting guidelines.
 - Poor or insufficient training.
 - Enhanced technology and transaction speed allowing greater volume with fewer underwriter "hands on" the file, and
 - Fraud.
-
- Qualifying Borrowers: *Qualify* means to prove capable or fit to meet requirements. In the mortgage world it means a consumer's ability to meet a lender's criteria for approving credit terms.

Whether a borrower qualifies for the mortgage loan can be a subjective decision by the underwriter. However, the underwriter is making that decision, or should be making that decision, based on very specific policies and procedures established by management. It is likely that the policies and procedures carry a certain degree of subjective latitude allowing the underwriter to make the "right" determination when enough elements of the qualification process are in place.

liquid assets, mortgage insurance or other credit enhancements. While higher pricing is often used to address elevated risk levels, it does not replace the need for sound underwriting.

Employee Training Program:

The institution's employee training program should include training on the institution's policies and employee skills development programs. Examples of skills development programs would include training to improve interactions with fellow employees, interactions with the general public, computer hardware skills and computer software skills.

Business Plan:

The institution's business plan should discuss:

- The types of loans the institution will originate and/or fund
- Whether or not the institution will participate in the mortgage loan secondary market as either a seller or purchaser of loans
- Types and volume of advertising
- How residential mortgage lending and/or brokering relates to other activities of the institution
- The geographic area in which the institution will operate

Investment Lending:

Policies and Procedures related to investment lending should address:

- Whether Standards require borrowers financing non-owner-occupied investment properties to qualify for loans based on their ability to service the debt over the life of the loan
- Whether the loan terms reflect an appropriate combined LTV ratio that considers the potential for negative amortization and maintains sufficient borrower equity over the life of the loan?
- Whether standards require evidence that the borrower has sufficient cash reserves to service the loan, considering the possibility of extended periods of property vacancy and the variability of debt service requirements.

Secondary Market Exposure:

Policies and Procedures related to secondary market exposure should address:

- The extent of secondary market activity within the institution's transactions
- The sophistication of the institution's secondary market risk management practices and whether they are commensurate with the nature and volume of activity
- The institutions contingency plan that addresses potential reduced demand in the secondary market
- Types of loan programs and types of origination channels utilized
- Loan pricing strategies and methodologies
- Areas of responsibility and levels of authority for personnel

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- Risk Limits for secondary market activities
 - Reporting Requirements
 - Types of permissible hedging instruments
 - Counterparty risk management, including financial capacity requirements
 - Concentration limits for high-risk loans and derivative assets

General Risk Management:

Examiners should consider the following when evaluating an institution's risk management practices:

- Does the institution have specialized risk management practices to monitor loan quality and performance of loans, including concentrations in particular product types, risk characteristics, borrower characteristics, and origination source?
- Does the institution have risk management practices?
 - Reporting system to quickly detect changes in the risk profile of their loan portfolio.
 - Reporting based on full range of product features (loan type, risk layering, underwriting) and terms and borrower characteristics (payment patterns, delinquencies, geographic concentration.
 - Management tracks volume and performance against expectations, internal lending standards, and policy limits.
 - Management sets limits on volume and performance.
 - Management sets and tracks variances to policies and thresholds. Variance analysis is critical to the monitoring of a portfolio's risk characteristics and should be an integral part of establishing and adjusting risk tolerance levels.
 - Management has assessed contingent liability of buy-back risk for poor performance of loans and has capital or other system to address risk.

Consumer Complaints:

Management's care in addressing consumer complaints is a critical component of operations. With regard to consumer complaints, the Management Component rating should take into consideration the following:

- Number of outstanding consumer complaints in relation to the size of the institution.
- Pro-activeness of management to address consumer complaints.
- Timeliness of resolving consumer complaints.
- Reputation of the institution in the community as a "good corporate citizen".

Regulatory Compliance

Examiners should assess the adequacy of regulatory compliance policies. If regulatory compliance policies are adequate, management has a program in

place that, if adhered to, would lead to compliance. Therefore, violations of law are both failures to adhere to policies and management failures to enforce policies. Consequently, the severity of violations (determined by the examiner in assigning a Regulatory Compliance component rating) will be used as a measure of adherence to and enforcement of regulatory compliance policies.

Residential mortgage lenders, brokers and originators are licensed with the explicit understanding that they are to comply with state and federal law, rules, regulations and statements of policy. Management should create adequate policies and procedures to ensure compliance and should monitor adherence to its policies to minimize noncompliance.

If regulatory compliance policies were judged inadequate in determining the Regulatory Compliance component rating, then management has not adequately expressed methods to obey regulatory compliance law. However, given the “explicit understanding” under which licenses are granted, the core of their policies (whether written or not) can be expressed as, “Comply with all law.” Therefore, again, violations of law are both failures to adhere to regulatory compliance policies in their simplest form and management failures to enforce these same policies. Consequently, when regulatory compliance policies are inadequate, the severity of violations will again be used as a measure of adherence to and enforcement of regulatory compliance policies.

Assessment of the Regulatory Compliance aspect of management should be based on:

- The quality and adequacy of appropriate internal controls and oversight for compliance with state and federal regulations, and all other regulations and policies.
- The presence of adequate written policies and procedures to ensure compliance with state and federal regulations.
- Demonstrated compliance with applicable state and federal regulations.
- Responsiveness to recommendations from auditors and regulatory agencies.
- Adequate Quality Control and Compliance Audit
- Adequate Gramm-Leach-Bliley security plan.

Management should have in place and examiners should consider the adequacy of policies and procedures to ensure compliance with the following laws and regulations:

- [Applicable State Laws](#)
- [Equal Credit Opportunity Act; Regulation B](#)
- [Home Mortgage Disclosure Act; Regulation C](#)
- [Truth-in-Lending Act; Regulation Z](#)
- [Fair Credit Reporting Act](#)
- [Fair Housing Act](#)
- [Real Estate Settlement Procedures Act; Regulation X](#)

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- [USA Patriot Act of 2001](#)
 - [Gramm-Leach-Bliley Act](#)
 - [Home Ownership Protection Act](#)
 - [Dodd-Frank Act](#)

Consumer Contact/Direct Origination:

Examiners should consider the following when evaluating an institutions consumer contact and origination practices:

- Marketing/Promotional Materials:
 - Do promotional materials and other product descriptions, including oral statements or scripts, provide information about the costs, terms, features, and risks of loan products that can assist consumers in their product selection decisions?
 - Do promotional materials and other product descriptions provide clear and balanced information about the relative risks of loan products?
 - Are product descriptions provided to the consumer when the consumer makes an inquiry about a loan product? (*rather than providing upon the submission of an application or at closing*)
 - Does the institution market loan products to borrowers with subprime credit characteristics?
 - Does the institution provide information about loan products in a timely manner *before* disclosures required under Truth in Lending Act or other laws in order to assist consumer in the product selection process?
- Direct Origination:
 - Does the institution provide information about loan products in a timely manner *before* disclosures required under Truth in Lending Act or other laws in order to assist consumer in the product selection process?
 - Does the institution apprise consumers of potential increases in payment obligations for ARM products including circumstances where interest rates or negative amortization reach a contractual limit?
 - For ARMs, does institution apprise the consumer of the difference between the initial rate and the fully indexed rate including the components and methods of calculation?
 - Are communications designed to provide clear and balanced information about the risks and benefits of loan products to minimize consumer confusion?
 - Are applicants alerted when a loan product they have selected has a prepayment penalty and the amount of the penalty?
 - Are consumers informed of pricing premiums attached to their specific loan product?

- If the borrower's monthly payments will not include escrowed reserves, are they fully informed of this fact in a clear and understandable manner well before closing?
- Are borrowers informed of the requirement to pay for real estate taxes and insurance in addition to their loan payments, a reasonable estimate of the closing costs, and the possibility that taxes and insurance costs can change substantially over time?
- Are borrowers informed that failure to make real estate tax payments may result in the loss of their home?
- Are borrowers informed that failure to maintain hazard insurance on their property may result in the lender "force placing" hazard insurance and billing the costs of such insurance to the borrower?
- Does the institution make comparisons between loans with escrowed reserves and loans without escrowed reserves in such a manner that the borrower might be confused about the payment structure of the loan?
- Does the institution's sales communications appropriately inform borrowers of the risks and benefits associated with their specific loan product?

Exam Objectives:

- Determine if policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/origination.
- Ensure that policies, procedures, and internal controls are formally established and outlined in writing.

Exam Procedures:

The extent of the examiner's review will depend on the degree of problems disclosed in other examination areas and previous examination and monitoring activities. New policies and procedures adopted by management should be considered when determining the scope of the review.

The following list of examination procedures is provided to assist examiners in determining the adequacy of policies and procedures. Some of the procedures may be performed by other examiners as they review their assigned areas. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution.

MMC Management Create and Implement Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Are policies, procedures, and risk limits adequate?			

2	Are internal controls adequate?			
3	Are the audit or independent review functions adequate?			
4	Are information communication systems adequate and accurate?			
5	Do the board and senior management effectively supervise controls related to financial condition, operations, regulatory compliance, and consumer contact?			
6	Review prior examination reports and file correspondence for an overview of any previously identified management concerns.			
7	Review board or committee minutes for evidence of oversight, responsibility, routine management reports, and any identified management concerns.			
8	Determine if there are any recent or planned changes in strategic direction and discuss with management the implications for risk management.			
9	Review management policies. Policies should provide sufficient guidance to management with regard to the board's risk tolerances and oversight responsibilities.			
10	Determine if policies, procedures, and risk limits are reasonable in relation to management abilities, current economic conditions, the nature and complexity, and the overall condition of the institution.			
11	Evaluate the frequency and timeliness of policy reviews and updates by the board of directors.			

12	Determine if sufficient separation of duties (or comparable controls) exists over the preparation of reports used in managing the specific functions of the institution.			
13	Determine if management complies with policy guidelines and documents the reasons for any variance.			
14	Determine that the scope of the audit or independent review is sufficient to identify policy, reporting, internal control, and compliance deficiencies.			
15	Determine that results are properly reported to the board.			
16	If recent reviews disclosed any deficiencies, determine if management responses are reasonable.			
17	Determine if board and senior management reports provide sufficient information to monitor compliance with board policies and guidelines.			
18	Evaluate management's Risk Management Program: <ul style="list-style-type: none"> • Is the program adequate? • Is the program appropriately designed? 			

- [MMC Management Create and Implement Exam Procedures](#)

Monitor Adherence to Plans, Enforce the Execution of Plans, and Modify Plans when Appropriate

The examiner should consider management's ability to monitor and enforce execution of all plans, including plans and policies related to financial condition, operations, regulatory compliance, and consumer contact/direct origination.

Once management has policies and procedures in place, which are designed to aid in meeting the institution's business goals, management must periodically review adherence to its policies and procedures. This requires a system to monitor the work product of all employees and provide feedback to employees regarding adherence to policies. Monitoring may be achieved using sampling and the frequency of sampling will probably vary based on the type of work being performed.

If possible, monitoring should be performed by someone other than the employee's direct supervisor and the results of such monitoring should be presented to executive management. Consequences for failure to adhere to policies should be outlined in writing to employees. Consequences should vary depending on the severity of the deviation from policy and the potential or actual effect the deviation could have or has had on operating results.

If exceptions to policies are allowed, there should be a method of pre-approving exceptions. In addition, the frequency of exceptions to policy should be analyzed to determine if policies should be rewritten or are being circumvented. At least annually, management should review its plans, policies and procedures. Necessary changes should be made in light of actual operating results and with consideration of the future operating goals of management.

Changes in business environment should be considered when setting future operating goals and modifying policies. What do current economic indicators signify for the overall economy and the mortgage industry in particular? What changes are occurring in the regulatory environment for the institution? What is the outlook for changes in law and what changes in enforcement are taking place?

Changes in the institution's business model should also be considered when setting future operating goals and modifying policies. How are the products offered by the institution changing? How are the institution's product delivery systems changing? How are changes in technology changing both products and delivery systems including; changes in computing and related hardware, changes in communications (such as the use of personal digital assistants and cell phones) and changes in software.

The outcome of complaints, examinations and investigations should be considered when modifying plans, policies and procedures. Complaints give management another viewpoint in considering the effectiveness of its operations and may point to areas of policies and procedures that can be improved upon. Examinations and investigations also offer a different perspective for management. Deficiencies noted by examinations and investigations should be given careful consideration by management and appropriate changes to plans, policies and procedures should be made as soon as possible. In order to garner the greatest benefits, management should fully cooperate with complaint resolution, examinations and investigations.

Exam Objectives:

- Determine if management's ability to monitor and enforce the execution of all plans related to financial condition, operations, regulatory compliance, and consumer contact/direct origination are adequate.
- Determine if the institution's systems for reviewing policies and procedures are adequate.

MMC Management Adherence to Plans Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Does management properly enforce all internal policies and procedures?			
2	Does management properly enforce policies and procedures related to financial condition?			
3	Does management properly enforce policies and procedures related to operations?			
4	Does management properly enforce policies and procedures related to regulatory compliance?			
5	Does management properly enforce policies and procedures related to consumer contact/direct origination?			
6	Are systems that are in place to, at least annually, review and modify policies adequate?			

- [MMC Management Adherence to Plans Exam Procedures](#)

Cooperate with Exams and Investigations

It is critical that examiners determine how well management has complied with outstanding enforcement actions and examinations. From time to time, management will fail to provide examiners with needed information and records for examination purposes. Such practices are not indicative of a well run institution. Institutions are expected to have policies and procedures in place to

facilitate multi-state examinations and assure that each institution staff person is aware of these procedures as necessary to assist in the examination process. Meritless obstacles or resistance to the multi-state examination should be avoided as such actions or non-compliance may result in additional time, burden and cost to the institution, as well as impede the spirit of cooperation and efficiency between the examination team and the institution. Institutions should note that most state authorities contain serious sanctions and remedies for failing to comply with examination authorities. In some states, sanctions include criminal penalties for non-compliance.

An institution's cooperation with examinations and investigations is factored into the management component rating. However, if an institution refuses to provide an examiner with applicable documents and company information in a timely manner for exam purposes, examiners may take certain actions against the institution if the issue is detrimental to the conducting of the exam. Institutions that refuse to provide pertinent information may be tampering with the requested information. It is important that examiners not allow an institution extended periods of time to produce important information without a reasonable explanation. If the institution does not provide the examiner with requested information 72 hours after the examiner's request, there are measures the examiner can take, including a demand letter. If the institution continues to withhold or fails to provide the requested information, examiners should report the situation to the MMC's enforcement liaison for a possible enforcement action.

Failure to cooperate with investigations and exams will have a negative impact on the management component rating.

Exam Objectives:

- Determine if the institution's policies for cooperating with examinations and investigations are adequate.

MMC Management Cooperation with Exams and Investigations Exam Procedures:

	Examination Procedures	Y	N	Examiner Notes [Document supporting evidence and note determinations and findings made]
1	Does the institution timely provide requested information?			
2	Is the institution forthcoming with information?			
3	Does the institution display a willingness to quickly and effectively correct violations?			

4	Does the institution display a willingness to quickly and effectively modify policies and procedures based on the findings of examinations and investigations?			
5	Is the institution in compliance with regulatory enforcement actions?			
6	Is the institution compliant with outstanding enforcement actions? If it is not, for how long has the enforcement action been outstanding?			

- [MMC Management Cooperation with Exams and Investigations Exam Procedures](#)

Management Component Rating

A rating of “1” indicates strong performance by management and the board of directors and strong risk management practices relative to the institution’s size, complexity, and risk profile. Management has strong policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination, and management adheres to those policies and controls. Systems for modification of policies and cooperation with examinations and investigations are strong.

A rating of “2” indicates satisfactory management and board performance and risk management practices relative to the institution’s size, complexity, and risk profile. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination may demonstrate some weaknesses. Adherence to those policies and controls is satisfactory. Systems for modification of policies and cooperation with examinations and investigations are satisfactory.

A rating of “3” indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution’s activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination may be inadequate. Systems for modification of policies and cooperation with examinations and investigations are less than satisfactory.

A rating of “4” indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution’s activities. The level of problems and risk exposure is excessive. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination are deficient. Adherence to those policies and controls is weak. Systems for modification of policies and cooperation with examinations and investigations are deficient.

A rating of “5” indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Policies, procedures, and internal controls related to financial condition, operations, regulatory compliance, and consumer contact/direct origination are critically deficient or nonexistent. Adherence to those policies and controls is also critically deficient or nonexistent. Systems for modification of policies and cooperation with examinations and investigations are unacceptable.

Supplement 1 - FDIC Guidance for Managing Third-Party Risk

- [FDIC Guidance for Managing Third-Party Risk](#)

Supplement 2 – CSBS-AARMR Guidance on Nontraditional Mortgage Product Risk

- [Guidance for Nontraditional Mortgage Product Risk](#)

Supplement 3 – Nontraditional Mortgage Products Risks and Subprime Lending Model Examination Guidelines (MEGs)

- [MEGs](#)

Regulatory Compliance

Introduction

The MMC has responsibility for reviewing and enforcing compliance by MMEs with certain consumer protection regulations, the state’s Mortgage Lending Act, and Federal lending laws and regulations, as well as any other applicable laws and regulations. While compliance with regulations is only one aspect of an institution’s operations, the presence of violations and the absence of an effective compliance program reflect adversely on management and the board of directors. These items may be indicative of inadequacies in other areas of management responsibility. Failure to comply with regulations or to possess an

adequate internal control process that promotes compliance can also expose an institution, its directors, and officers to costly civil liability, litigation, and a loss of customer goodwill. Any of these may lead to reputation risk resulting in significant negative outcomes to the institution. Additionally, noncompliance with regulations may subject the institution to enforcement actions by the state or a Federal or State agency responsible for enforcement.

Even though most areas of examination activity involve some aspects of compliance, this module is limited to those regulations which lend themselves to a stand-alone examination process. To accomplish a stand-alone examination process, samples are periodically drawn and tested to measure an institution's compliance with regulations. The degree and depth of sampling should ordinarily be based on risk determined to be present. This risk may be minimal if policies, procedures, and internal controls are adequate and previous examinations or internal reviews have not disclosed substantive violations. However, if policies, procedures and internal controls are inadequate and/or substantive violations were previously detected, the examiner-in-charge (EIC) must ensure that sufficient testing is conducted to adequately evaluate the compliance area being tested. If material violations are identified in areas with limited examination samples, additional sampling may be necessary to determine the cause of the problem (e.g., a pattern or practice, or an isolated error). In addition, testing should include a review of the extent and types of noncompliance disclosed in previous examination activity and the adequacy of corrective action taken by the institution since the previous examination. More specific sampling techniques are described elsewhere in this section.

To aid examiners in understanding and evaluating regulatory compliance, flow charts and workpapers have been provided where practicable. The flow charts, included as a separate section in this module, provide the examiner with a simplified road map for walking through the regulations. The workpapers, provided to examiners separately from this manual, facilitate the documentation of the examination process when necessary.

Examination Objectives

- Determine if policies, procedures, and a system of internal controls provide adequate assurance that regulatory requirements will be met;
- Determine if the institution's personnel are adhering to prescribed procedures;
- Determine if deficiencies are brought to management's attention for appropriate corrective action.

Comprehensive File Review versus Sampling

Traditionally, examination processes have employed a file review method known as "sampling" to determine which files will be actually scrutinized.

Compliance Sampling Techniques

Basically, there are two accepted types of compliance sampling techniques-- judgmental and statistical. Judgmental sampling is normally more efficient and effective than statistical sampling in uncovering whatever types of disclosure violations may exist in consumer loans and borrower rights areas. Because the volume of consumer loans is relatively small in most institution operations, it is contemplated that judgmental sampling will generally be used. However, in addition to judgmental sampling, a brief discussion of statistical sampling is included below.

Judgmental Sampling

Judgmental sampling accommodates the risk-based approach to examining by allowing examiners to target areas for testing based on what is perceived as risk. As detailed in the Mortgage Pre-examination Planning section of the Planning and Administration module, the EIC develops focal points of risk based upon ongoing monitoring activities, prior examination findings, discussions with management, and any additional information discovered during survey activities. Targeted or judgmental samples typically consist of several smaller samples of specific loans tailored to fit the particular concerns being investigated. This type of sampling is generally more effective and efficient than random or statistical sampling since examiners are reviewing for only one or two pertinent factors on a smaller targeted sample instead of examining several generic items on every loan in a larger random sample. The depth of testing is continually reevaluated based on examination results. When sufficient work has been done to reach a conclusion, no further testing is required. If a conclusion cannot be reached, then the targeted sample should be expanded or refocused on those areas of significant risk.

The examiner should sample judgmentally, if necessary, by selecting from among the various loan categories a few of each type of mortgage loan transaction with different characteristics. If disclosure or other violations are apparent in any type of transaction, the sample of that transaction type should be expanded to a level where the examiner is satisfied, after investigating the apparent cause or source of the violations, that a pattern or practice of such violations either does or does not exist.

Loans to be tested for compliance should be selected from applications received and closed since the last examination. The identification of mortgage loans might also be accomplished by using criteria (such as loan type, interest feature, settlement fees, and other criteria extracted from the specific regulations being tested) that are indicative of mortgage loans.

Discussions with management and loan officers will identify additional mortgage loans that may have been overlooked. This approach can also identify the "population or universe" of mortgage loans and, if such loans are numerous, statistical sampling techniques could be applied to facilitate the review for compliance with applicable regulations.

In addition to mortgage loans, the institution's denied application log and/or file can be reviewed to evaluate compliance with adverse action regulations.

Statistical Sampling

Statistical sampling may be desirable in certain circumstances. For example, when numerous, seemingly unrelated violations are noted, the examiner may wish to obtain a statistical sample to determine the probable extent of such violations throughout the consumer loan portfolio. A volume of such violations sufficient to indicate a breakdown in established procedures could be considered a pattern or practice warranting reimbursement or civil money penalties. Statistical sampling is also helpful in attaining a representative sample from a large universe of mortgage loans.

Flow Charts and Workpaper Documentation

Where practicable, a flow chart is provided; as well as, applicable workpapers are provided to simplify an examiner's journey through the intricacies of certain regulations. These flow charts (i.e., road maps) were developed with an "on/off switch" approach. Either the answer is "yes" and compliance is required (the journey continues), or the answer is "no" and the regulation is not applicable (the journey is over). While an experienced examiner who evaluates compliance with some regularity may not need a flow chart, inexperienced examiners or those who infrequently evaluate compliance may find the flow charts to be a useful tool for establishing familiarity with the regulations. Flowcharts are included as a separate section in this module.

Workpapers were developed to facilitate documenting an examiner's evaluation of compliance with the various regulations. These workpapers are provided to examiners separate from this manual. Although all workpapers are optional, some are well suited to providing the best means of documenting an institution's compliance with certain regulations. Each workpaper is numbered, and where appropriate within the violation summary sheet, specific reference is made to these numbered workpapers.

State Laws and Regulations

In general, examiners should access applicable state laws when appropriate. Examiners should request such laws from the state regulatory entity in which he or she is performing an evaluation. For mortgage operations in most states, institutions must comply with a state mortgage lending law, a state predatory lending law, a state mortgage fraud act, the state's SAFE Act, and a number of other possible state laws. In addition to requesting such laws from the appropriate state department, examiners can access applicable state laws through the ComplianceEase® tool ComplianceAnalyzer®.

The portfolio review tool, ComplianceAnalyzer®, offers a lookup function for state and federal lending rules and regulations. This function is available after loan data has been processed by the system. Once a loan data has been processed,

the user should access the *Mortgage Compliance Analysis Report* within the system. The *Findings Detail* section of this report contains information on which tests, both state and federal, the loan did not pass. For example, if a particular loan failed Federal Truth-in-Lending regulations, failure will be indicated by a red “FAIL” and a description of the circumstances causing failure is provided. If more detail is needed on a particular rule or regulation, the description will include a hyperlink to the specific language as it appears in legislation.

Users with access to ComplianceAnalyzer® also have access to the legislative database used by the system to process loan data. This database is called *BillTracker®*. By selecting *BillTracker®* from the main menu on the ComplianceEase® website, the user will be directed through a series of pages to locate the desired rule or regulation. The *BillTracker®* system contains all relevant federal lending rules and regulations, as well as state and local rules and regulations from all state jurisdictions and Puerto Rico. The *BillTracker®* database is updated regularly and even includes references to legislation that has been passed, but is awaiting enactment.

Equal Credit Opportunity Act

Authority and Purpose

The [Equal Credit Opportunity Act](#) (ECOA) was enacted through an amendment (which added Title VII) to the Consumer Credit Protection Act. The Federal Reserve Board (FRB) promulgated [Regulation B](#) (12 CFR Part 202) based on the authority it was given to issue implementing regulations.

The purpose of ECOA and the regulation is to promote the availability of credit to all creditworthy applicants without regard to:

- Race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract);
- The fact that all or part of the applicant's income derives from a public assistance program; or
- The fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act.

FRB Regulation B prohibits creditor practices that discriminate on the basis of any of these factors. It also requires creditors to notify applicants of action taken on their applications; report credit history in the names of both spouses on an account, if applicable; retain records of credit applications; collect information about the applicant's race and other personal characteristics in the applications for certain dwelling-related loans; and provide applicants with copies of appraisal reports used in connection with credit transactions.

In addition to the prohibitions of ECOA and FRB Regulation B, the Fair Housing Act and FCA Regulation 12 CFR Part 613 prohibit discrimination in residential real estate transactions. Refer to the Fair Housing Section for further details.

Applicability and Exemptions

The ECOA applies to all creditors and most types of loan transactions. Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce FRB Regulation B over MMC institutions. To facilitate an understanding of FRB Regulation B, some of the pertinent provisions of the regulation for citation purposes are presented with brief explanatory comments. Other pertinent provisions for citation purposes are listed without explanation but can be referenced in the regulation itself. Note that this is a summary of the regulation and is not comprehensive.

NOTE: Regulation B has a definitions section (§202.2), appendices with model forms and official staff interpretations (Supplement) for use in determining if the requirements of the regulation have been met.

§ 202.4, General Rules

- §202.4(b) - Discouraging Application -- A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application.

§ 202.5, Rules Concerning Requests for Information

A creditor may request any information in connection with an application that is necessary to evaluate the applicant's creditworthiness and must obtain the information required for monitoring purposes by § 202.13 for credit extended for the purchase or refinancing of the applicant's dwelling and secured by the applicant's dwelling. A creditor may also obtain information required by a regulation, order, or agreement with a court or enforcement agency to monitor or enforce compliance with ECOA and FRB Regulation B or other Federal or state statute or regulation. (Rules governing how information obtained by a creditor may be used are covered in § 202.6.)

- §202.5(a) - Requests for Information
- §202.5(b)(1) - Race, Color, Religion, National Origin, or Sex
- §202.5(b)(2) - Use of Mr., Ms., Miss, or Mrs. and Sex Neutral Terms
- §202.5(c)(2) - Spouse or Former Spouse -- A creditor shall not request any information concerning the spouse or former spouse of the applicant except as follows:
 - The spouse will be permitted to use the account, accept the loan proceeds, or draw on the account;
 - The spouse will be contractually liable on the obligation through cosigning, endorsing, or guaranteeing the debt;

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- The applicant is relying on the spouse's income and/or property, especially that property held as joint tenants or tenants by the entirety with the spouse, as the basis for repayment of the credit requested;
 - The applicant resides in a community property state or the property on which the applicant is relying as a basis for repayment of the credit requested is located in such a state; or
 - The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.
- § 202.5(c)(3) - Other Accounts --A creditor may request an applicant to list any account upon which the applicant is liable and to provide the name and address in which the account is carried. A creditor may also ask the names in which an applicant has previously received credit.
 - § 202.5(d)(1) - Marital Status-- Generally when an applicant applies for individual unsecured credit, a creditor may not inquire about the applicant's marital status. The creditor may ask the applicant's marital status:
 - If the loan is to be secured;
 - If the applicant resides in a community property state or lists assets located in such a state as a basis for repayment of the loan; or
 - If the application is for other than individual unsecured credit.

NOTE: When a creditor is permitted to request marital status, only the terms "married," "unmarried," and "separated" may be used.

- § 202.5(d)(2) - Sources of Income--A creditor shall not inquire whether income stated in an application is derived from alimony, child support, or separate maintenance payments unless the creditor advises the applicant that disclosure of such income need not be revealed if the applicant does not want the creditor to consider it in determining creditworthiness. However, the creditor may inquire into an applicant's ability to make such payments.
- § 202.5(d)(3) - Applicant's Sex--A creditor shall not inquire about the sex of an applicant. An applicant may be requested to designate a title on an application form (such as Mr., Ms., Miss, or Mrs.) if the form discloses that the designation of a title is optional.
- § 202.5(d)(4) - Childbearing/Childrearing --A creditor shall not inquire about birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. A creditor may inquire about the number and ages of an applicant's dependents or about dependent-related financial obligations and expenditures, provided such information is requested without regard to sex, marital status, or any other prohibited basis.

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- § 202.5(d)(5) - Race, Color, Religion, National Origin --A creditor shall not inquire about the race, color, religion or national origin of an applicant or any other person in connection with a credit transaction. A creditor may inquire about an applicant's permanent residence and immigration status.
 - § 202.5(e) - Written Applications--A creditor shall take written applications for credit requested for the purchase or refinancing of residential real property, secured by a lien on such property.

§ 202.6, Rules Concerning Evaluation of Applications

When evaluating an application for credit, a creditor generally may consider any information that it is not barred from obtaining by § 202.5 of FRB Regulation B. This is subject to the general rule (§ 202.4) that the information obtained may not be used, or have the effect of discriminating against the applicant on any prohibited basis.

Creditors may use either a judgmental or a credit scoring evaluation system to evaluate creditworthiness; however, neither can discriminate against applicants using prohibited bases as variables in the evaluation process. FRB Regulation B defines a judgmental system as any system other than an empirically derived, demonstrable and statistically sound credit scoring system. The qualifications for empirically derived systems are at § 202.2(p) in the regulation.

The use of certain information in evaluating applications is prohibited except when certain conditions are met.

- §202.6(a) - General Rule Concerning Use of Information
- §202.6(b)(1) - Specific Rule Concerning Use of Information
- § 202.6(b)(2) - Applicant's Age--In a qualified credit scoring system, the applicant's age can be used provided the age of an elderly applicant is not assigned a negative score. In a judgmental system, age may be considered only as follows:
 - To determine the applicant's ability to enter into a binding contract
 - If used in an elderly applicant's favor; and
 - In determining a pertinent element of creditworthiness.
- § 202.6(b)(2) - Public Assistance Income--The fact that an applicant's income is derived from a public assistance program may be considered in evaluating a credit application, but only to the extent that such consideration has a provable relationship to the applicant's ability to repay the credit requested.
- § 202.6(b)(3) - Childbearing/Childrearing --In evaluating creditworthiness, a creditor shall not use assumptions or aggregate statistics relating to the likelihood that any group of persons will bear or rear children or will, for that reason, receive diminished or interrupted income in the future.
- § 202.6(b)(4) - Telephone Listing--A creditor shall not take into account whether there is a telephone listing in the name of an applicant for

consumer credit, but may take into account whether there is a telephone in the applicant's residence.

- § 202.6(b)(5) - Other Income --The income of an applicant and/or spouse of an applicant that is derived from part-time employment, or from an annuity, or pension, or other retirement benefit is not to be discounted or excluded from consideration as income in evaluating the application. Nonetheless, the amount and probable continuance of the receipt of income from these sources may be considered in evaluating the applicant's repayment ability. When an applicant relies on alimony, child support, or separate maintenance payments in applying for credit, the creditor shall consider such payments as income to the extent that they are likely to be consistently made.
- § 202.6(b)(6) - Credit History--When examining the credit history of an applicant, the creditor shall consider:
 - The credit history of accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable;
 - On the applicant's request, any information the applicant may present that tends to indicate that the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness;
 - On the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's own creditworthiness.
- § 202.6(b)(7) - Immigration Status--A creditor may consider whether an applicant is a permanent resident of the United States, the applicant's immigration status, and any additional information that may be necessary to ascertain the creditor's rights and remedies regarding repayment.
- § 202.6(c) - State Law--Consideration of state property laws such as dower rights, homestead rights, and other statutory restrictions on transfer of property may be considered as to their effects on creditworthiness and such consideration does not constitute discrimination under ECOA or FRB Regulation B.

§ 202.7, Rules Concerning Extensions of Credit

- § 202.7(a) - Individual Accounts--A creditor shall not refuse to grant an individual account to a creditworthy applicant on the basis of sex, marital status, or any other prohibited basis.
- §202.7(b) - Designation of Name
- §202.7(c)(1) - Action Concerning Existing Open-End Accounts
- §202.7(c)(2) - Requiring reapplication
- § 202.7(d) (1) - Signature Rules--The signature rules ensure that qualified applicants are able to obtain credit in their own names. A creditor

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- generally may not require the signature of another person, other than a joint applicant, on any credit instrument unless the applicant alone does not qualify for the credit requested. Other signatures may be required if necessary to perfect a valid lien and ensure payment of the debt.
- §202.7(d)(2) - Unsecured Credit
 - §202.7(d)(3) - Unsecured Credit, Community Property States
 - § 202.7(d)(4) - Secured Credit--If an individual secured loan is requested and established credit standards are met, the applicant should be granted the separate account and neither the applicant's spouse nor any other person can be required to become liable for the payment of the debt through the execution of the legal instruments. Nonetheless, a spouse or any other person whose signature under applicable state law is needed to make the property available as security to repay the debt in the event of default can be required to join in the execution of all necessary security instruments, (i.e., deed of trust, security agreements, mortgage, and financing statement).
 - § 202.7(d) (5) - Other Signatures--If, under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the extension of the credit requested, a creditor may request a cosigner, guarantor, or the like. The additional party may be any person meeting the necessary credit standards. The applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party.
 - Rights of Additional Parties, §202.7(d)(6)
 - § 202.7(e) - Insurance--A creditor shall not refuse to extend credit or terminate a loan because credit life, health, accident, or disability insurance is not available due to the applicant's age. However, information about an applicant's age, sex, or marital status may be requested in an application for insurance, and use of such information in differentiating in the availability, rate, and terms upon which such insurance is offered shall not constitute discrimination under ECOA.

Notifications, § 202.9

- § 202.9(a)(1) - Notification Requirement--Generally, the creditor is required to notify an applicant of both favorable and adverse action taken within:
 - Thirty (30) days after receiving a completed application concerning the creditor's approval of, counter offer to, or adverse action on the application. A "completed application" is defined as an application in connection with which a creditor has received all the information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested (including, but not limited to, credit reports, any additional information requested from the applicant, and any approvals or reports by governmental agencies or other persons that are necessary to guarantee, insure, or provide security for the credit or collateral). The creditor is obliged to exercise reasonable diligence in obtaining

such information. A very important point here is that the 30-day clock does not begin until all information necessary to make a credit decision is received. Such information would include a real estate appraisal.

- Thirty (30) days after taking adverse action on an incomplete application;
 - Thirty (30) days after taking adverse action on an existing account; or
 - Ninety (90) days after notifying the applicant of a counter offer if the applicant does not expressly accept or use the credit offered.
- § 202.9(a)(2) and § 202.9(b) - Adverse Action--When adverse action is taken, the applicant must be given written notification which must contain:
 - A statement of the action taken;
 - The name and address of the creditor;
 - The ECOA notice, and the name and address of the Federal agency that administers compliance with respect to the creditor.The form of notice should be substantially as follows:

"The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided that the applicant has the capacity to enter into a binding contract), because all or part of the applicant's income derives from any public assistance program, or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act.

- A statement of the specific reasons for the adverse action taken on the application. The specific reason(s) must relate to and accurately describe the factors actually considered by the creditor. If the adverse action is based on information obtained from a consumer credit reporting agency, simply disclosing that the credit report was used to deny the application does not meet the ECOA requirement to disclose specific reasons. The specific factors must be disclosed as stated above. Under the Fair Credit Reporting Act (FCRA), the applicant must be provided the name and address of the credit reporting agency and the ECOA/FCRA disclosures may be combined.
- § 202.9(c) - Incomplete Applications--Within 30 days after receiving an application that is incomplete, the creditor shall notify the applicant either of adverse action taken or of the incompleteness. If additional information is needed from an applicant, the creditor shall send a written notice to the applicant specifying the information needed, designating a reasonable period of time for the applicant to provide the information, and informing the applicant that failure to provide the information requested will result in no further consideration being given to the application. The creditor shall have no further obligation under this section if the applicant fails to respond within the designated time period. If the applicant supplies the

requested information within the designated time period, the creditor shall take action on the application and notify the applicant.

- §202.9(c)(1) - Incomplete Applications, Notice Alternatives
- §202.9(c)(2) - Notice of Incompleteness
- §202.9(c)(3) - Oral Request for Information

A creditor may orally inform the applicant of the need for additional information. If the applicant does not submit the requested information, the creditor shall send a written notice as set forth above.

- § 202.9(d) - Oral Notifications--The requirements of § 202.9 (including statements of specific reasons) are satisfied by oral notifications in the case of any creditor who did not receive more than 150 applications during the preceding calendar year.
- § 202.9(e) - Withdrawal of Approved Applications--When an applicant submits an application and the parties contemplate the applicant will inquire about its status, if the creditor approves the application and the applicant has not inquired within 30 days after applying, the creditor may treat the application as withdrawn and need not comply with the notification requirements of § 202.9(a)(1).
- § 202.9(f) - Multiple Applicants--When an application involves more than one applicant, notification need only be given to one of them, but must be given to the primary applicant where one is readily apparent.
- § 202.9(g) - Third Party Applications--When an application is made on behalf of an applicant to more than one creditor and the applicant expressly accepts or uses credit offered by one of the creditors, notification of action taken by any of the other creditors is not required. If no credit is offered or if the applicant does not expressly accept or use any credit offered, each creditor taking adverse action must comply with this section, directly or through a third party. A notice given by a third party shall disclose the identity of each creditor on whose behalf the notice is given.

§ 202.1, State Law

Generally, FRB Regulation B alters, affects, or preempts only those State laws that are inconsistent with ECOA and the regulation, and then only to the extent of the inconsistency. A State law is not inconsistent if it is more protective of the applicant. If a determination of the inconsistency of any State law cannot be resolved from a review of § 202.11(b) (1) and relevant official staff interpretations, a formal FRB interpretation may be requested.

§ 202.12, Record Retention Requirements

Generally, the creditor must retain the original or a copy of the following documents for a period of 25 months (12 months for business credit) after the date that the applicant is notified of the action taken on the application, or of incompleteness:

- Any application and any information required to be obtained concerning characteristics of the applicant to monitor compliance with ECOA and this regulation and not returned to the applicant at the applicant's request;
- A copy of the notification of the action taken or the notification of incompleteness;
- The statement of the specific reasons for the adverse action; and
- Any written statement(s) submitted by the applicant alleging a violation of ECOA or this regulation.

Records of withdrawn applications and incomplete applications must also be retained for 25 months (12 months for business credit). If no notice of action is required by § 202.9 above, the 25-month requirement runs from the date the creditor receives the application.

If the creditor has received notice that it is under investigation or is subject to an enforcement proceeding for an alleged violation of ECOA or the regulation, all records regarding a credit transaction must be maintained until the final disposition of the matter occurs.

- §202.12(a) - Retention of Prohibited Information
- §202.12(b)(1)(i) - Preservation of Records, Applications and Other Written or Recorded Information
- §202.12(b)(1)(ii) - Notification of Action Taken, Statement of Specific Reasons for Adverse Action
- §202.12(b)(1)(iii) - Written Statement Submitted by the Applicant Alleging a Violation
- §202.12(b)(2) - Existing Accounts
- §202.12(b)(3) - Applications Not Requiring Notification
- §202.12(b)(4) - Enforcement Proceedings and Investigations
- §202.12(b)(6) - Self-Tests
- §202.12(b)(7) - Prescreened Solicitations

§ 202.13, Information for Monitoring Purposes,

A creditor that receives an application for credit primarily for the purchase or refinance of a dwelling occupied or to be occupied by the applicant as a principal residence secured by a lien on such property shall request the following as a part of the written application for the credit:

- Race or national origin, using the categories American Indian or Alaskan Native, Asian or Pacific Islander, Black, White, Hispanic, or Other (Specify)
- Sex;
- Marital status, using the categories Married, Unmarried, and Separated; and
- Age.

The request for this information may be listed, at the creditor's option, on the application form or on a separate form that refers to the application. The applicant(s) shall be asked but not required to supply this information and advised that the information is being requested by the Federal Government for the purpose of monitoring compliance with Federal statutes that prohibit creditors from discriminating against applicants on those bases. If the applicant does not provide this information, that fact shall be noted on the form. The creditor is required to note on the form, to the extent possible, the race or national origin and sex on the basis of visual observation or surname. The creditor shall also advise the applicant(s) that if the applicant(s) chooses not to provide this information, the creditor is required to note this information on the basis of visual observation or surname. For additional information, refer to [Flow Chart 1](#) at EM-695.

- §202.13(a)(1) - Information to be Requested (Purchase or Refinance of Principal Residence)
- §202.13(a)(2) - Dwelling (Definition)
- §202.13(b) - Obtaining Information (Regarding Ethnicity, Race, Sex, Marital Status, and Age)
- §202.13(c) - Disclosure to Applicant(s)
- §202.13(d) - Substitute Monitoring Program

§ 202.14, Rules on Providing Appraisal Reports

- § 202.14(a) - Providing Appraisals--A creditor shall provide a copy of the appraisal report used in connection with an application for credit that is to be secured by a lien on a dwelling. Dwelling means a residential structure that contains one to four units whether or not that structure is attached to real property. The term includes an individual condominium or cooperative unit, and a mobile or other manufactured home. A creditor may comply with either of the following methods of delivery:
 - § 202.14(a)(1) - Routine Delivery--A creditor may routinely provide a copy of the appraisal report to an applicant (whether credit is granted or denied or the application is withdrawn).
 - § 202.14(a)(2) - Upon Request--A creditor that does not routinely provide appraisal reports shall provide a copy upon an applicant's written request
 - § 202.14(a)(2)(i) - Notice--A creditor that provides appraisal reports only upon request shall notify an applicant in writing of the right to receive a copy of an appraisal report. The notice may be given at any time during the application process but no later than when the creditor provides notice of action taken under § 202.9 of FRB Regulation B. The notice shall specify that the applicant's request must be in writing, give the creditor's mailing address, and state the time for making the request as provided in § 202.5a(a)(2)(ii) below.

- § 202.14(a)(2)(ii) - Delivery--A creditor shall mail or deliver a copy of the appraisal report promptly (generally within 30 days) after the creditor receives an applicant's request, receives the report, or receives reimbursement from the applicant, **whichever is last to occur**. A creditor need not provide a copy when the applicant's request is received more than 90 days after the creditor has provided notice of action taken on the application under § 202.9 of FRB Regulation B or 90 days after the application is withdrawn.

Examination Objectives

- Determine that policies, procedures and internal controls relating to FRB Regulation B have been established and evaluate their adequacy to provide reasonable assurance of compliance with ECOA and FRB Regulation B.
- Evaluate adherence to established policies, procedures, and internal control guidelines.

Examination Procedures

The following examination procedures are provided to facilitate an evaluation of compliance with ECOA and FRB Regulation B. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution.

MMC Equal Credit Opportunity Act Exam Procedures:

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasis should be on identifying violations of law and regulation; integrating those findings with the examination; and concluding on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of ECOA and FRB Regulation B.			
3	Determine whether applications are accepted from all eligible persons without regard to race, color, religion, national origin, sex, marital status, age, receipt of public assistance income,			

MMC Equal Credit Opportunity Act Exam Procedures:

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	or good faith exercise of credit rights.			
4	Determine if the information requested on the loan application is in compliance with the provisions of ECOA that prohibit requesting certain information.			
5	Determine if voluntary monitoring information is obtained only when required by ECOA and whether the applicant(s) was informed that if the applicant(s) chose not to provide the monitoring information, the creditor is required to note the race or national origin and sex on the basis of visual observation or surname. If the information was recorded based on visual observation or surname, determine whether this fact was also noted on the form.			
6	Determine whether income and age were considered in accordance with ECOA.			
7	Determine whether the loan files were free from information prohibited by ECOA.			
8	Determine whether applicants were given timely notification of approval, rejection or counter offers in accordance with ECOA.			
9	Determine whether applicants were provided or notified of the right to receive--a copy of appraisal reports on loans secured by a dwelling.			
10	Determine whether ECOA record retention requirements were met.			
11	Review rejected and withdrawn applications and determine whether the following provisions were observed:			
	a. Was the notice timely?			
	b. Did the notice include: (1) the action taken, (2) the ECOA Notice, (3) the specific reason for the action taken, and (4) the names of all creditors involved?			
	c. Were the reasons for the action taken based solely on economic factors?			
12	Determine whether any complaints were filed against the institution. If so, ascertain whether appropriate action was taken.			

MMC Equal Credit Opportunity Act Exam Procedures:

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
13	Conclude as if the institution is adequately complying with FRB Regulation B. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
14	Utilize discussions with institution managers as needed to gather information and discuss whether procedures and practices followed by institution personnel ensure compliance with laws and regulations.			
15	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
16	Organize and compile, if necessary, violations of law and regulation into Violation Summary Sheet.			

- [MMC Equal Credit Opportunity Act Exam Procedures](#)

Home Mortgage Disclosure Act

Authority and Purpose

The [Home Mortgage Disclosure Act of 1975](#) (HMDA), which has been implemented by Federal Reserve Board (FRB) [Regulation C](#) (12 CFR Part 203), requires each covered institution to disclose on an annual basis its mortgage loan originations, purchases, and applications (i.e., loans secured by and made for the purpose of purchasing or improving a dwelling, including) refinances. The information is required to be itemized by census tract (or by county, in some instances) and also by the type of loan. Data must be recorded on a Loan/Application Register (HMDA-LAR) that each reporting institution is required to send to its Federal supervisory agency by March 1 following the calendar year for which the data are compiled. In addition, a disclosure statement covering the data on a calendar year basis must be made available to the public for inspection and copying.

As the name implies, HMDA is a disclosure law that relies upon public scrutiny for its effectiveness. The HMDA evolved from public concern over credit shortages in certain urban neighborhoods. Congress found that some financial institutions had contributed to the decline of some geographic areas by their failure to provide adequate home financing to qualified applicants on reasonable terms and conditions. Therefore, the purpose of the HMDA is to provide the public with loan data that can be used to: (1) help determine whether financial institutions are serving the housing needs of their communities; (2) assist public

officials in distributing public-sector investments so as to attract private investment to areas where it is needed; and (3) assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes. However, neither the HMDA nor FRB Regulation C is intended to encourage unsound lending practices or the allocation of credit.

Applicability and Exemptions

Initially, only depository institutions, mortgage lending subsidiaries of holding companies, and savings and loan service corporations that had over \$10 million in assets and offices in a "metropolitan statistical area" or a "primary metropolitan statistical area" (both referred to by the term "MSA") were required to comply. Subsequently, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) amended HMDA to expand its coverage to include "other lending institutions." An "other lending institution" is defined as "any person engaged for profit in the business of mortgage lending." As a result of the amendments, MMC mortgage banker institutions became subject to the HMDA and FRB Regulation C as of January 1, 1990. FRB Regulation C refers to these entities as "mortgage lending institutions" and requires their reports to be filed with the U.S. Department of Housing and Urban Development (HUD), their designated Federal supervisory agency.

An institution must make its HMDA-LAR available to the public after removing the application or loan number, date application was received, and date of action taken. This must be available following the calendar year for which the information was compiled, by March 31 for a request received on or before March 1, and within 30 days for a request received after March 1. This modified register does not have to be compiled before a request is received, but it must be available for a period of 3 years.

The Federal Financial Institutions Examination Council (FFIEC), in conjunction with the Federal supervisory agency, produces disclosure statements based on the HMDA-LAR. An institution is required to make its mortgage loan disclosure statement available to the public no later than 3 business days after the institution receives it from its supervisory agency. The institution shall make the statement available to the public for a period of 5 years. The statement must be made available at the institution's home office (corporate headquarters or service center headquarters) and, if it has a physical branch office in other MSAs, it must also make the statement available in at least one branch office in each of those MSAs. Branch offices in an MSA must make a copy available within 10 business days.

MMC mortgage banker institutions would be exempt from the requirements of FRB Regulation C for a given calendar year if the institution had neither a home office nor a branch office in an MSA on the preceding December 31; and the institution's total assets were \$10 million or less on the preceding December 31, or the institution originated fewer than 100 home purchase loans in the preceding calendar year. Institutions also need not complete a report, even if they meet the test for asset size and location, if the home purchase loans originated in the

preceding calendar year came to less than 10 percent of the institution's total origination volume, measured in dollars.

NOTE: It is important to note that for "mortgage lending institutions" the definition of branch office extends beyond a physical presence. These types of entities are deemed to have a branch office in an MSA if, in the preceding calendar year, it received applications for, originated, or purchased five or more home purchase or home improvement loans on property located in that MSA. This five-or-more rule applies in determining, for purposes of coverage, whether an institution has an office within an MSA, and also whether an institution must itemize data by census tract within a given MSA.

Final Rule for the Home Mortgage Disclosure Act Changes (Reg.C) Effective October 1, 2009

On October 20, 2008, the Federal Reserve announced the final rule for the Home Mortgage Disclosure Act changes. These changes were originally proposed in July 2008 when final Regulation Z rules were published.

The HMDA revisions were made to:

- Facilitate regulatory compliance by conforming the test for rate spread reporting Under Reg. C to the definition of higher-priced mortgage loans (HPML's) under Reg. Z
- To use a benchmark that more closely tracks mortgage rates.
- Relieve compliance burdens.

The primary change to HMDA that will be critical for all HMDA reporting institutions is the change in the rate spread calculation. Refer to [Supplement 1](#) for information on rate spread trigger points. Currently, the HMDA rate spread must be calculated for all reportable loans that are covered by Regulation Z where the APR exceeds the comparable Treasury security rate by 3% for first lien loans and 5% for subordinate lien loans. Keep in mind that the HMDA calculations are not, and never were, the calculations for Section 32 mortgages (i.e., HOEPA loans).

For all applications received on or after **October 1, 2009**, a HMDA reportable institution will calculate the rate spread using the new calculation. For all loans that close after **January 1, 2010**, the new calculation will apply regardless when the application was taken. Otherwise, if a loan application was received prior to October 1, 2009, the old calculation will apply. The new HMDA revisions take the current HMDA rate spread calculation and align it with Regulation Z's higher-priced mortgage loan calculation. So now, **instead** of calculating your spread based on **3% and 5% over Treasury security rates**, you'll calculate it based on **1.5% and 3.5% over the new Average Prime Offer Rate**.

The tables for "Average Prime Offer Rates" are posted weekly and found at <http://www.ffiec.gov/ratespread/newcalc.aspx>

Link to the Rate Spread Calculator is <http://www.ffiec.gov/ratespread>

More information/links are on the “Federal Required Disclosure & Fact Sheet Itemization”

To facilitate an understanding of FRB Regulation C, some of the pertinent provisions of the regulation for citation purposes are presented with brief explanatory comments. Other pertinent provisions for citation purposes are listed without explanation but can be referenced in the regulation itself. Note that this is a summary of the regulation and is not comprehensive.

NOTE: Regulation C has a definitions section (§203.2), appendices with model forms and official staff interpretations (Supplement I) for use in determining if the requirements of the regulation have been met. The definition section outlines in detail the conditions that must be met in order for an institution to be required to compile and report data.

§203.4, Compilation of Loan Data

- §203.4(a) - Compilation of Loan Data, Data Format and Itemization
- §203.4(b) - Collection of Data on Ethnicity, Race, Sex, and Income
- §203.4(c) - Optional Data
- §203.4(d) - Excluded Data

§203.5, Disclosure and reporting

- §203.5(a) - Reporting to Agency
- §203.5(b) - Public Disclosure of Statement
- §203.5(c) - Public Disclosure of Modified Loan/Application Register (HMDA-LAR)
- §203.5(d) - Availability of Data
- §203.5(e) - Notice of Availability
- §203.5(f) - Loan Aggregation and Central Data Depositories

Examination Objectives

- Determine that policies, procedures, and internal controls have been developed and implemented to provide reasonable assurance of compliance with the various provisions of FRB Regulation C and the HMDA, if applicable.

Examination Procedures

Qualification

Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce FRB Regulation C and HMDA over MMC mortgage banker institutions.

1. Did the institution have a home office or a branch office in an MSA on the preceding December 31, and did the institution have more than \$10 million in assets on the preceding December 31, or did the institution originate 100 or more home purchase loans in the preceding calendar year?
2. Did the institution originate home purchase loans which equaled or exceeded 10 percent of its total loan origination volume, measured in dollars, in the preceding calendar year?

If the institution did not have an office in an MSA, then it is not required to complete a HMDA-LAR and no further examination work is required. If the institution does have an office in an MSA and the answer to either the asset size or number of loans questions is affirmative, then the HMDA-LAR must be completed and further examination work may be required. If the institution does have an office in an MSA and the answer to both asset size and number of loans is negative, the HMDA-LAR is not required and no further examination work is required. Furthermore, regardless of location, size, or number of loans originated, the institution is not required to complete a HMDA-LAR if the answer to the second question regarding the 10-percent loan origination rule is negative.

Examination

If the institution is subject to the HMDA and FRB Regulation C, the following examination procedures are provided to facilitate an evaluation of compliance with HMDA and FRB Regulation C. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution:

MMC Home Mortgage Disclosure Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasis should be on identifying violations of law and regulation; integrating those findings with the examination; and concluding on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of HMDA and FRB Regulation C.			
3	Determine if the institution is ensuring that home mortgage loan information and records are properly compiled, maintained, and accurately			

MMC Home Mortgage Disclosure Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	disclosed.			
4	Ascertain whether management ensures that policies, procedures, and training, on an ongoing basis, are adequate and help facilitate awareness among responsible staff.			
5	Determine whether the correct HMDA-LAR form or format being used. If so, determine if it is in machine-readable format.			
6	Determine if the institution has posted notices in the lobbies of its home and branch offices that are located in MSAs on the availability of the HMDA disclosure statement and the modified HMDA-LAR. Find out if the disclosure statement and HMDA-LAR is actually available at the home office and at least one branch office, if any, in each MSA.			
7	Determine whether HMDA disclosure statements are retained for 5 years, and if the HMDA-LARs are retained for 3 years.			
8	Determine whether the necessary census tract information is available and if the census tracts and/or county designations are accurate on the HMDA-LAR.			
9	Ascertain whether the latest disclosure statement was available to the public by March 31 following the calendar year for which the data were compiled.			
10	Determine if the institution also reports data regarding the race or national origin, sex, and annual income of applicants for loans originated or applied for (does not include loans that are purchased). If the information is not provided, determine if the institution notes the data based on visual observation or surname. NOTE: Alternatively, the form used to obtain monitoring information under Section 202.13 of FRB Regulation B (Equal Credit Opportunity Act) may be used.			
11	Conclude whether the institution is adequately complying with FRB Regulation C. If not,			

MMC Home Mortgage Disclosure Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
12	Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution personnel to ensure compliance with laws and regulations.			
13	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
14	Utilize HMDA Analyzer as described in the <i>Technology for Portfolio Review</i> Section to check for violations.			
15	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC Home Mortgage Disclosure Act Exam Procedures](#)

Truth-in-Lending Act

Authority and Purpose

The [Truth in Lending Act](#) (TILA) was enacted on May 29, 1968, as Title I of the Consumer Credit Protection Act. The TILA, implemented by the Federal Reserve Board (FRB) Regulation Z, became effective July 1, 1969. The Truth in Lending Simplification and Reform Act was enacted on March 31, 1980, as Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980. That legislation added new administrative enforcement provisions to the TILA, effective on March 31, 1980, and substantially amended other provisions of TILA. The other amendments were not effective until October 1, 1982, and were implemented by a completely revised [FRB Regulation Z](#).

The FRB amended FRB Regulation Z in December 1987 to implement section 1204 of the Competitive Equality Banking Act of 1987. The amendment requires creditors to provide consumers with more extensive information about the variable rate feature of closed-end adjustable rate mortgages (ARMs), with longer than a 1-year maturity, that are secured by the consumer's principal dwelling. The amendment was effective December 28, 1987, but compliance was not mandatory until October 1, 1988.

On July 30th, 2009 the FRB 's new Mortgage Disclosure Improvement Act (MDIA) went into effect. The rules were finalized Friday, May 8th, 2009 and are applicable to all mortgage lenders (federally chartered or state licensed). For applications taken as of July 30, 2009, new requirements about the delivery and the accuracy of disclosures apply. The MDIA expands greatly the type of loans that must receive good faith estimates of the disclosures required under Regulation Z Section 226.18, as set forth in the Truth-in-Lending disclosure statement. Specifically, a Truth-in-Lending disclosure statement must be provided in connection with any closed-end mortgage transaction subject to RESPA that is secured by a consumer's dwelling. In addition to purchase money and construction loans, refinance loans of all stripes are also covered without regard to lien position (first- and junior-lien loans) or occupancy status (principal dwelling or second home). HELOCs and timeshare plans are excluded, and business purpose loans (investment properties) remain exempt from coverage under Regulation Z.

On August 16, 2010, the FRB announced final rules to protect mortgage borrowers from unfair, abusive or deceptive lending practices that may arise from loan originator compensation practices. Under the final rules, a loan originator may not receive compensation that is based on the interest rate or other loan terms. This will prevent loan originators from increasing their own compensation by raising the consumers' loan costs, such as by increasing the interest rate or points. Loan originators may continue to receive compensation that is based on a percentage of the loan amount. The rules also prohibit a loan originator who receives compensation directly from the consumer from also receiving compensation from the lender or another party. The rules seek to ensure that consumers who agree to pay the originator directly do not also pay the originator indirectly through a higher interest rate, thereby paying more in total compensation than they realize. Loan originators also may not direct or steer a consumer to accept a mortgage that is not in the consumer's interest to increase the originator's compensation. The rules go into effect on April 1, 2011.

On August 16, 2010, the FRB issued final rules to require organizations acquiring mortgages to inform consumers that their mortgage loans were sold or transferred. The new disclosure requirements were required by the Helping Families Save Their Homes Act. Under the law, a purchaser or assignee that acquires a mortgage loan must provide the required disclosures in writing within 30 days.

The purpose of FRB Regulation Z (12 CFR Part 226) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost so that consumers will be able to more readily compare the various terms available and avoid the uninformed use of credit. The regulation also gives consumers the right to cancel certain credit transactions that involve a lien on the consumer's principal dwelling. The regulation does not govern charges by financial institutions for consumer credit or contain requirements related to the granting of consumer loans.

Applicability and Exemptions

In general, FRB Regulation Z applies to each individual or business that offers or

extends credit when the following four conditions are met: (1) the credit is offered or extended to consumers; (2) the offering or extension of credit is done regularly; (3) the credit is subject to a finance charge or is payable in more than four installments; and (4) the credit is primarily for personal, family, or household purposes. Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce FRB Regulation Z over MMC institutions.

To facilitate an understanding of FRB Regulation Z, some of the pertinent provisions of the regulation for citation purposes are presented with brief explanatory comments. Other pertinent provisions for citation purposes are listed without explanation but can be referenced in the regulation itself. Note that this is a summary of the regulation and is not comprehensive.

NOTE: Regulation Z has a definitions section (§226.2), appendices with model forms and official staff interpretations (Supplement I) for use in determining if the requirements of the regulation have been met.

Subpart A – General Provisions

Subpart A (§§226.1 through 226.4) of the regulation provides general information that applies to open-end and closed-end credit transactions. It sets forth definitions and stipulates which transactions are covered and which are exempt from the regulation. It also contains the rules for determining which fees are finance charges.

§ 226., Authority, purpose, coverage, organization, enforcement, and liability

- **§ 226.1(c) - Covered Transactions:** A credit transaction is subject to FRB Regulation Z if it is:
 - Consumer Credit--credit to a natural person where 50 percent or more is for personal, family, or household purposes.
 - Extended Regularly--the creditor extends such credit more than 25 times a year or more than 5 times for transactions secured by a dwelling.
 - Subject to Finance Charge--credit subject to a finance charge or payable by written agreement in more than four installments.

§ 226.3, Exempt Transactions

A transaction that does not have a consumer purpose is exempt from the regulation. The following credit transactions are generally not subject to FRB Regulation Z requirements:

- Credit over \$25,000 not secured by real property, or secured by real property expected to be used as the consumer's principal dwelling.
- Credit extended other than to a natural person (e.g., corporations, partnerships, associations, unions, trusts, fraternal organizations, and government agencies or instrumentalities).

- Credit extended primarily for a business, commercial or agricultural purpose.
- Credit involving certain public utility services if the charge for the service, delayed payment, or any discounts for prompt payment are filed with or regulated by any Government unit.
- Transactions in securities or commodities accounts in which credit is extended by a broker-dealer registered with the Securities and Exchange Commission or the Commodities Futures Trading Commission.
- An installment agreement for the purchase of home fuels in which no finance charge is imposed (even if a charge is assessed to cover billing cost).
- Loans made, insured, or guaranteed pursuant to a program authorized by Title IV of the Higher Education Act of 1965 (i.e., student loans).

For additional information, refer to [Flow Chart 2](#).

- §226.3(a) - Business, Commercial, Agricultural, or Organizational Credit
- §226.3(b) - Credit over \$25,000 Not Secured by Real Property or a Dwelling

§226.4, Finance Charge

- §226.4(a) - Definition
- §226.4(b) - Examples of Finance Charges
- §226.4(c) - Charges Excluded From the Finance Charge
- §226.4(d)(1) - Voluntary Credit Insurance Premiums
- §226.4(d)(2) - Property Insurance Premiums
- §226.4(d)(3) - Voluntary Debt Cancellation or Debt Suspension Fees
- §226.4(e) - Certain Security Interest Charges (Exclusions)
- §226.4(f) - Prohibited Offsets

Note: Refer to [Supplement 2](#) for more details on Finance Charge Examination.

Credit Categories

FRB Regulation Z divides covered consumer credit transactions into two categories, open-end and closed-end credit. The requirements for each are provided separately in the regulation. Open-end credit is consumer credit extended under a plan in which the financial institution:

- Reasonably contemplates repeated transactions;
- May impose a finance charge from time to time on the outstanding unpaid balance; and

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- Generally makes credit extension available to the consumer during the term of the plan (up to any limit set by the financial institution) to the extent that any outstanding balance is repaid.

Under open-end credit plans, the creditor furnishes the consumer with appropriate disclosures before the account is actually used. Later, when the account is used, the creditor provides certain disclosures on each billing statement sent to the consumer.

Closed-end credit encompasses all consumer credit not extended under an open-end plan. Under closed-end credit plans, the consumer receives a complete disclosure of the costs associated with the credit transaction before the transaction is actually consummated.

At the present time, open-end consumer credit plans are rare and most consumer credit is extended under closed-end plans. However, if an institution offers in Home Equity Plans (open-end credit plans secured by the consumer's dwelling), examiners should refer to the requirements of § 226.5b regarding disclosures. Further discussion of FRB Regulation Z requirements in this section will be limited to those related to closed-end credit.

Subpart C- Closed- End Credit

§ 226.1, General Disclosure Requirements

- § 226.17(a)(1) - Form of Disclosures--Required disclosures shall be made clearly and conspicuously in writing, and in a form that the consumer may keep. The disclosures shall be grouped together, segregated, and shall not contain information not directly related to the disclosures. The terms "finance charge" and "annual percentage rate" together with a corresponding amount or percentage rate shall be more conspicuous than any other disclosure, except the creditor's identity. Directly related information, such as a grace period, may also be disclosed under § 226.17(a).
- § 226.17(b) - Time of Disclosures--The creditor shall make disclosures before consummation of the transaction. In certain residential mortgage transactions, special timing requirements are set forth in § 226.19(a). In certain variable rate transactions, special timing requirements for variable rate disclosures are set forth in § 226.19(b) and § 226.20(c). In certain transactions involving mail or telephone orders or a series of sales, the timing of disclosures may be delayed in accordance with paragraphs (g) and (h) of § 226.17.
- § 226.17(c)(1) and § 226.17(c)(5) - Basis of Disclosures--Disclosures shall reflect the terms of the legal obligation between the parties. If an obligation is payable on demand, the disclosures shall be based on an assumed maturity of 1 year. If an alternate maturity date is stated in the legal obligation, the disclosures shall be based on that date.

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- § 226.17(c)(2) - Use of Estimates--If information necessary for an accurate disclosure is unknown, a financial institution shall make the disclosure based on the best information reasonably available and shall state that the disclosure is an estimate.
 - § 226.17(c)(3) and § 226.17(c)(4) - Minor Irregularities Provisions--The creditor may disregard the effects of the following in making calculations and disclosures:
 - Collecting payments in whole cents.
 - Dates of scheduled payments and advances may be changed because the scheduled date is not a business day.
 - Months have different numbers of days.
 - Leap year.

- In making calculations and disclosures, the creditor may disregard any irregularity in the first period or any payment schedule irregularity that results from the irregular first period when the first payment falls within one of the limits described below:

- For transactions in which the term is less than 1 year where the first payment is due within 24 to 43 days;

- For transactions in which the term is at least 1 year and less than 10 years where the first payment is due within 9 to 51 days; or

- For transactions in which the term is at least 10 years where the first payment is due within zero to 62 days.

- § 226.17(c)(6)(ii) - Construction Loans--When a multiple-advance loan to finance the construction of a dwelling may or will be permanently financed by the same creditor, the construction phase and the permanent phase may be treated either as one transaction or as more than one transaction and disclosures made accordingly.
- § 226.17(d) - Multiple Creditors--If a transaction involves more than one creditor, only one complete set of disclosures shall be given by one of the creditors rather than partial disclosures from several creditors.
- § 226.17(d) - Multiple Consumers--If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation. If the transaction is rescindable, one copy of the disclosure must be given to each person who has the right to rescind the transaction whether or not such person is primarily liable or has signed the evidence of debt.

NOTE: Two copies of the rescission notice must also be given to each person who has the right to rescind the transaction [§ 226.23(b)].

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- § 226.17(e) - Subsequent Events--All disclosures shall be made on the assumption that the terms and conditions of the legal contract will be fulfilled. If a disclosure becomes inaccurate because of an event that occurs after the disclosures are made such as a default on contract terms, the inaccuracy is not a violation. [Re-disclosures may be required under certain conditions as stated under Early Disclosures below or under § 226.19 and § 226.20.]
 - § 226.17(f) - Early Disclosures--If disclosures, whether estimated or believed to be accurate, are given before consummation of the transaction and a subsequent event makes them inaccurate, the changed terms must be disclosed before consummation when the annual percentage rate (APR) exceeds the tolerances of 1/8 of 1 percent in a regular transaction or 1/4 of 1 percent in an irregular transaction (as defined in § 226.22(a), footnote 46).

§ 226.18, Content of Disclosures

Disclosures required by the regulation need to be made only as applicable to the transaction. Any disclosure not relevant to a particular transaction may be eliminated entirely.

- § 226.18(a) - Creditor--The identity of the creditor making the disclosure. Inclusion of the creditor's address and/or telephone number is optional.
- § 226.18(b) - Amount Financed--The "amount financed" must be disclosed using that term and a descriptive explanation such as "the amount of credit provided to you or on your behalf." The amount financed is the total of the principal loan amount and other amounts financed that are not part of the finance charge (**including borrower stock**) less any prepaid finance charges. The amount financed normally equals the total of payments less the finance charge on a loan.
- § 226.18(c) - Itemization of Amount Financed--In addition to disclosing the amount financed, the creditor shall also provide an itemization of the amount financed separately from the other disclosures.

NOTE: If the creditor provides a statement that the consumer has the right to receive a written itemization of the amount financed, together with a space for the consumer to indicate whether it is desired, and the consumer does not request it, the creditor is not required to provide this information.

NOTE: Good faith estimates of settlement costs provided for transactions subject to the Real Estate Settlement Procedures Act (RESPA) may be substituted for an itemization of the amount financed. However, the inverse situation would not be true. For example, an itemization of the

amount financed would not be an appropriate substitute for the good faith estimate on loans subject to RESPA.

- § 226.18(d) - Finance Charge--The "finance charge" using that term and a brief description such as "the dollar amount the credit will cost you" must be disclosed with the segregated disclosures and more conspicuously (along with the APR) than other required disclosures as stated in § 226.17(a)(1).
- § 226.18(e) - Annual Percentage Rate--The "annual percentage rate" using that term and a brief description such as "the cost of your credit as a yearly rate" must be disclosed with the segregated disclosures and more conspicuously (along with the finance charge) than other required disclosures as stated in § 226.17(a)(1).

NOTE: Computation of APRs is covered in a separate section of this module.

- § 226.18(f) - Variable Rate--If the APR may increase after consummation in a transaction:
 - Not secured by the consumer's principal dwelling or in a transaction secured by the consumer's principal dwelling with a term of 1 year or less, the following disclosures are required:
 - The circumstances under which the rate may increase;
 - Any limitations on the increase;
 - The effect of an increase; and
 - An example of the payment terms that would result from an increase.
 - Secured by the consumer's principal dwelling with a term greater than 1 year, the following disclosures are required:
 - The fact that the transaction contains a variable rate feature, and
 - A statement that variable rate disclosures have been provided earlier.
- § 226.18(g) - Payment Schedule--The number, amounts, and timing of payments scheduled to repay the obligation must be disclosed with the segregated disclosures. In addition
 - In a demand obligation with no alternate maturity date, the creditor may comply with § 226.18(g) by disclosing the due dates or payment periods of any scheduled interest payments for the first year; and
 - In a transaction in which a series of payments varies because a finance charge is applied to the unpaid principal balance, the creditor may comply with § 226.18(g) by disclosing the dollar amounts of the largest and smallest payments in the series, and making a reference to the variations in the other payments in the series. Since this provision simplifies disclosure of the most complex payment schedule, it is not appropriate to attach a

payment amortization schedule and indicate "see attached" in the area of the disclosure where the payment schedule is normally disclosed.

- § 226.18(h) - Total of Payments--The "total of payments," using that term, and a descriptive explanation such as "the amount you will have paid when you have made all scheduled payments" must be disclosed with the other segregated disclosures.

NOTE: In any transaction involving a single payment, the creditor need not disclose the total of payments.

- § 226.18(i) - Demand Feature--If the obligation has a demand feature, that fact must be disclosed with the segregated disclosures, and if the disclosures are based on an assumed maturity of 1 year as provided in § 226.17(c)(5), that fact must also be disclosed.
- § 226.18(j) - Total Sale Price--In a credit sale, the "total sale price," using that term, and a descriptive explanation such as "the total price of your purchase on credit, including your down payment of \$____," must be disclosed.

NOTE: When an institution is both the creditor and seller (i.e., when it finances the sale of foreclosed property), it must disclose the total sale price.

- § 226.18(k) - Prepayment--The creditor must give a definitive statement of whether or not a penalty will be imposed if the obligation is prepaid in full. The absence of a penalty disclosure does not infer the absence of a penalty; the creditor must state that prepayment will not result in a penalty.
- § 226.18(l) - Late Payment--Any dollar or percentage charges that may be imposed before maturity due to a late payment, other than a deferral or extension charge, must be disclosed with the segregated disclosures.
- § 226.18(m) - Security Interest--If the creditor has or will acquire a security interest in the property purchased as part of the transaction or in other property, that fact must be disclosed and the property identified by item or type.
- § 226.18(n) - Insurance Information--If the financial institution elects to meet certain conditions specified in § 226.4(d) and discloses these conditions, it may exclude certain insurance premiums from the finance charge.
- § 226.18(o) - Security Interest Charges--Certain security interest charges specified in § 226.4(e) may be excluded from the finance charge if itemized and disclosed.

- § 226.18(p) - Contract Reference--The disclosure must include a statement that the consumer should refer to the appropriate contract document for information about nonpayment, default, right to accelerate the maturity of the obligation, and prepayment rebates and penalties, as applicable.
- § 226.18(g) - Assumption Policy--In residential mortgage transactions the disclosure must include a statement whether or not a subsequent purchaser may be permitted to assume the remaining obligation on its original terms. If the disclosure is an affirmative statement, it may be qualified by stating "subject to conditions" or "under certain circumstances."
- § 226.18(r) - Required Deposit--If the consumer is required to maintain a deposit as a condition of the transaction, a statement that the annual percentage rate does not reflect the effect of the required deposit must be included in the disclosure. For institutions required stock purchases qualify as required deposit balances.

§ 226.19, Certain Residential Mortgage and Variable Rate Transactions

Certain provisions of the regulation apply primarily or entirely to loans secured by a dwelling or real property. An understanding of the terms "dwelling" and "residential mortgage transaction" as defined in the regulation at § 226.2(a)(19) and § 226.2(a)(24), respectively, is necessary to properly determine the applicability of the regulation to such transactions. Specific rules for nonowner-occupied rental property are at Official Staff Commentary (OSC) § 226.3(a)3 and at OSC § 226.3(a)4 for owner-occupied rental property and must also be considered in determining whether disclosures are required or certain transactions are rescindable.

- § 226.19(a) - Mortgage Disclosures Subject to RESPA--For residential mortgage transactions that are also subject to RESPA, the creditor must make good faith estimates of the FRB Regulation Z disclosures before consummation, or deliver or place them in the mail not later than 3 business days after receipt of the consumer's written application, whichever is earlier.

NOTE: The 3-day period for truth-in-lending (TIL) disclosure coincides with the RESPA requirement for providing good faith estimates of settlement costs.

- §226.19(a)(1)(i) - Time of Disclosures
 - §226.19(a)(1)(ii) - Imposition of Fees
 - §226.19(a)(1)(iii) - Exception to Fee Restriction
- § 226.19(a)(2) - Re-disclosure Required--If the APR in the consummated transaction varies from the disclosed APR by more than 1/8 of 1 percentage point in a regular transaction or more than 1/4 of 1 percentage point in an irregular transaction (as defined in § 226.22, footnote 46), the creditor must make new disclosures not later than consummation or settlement.

- § 226.19(a)(3) - Consumer's Waiver of Waiting Period Before Consummation.
- §226.19(a)(4) - Notice (Not Required to Complete Agreement Because Have Received Certain Notices)
- §226.19(a)(5) - Timeshare Plans

NOTE: If the only inaccuracies involve estimates other than the APR, and no variable rate feature was added, re-disclosure is not required. See OSC § 226.19(a)(2)2.

- Itemization of Amount Financed--Creditors furnishing the RESPA good faith estimates need not give consumers an itemization of the amount financed either with the early disclosures or those given at consummation or settlement. See OSC § 226.19(a)(1)5.
- Exceptions--The creditor need not make the early TIL disclosures when it determines, within the 3-day period, that the application will not or cannot be approved on the terms requested. See OSC § 226.19(a)(1)4.
- § 226.19(b) - Certain Variable Rate Transactions--If the APR may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than 1 year, the following disclosures must be provided at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier:
 - The booklet titled, *Consumer Handbook on Adjustable Rate Mortgages*, published by the FRB and the Federal Home Loan Bank, or a suitable substitute. § 226.19(b)(1)
 - A loan program disclosure for each variable rate program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided:
 - The fact that the interest rate, payment, or term of the loan can change-- § 226.19(b)(2)(i);
 - The index or formula used in making adjustments, and a source of information about the index or formula-- § 226.19(b)(2)(ii);
 - An explanation of how the interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin-- § 226.19(b)(2)(iii);
 - A statement that the consumer should ask about the current margin value and current interest rate- § 226.19(b)(2)(iv);
 - The fact that the interest rate will be discounted, and a statement that the consumer should ask about the amount of the interest rate discount-- § 226.19(b)(2)(v);
 - The frequency of interest rate and payment changes--§ 226.19(b)(2)(vi);
 - Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment

limitations, negative amortization, and interest rate carryover-- § 226.19(b)(2)(vii);

- An historical example, based on a \$10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program. The example shall be based upon index values beginning in 1977 and be updated annually until a 15-year history is shown. Thereafter, the example shall reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms; such as, negative amortization, interest rate carryover, interest rate discounts, and interest rate and payment limitations that would have been affected by the index movement during the period-- § 226.19(b)(2)(viii);
 - An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example--§ 226.19(b)(2)(ix);
 - The maximum interest rate and payment for a \$10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increases in rates and payments under the program, and the initial interest rate and payment for that loan--§ 226.19(b)(2)(x);
 - The fact that the loan program contains a demand feature--§ 226.19(b)(2)(xi);
 - The type of information that will be provided in notices of adjustments and the timing of such notices-- § 226.19(b)(2)(xii); or
 - A statement that disclosure forms are available for the creditor's other variable rate loan programs-- § 226.19(b)(2)(xiii).
- §226.19(c) - Electronic Disclosures

§ 226.20, Subsequent disclosure requirements

Refinances and assumptions require new disclosures in accordance with the regulation when a transaction qualifies as a refinancing or assumption under the regulation.

NOTE: When an obligation is satisfied and replaced by a new obligation to the original financial institution and is undertaken by the same consumer, it must be treated as a refinancing for which a complete set of new disclosures must be furnished. A refinancing may involve the consolidation of several existing

obligations, disbursement of new money to the consumer, or the rescheduling of payments under an existing obligation. In any form, the new obligation must be considered a refinancing under the regulation. (However, a change in rate on a transaction in which a variable rate feature was not disclosed results in a new transaction requiring new disclosures.) The finance charge on the new disclosure must include any unearned portion of the old finance charge that is not credited to the existing obligation.

- §226.20(a) - Refinancings, - The following transactions are not considered refinances under § 226.20(a):
 - A renewal of an obligation with a single payment of principal and interest or with periodic interest payments and a final payment of principal with no change in the original terms;
 - An APR reduction with a corresponding change in the payment schedule;
 - An agreement involving a court proceeding;
 - Changes in credit terms arising from the consumer's default or delinquency. If the rate is increased or the new amount financed exceeds the unpaid balance plus earned finance charges and premiums for continuation of credit life, property, or liability insurance, the transaction is a refinancing; or
 - The renewal of optional insurance purchased by the consumer and added to an existing transaction, if required disclosures were provided for the initial purchase of the insurance.
- § 226.20(b) - Assumptions--When a creditor expressly agrees in writing with a subsequent consumer to accept that consumer as a primary obligor on an existing residential mortgage transaction, the creditor must make new disclosures to the subsequent consumer based on the remaining obligation. Both the previous and subsequent borrower must be consumers, but the determination of an "existing residential mortgage transaction" is based on the conditions related to the assuming consumer. See OSC § 226.20(b)(2).
- § 226.20(c) - Variable Rate Adjustments--An adjustment to the interest rate with or without a corresponding adjustment to the payment in a variable rate transaction subject to § 226.19(b) is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an acinstitutioning payment change and at least 25 but no more than 120 calendar days before a payment at a new level is due, the following disclosures, as applicable, must be delivered or placed in the mail:
 - The current and prior interest rates;
 - The index values upon which the current and prior interest rates are based;
 - The extent to which the creditor has foregone any increase in the interest rate;

- The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance; and
- The payment, if different from that referred to in the immediately preceding paragraph that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.

§ 226.22, Determination of the Annual Percentage Rate (APR)

- § 226.22(a)(1) - Accuracy of the Annual Percentage Rate--The term "annual percentage rate" was created by TILA and for practical purposes may be considered the same as the actuarial rate. FRB Regulation Z defines the annual percentage rate as a measure of the cost of credit, expressed as a yearly rate that relates the amount and timing of value received by the consumer to the amount and timing of payments made. Section 107(a)(1) of TILA [15 USC § 1606(a)(1)] provides a more detailed definition of the annual percentage rate.
- § 226.22(a)(1) - Calculation Methods--The regulation recognizes both the actuarial method and the United States Rule method (U. S. Rule) as measures of an exact annual percentage rate. Appendix J of FRB Regulation Z provides detailed instructions for determining the APR in accordance with the actuarial method for closed-end credit transactions.
- § 226.22(a)(2) - Accuracy Tolerances--The disclosed APR in a regular transaction is considered accurate if it is not more than 1/8 of 1 percentage point above or below the APR calculated under FRB Regulation Z.

The disclosed APR in an irregular transaction (as defined in § 226.22(a), footnote 46) is considered accurate if it is not more than 1/4 of 1 percentage point above or below the APR calculated under FRB Regulation Z.

- §226.22(a)(3) - Irregular Transaction 1/4 of 1 Percentage Point Above or Below
- §226.22(a)(4) - Mortgage Loans (Additional Tolerances with Accurate Finance Charge Calculations)
- §226.22(a)(5) - Additional Tolerance for Mortgage Loans (Inaccurate Finance Charge Calculations)
- § 226.22(b) and § 226.17(c)(3) - Computation Tools--Creditors may use the FRB Regulation Z APR tables available from the FRB and the APR determined from these tables in accordance with their instructions if deemed to comply with the regulation. Creditors may use any other computation tools in determining the APR if the rate determined by the other computation tools equals the APR determined in accordance with Appendix J, within the accuracy tolerances specified in the regulation.

Creditors may use computation tools that assume all months have an equal number of days (360-day basis) although the creditor collects interest on the actual number of days (365-day basis) to calculate the

APR. The creditor has the option of using this special rule for some or all disclosures for a transaction. See OSC § 223.17(c)(3).

APRWIN is a useful tool in calculating APR. In order to download APRWIN, access the following link: <http://www.occ.treas.gov/aprwin.htm>.

NOTE: APRWIN is not effective calculating the APR associated with some non-traditional mortgage products.

- §226.22(d) - Certain Transactions Involving Ranges of Balances

§ 226.23, Right of Rescission

In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction at any time before the expiration of the rescission period although that person may not be a signatory to the credit contract. An understanding of the term "principal dwelling" as discussed in the FRB Regulation Z OSC § 226.23(a)(1) 3 and 4 is necessary to determine when the right of rescission is applicable to a transaction. For additional information, refer to Flow Chart 4 at EM-695[?]. Also, the right of rescission does not apply to residential mortgage transactions, which include any transaction to construct or acquire a principal dwelling, whether considered real or personal property and certain other transactions as stated in § 226.23(f).

NOTE: The right of rescission does not apply to extensions of credit that are not subject to FRB Regulation Z even if the borrower's principal dwelling is the collateral securing the credit.

- §226.23(a)(1) - Consumer's Right to Rescind
- § 226.23(a)(3) - Rescission Period--The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery to the consumer of the rescission notice, or delivery of all material disclosures, whichever occurs last. If the required notice or material disclosures are not delivered, the rescission period does not expire for 3 years after consummation, upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first.
- § 226.23(a)(2) and § 226.23(a)(4) - Exercise of Right to Rescind--The consumer must notify the creditor of the rescission by mail, telegram, or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission, or when delivered to the creditor's designated address if sent by other means. When more than one consumer is entitled to rescind, the exercise of the right by one consumer is effective for all.
- § 226.23(b) - Notice of Right to Rescind--When a transaction is subject to rescission, the creditor shall deliver two copies of the notice of the right to

rescind and all required material disclosures to each consumer entitled to rescind. OSC § 226.23(b)

- § 226.23(b) - Form and Content of Notice--The notice shall be on a separate document that identifies the transaction and clearly and conspicuously discloses the following:
 - The retention or acquisition of a security interest in the consumer's principal dwelling;
 - The consumer's right to rescind the transaction;
 - How to exercise the right to rescind, with a form for that purpose including the creditor's address;
 - The effects of rescission as described in § 226.23(d); and
 - The date the rescission period expires.
- § 226.23(c) - Creditor's Delay of Performance --Unless a consumer waives the right of rescission, no money shall be disbursed other than in escrow. No services shall be performed, and no materials delivered until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded.
- § 226.23(d) - Effect of Rescission--When a transaction is rescinded, the security interest becomes void. The consumer is not liable for any amount, and the creditor must return any money or property given to anyone in connection with the transaction and take any action necessary to effect termination of the security interest within 20 days after receipt of the notice of rescission.
- § 226.23(e) - Waiver of Right to Rescind--A consumer may modify or waive the right to rescind by giving a dated written statement that specifically waives or modifies the right to rescind that includes a brief description of a bona fide personal financial emergency that must be met before the end of the rescission period. The statement must be signed by all consumers entitled to rescind. The use of printed forms for this purpose is prohibited.
- § 226.23(f) - Exempt Transactions--The right to rescind does not apply to:
 - A residential mortgage transaction;
 - A refinancing or consolidation by the same creditor of an extension of credit already secured by the consumer's principal residence;

NOTE: The right of rescission shall apply to the extent the new amount financed exceeds the unpaid principal balance, any earned unpaid finance charge on the existing debt, and amounts attributed solely to the costs of the refinancing or consolidation.

- A transaction in which a state agency is a creditor;

- An advance, other than an initial advance, in a series of advances or in a series of single payment obligations that is treated as a single transaction under § 226.17(c)(6) if the Notice of the Right to Rescind and all material disclosures have been given to the consumer; or
- A renewal of optional insurance premiums that is not considered a refinancing under § 226.20(a)(5).
- §226.23(g)(1) - Tolerances for Accuracy, One-Half of 1 Percent Tolerance
- §226.23(g)(2) - Tolerances for Accuracy, One Percent Tolerance
- §226.23(h)(1) - Special Rules for Foreclosures, Right to Rescind
- §226.23(h)(2) - Special Rules for Foreclosures, Tolerance for Disclosures

Other Requirements

§ 226.21 - Credit Balances--If a credit balance in excess of \$1 is created on an account, the regulation requires certain actions by the creditor to dispose of the credit balance.

§ 226.24 - Advertising--FRB Regulation Z imposes certain requirements and restrictions on advertising by creditors to provide complete and accurate information on the terms and conditions of the credit being offered to consumers.

Subpart D- Miscellaneous

- § 226.25 - Record Retention--A creditor must retain evidence of compliance with the regulation (other than the advertising requirements) for 2 years after the date required for disclosures to be furnished or other action to be taken and must make the records available for inspection by the agency responsible for enforcing the regulation with respect to the creditor.
- § 226.26 - APRs in Oral Disclosures--In oral responses to consumer inquiries about the cost of credit, FRB Regulation Z generally requires that only the APR be stated.
- § 226.27 - Spanish Language Disclosures--All required disclosures must be in English, except in Puerto Rico where creditors have the option to make disclosures in Spanish.
- § 226.28 - State Laws--Generally, state law requirements that are inconsistent with the disclosure requirements of the regulation are preempted to the extent of the inconsistency. Determinations of inconsistency are made by the FRB, on request.
- § 226.29 - State Exemptions--A state may apply to the FRB to exempt a class of transactions within that state from certain requirements of TILA.

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- § 226.30 - Limitations on Rates--A creditor shall include in any consumer credit contract secured by a dwelling and subject to TILA and FRB Regulation Z the maximum interest rate that may be imposed during the term of the obligation when the annual percentage rate may increase after consummation.

Subpart E - Special Rules for Certain Home Mortgage Transactions

Subpart E (§§226.31 through 226.36) contains special requirements for mortgages that fit the criteria in §226.32(a) ("high-cost mortgages"), §226.33(a) ("reverse mortgages"), and §226.35(a) ("higher-priced mortgage loans"), as well as loans secured by a consumer's principal dwelling.

§226.3, General Rules

- §226.31(a) - Requirements and Limitations of Subpart are in Addition to Those in Other Subparts of this Part
- §226.31(b) - Form of Disclosures (Clearly and Conspicuously in Writing, in Form the Consumer May Keep or Electronic Form)
- §226.31(c)(1) - Timing of Disclosure, Disclosures for Certain Closed-End Home Mortgages
 - §226.31(c)(1)(i) - Change in Terms
 - §226.31(c)(1)(ii) - Telephone Disclosures
 - §226.31(c)(1)(iii) - Consumer's Waiver of Waiting Period before Consummation
- §226.31(c)(2) - Disclosures for Reverse Mortgages
- §226.31(d)(1) - Basis of Disclosures and Use of estimates, Legal Obligation
- §226.31(d)(2) - Basis of Disclosures and Use of estimates, Estimates
- §226.31(d)(3) - Basis of Disclosures and Use of estimates, Per-Diem Interest
- §226.31(e) - Multiple Creditors; Multiple Consumers
- §226.31(f) - Effect of Subsequent Events
- §226.31(g) - Accuracy of Annual Percentage Rate

§226.32, Requirements for Certain Closed-End Home Mortgages

- §226.32(a)(1) - Coverage, Consumer Credit Transaction Secured by Consumer's Principal Dwelling in Which
 - §226.32(a)(1)(i) - APR at consummation will exceed by more than 8 percentage points for first-lien loans, or by more than 10 percentage points for subordinate-lien loans, the yield on Treasury securities having comparable periods of maturity to the loan maturity as of the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor or
 - §226.32(a)(1)(ii) - The total points and fees payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount, or \$400; the \$400 figure shall be adjusted annually on January 1

by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1.

- §226.32(a)(2) - Exceptions
- §226.32(b) - Definitions (Points and Fees, Affiliate)
- §226.32(c) - Disclosures (Conspicuous Type Size)
- §226.32(c)(1) - Notices (Specific Wording)
- §226.32(c)(2) - Annual Percentage Rate
- §226.32(c)(3) - Regular Payment, Balloon Payment
- §226.32(c)(4) - Variable-Rate
- §226.32(c)(5) - Amount Borrowed
- §226.32(d) - Limitations (Shall Not Include the Following)
- §226.32(d)(1)(i) - Balloon Payment
- §226.32(d)(1)(ii) - Exception
- §226.32(d)(2) - Negative Amortization
- §226.32(d)(3) - Advance Payments (Loan Payments Not Fees)
- §226.32(d)(4) - Increased Interest Rate after Default
- §226.32(d)(5) - Rebates (No Method Less Favorable than Actuarial Method)
- §226.32(d)(6) - Prepayment Penalties
- §226.32(d)(7) - Prepayment Penalty Exception
- §226.32(d)(8) - Due-on-Demand Clause (With Exceptions)

§226.33(a), Requirements for Reverse Mortgages

- §226.33(a) - Definition
- §226.33(b) - Content of Disclosures (In addition to Others Required by Regulation Z)
- §226.33(b)(1) - Notice (Not Obligated to Contract Because Received Disclosures)
- §226.33(b)(2) - Total Annual Loan Cost Rates
- §226.33(b)(3) - Itemization of Pertinent Information
- §226.33(b)(4) - Explanation of Table (Model Form Found in Paragraph (d) of Appendix K)
- §226.33(c) - Projected Total Cost of Credit
- §226.33(c)(1) - Costs to Consumer
- §226.33(c)(2) - Payments to Consumer
- §226.33(c)(3) - Additional Creditor Compensation (Shared Appreciation)
- §226.33(c)(4) - Limitations on Consumer Liability
- §226.33(c)(5) - Assumed Annual Appreciation Rates
- §226.33(c)(6) - Assumed Loan Period

Prohibited Acts or Practices in Connection with Credit Subject to §226.32, §226.34

- §226.34(a)(1) - Home Improvement Contracts
- §226.34(a)(2) - Notice to Assignee (Required Wording)
- §226.34(a)(3) - Refinancings within One-Year Period

- §226.34(a)(4) - Repayment Ability (Cannot be Based on Collateral Alone, Must Consider Ability to Repay)
- §226.34(a)(4)(i) - Mortgage-Related Obligations
- §226.34(a)(4)(ii) - Verification of Repayment Ability
- §226.34(a)(4)(ii)(A) - Verify Income or Assets Relied on to Determine Repayment Ability (Lists Methods)
- §226.34(a)(4)(ii)(B) - Not Violation if Income or Assets Amounts Used is Not Materially Greater than Actual Amounts
- §226.34(a)(4)(ii)(C) - Must Verify Current Obligations
- §226.34(a)(4)(iii) Presumption of Compliance
- §226.34(a)(4)(iii)(A) - If Complies with §226.34(a)(4)(ii)
- §226.34(a)(4)(iii)(B) - Determines Repayment Ability Using Largest Payment of P&I Scheduled in First Seven Years
- §226.34(a)(4)(iii)(C) - Determines Repayment Ability Using Total Debt to Income Ratio or Ratio of Income after Paying Debt Obligations to Income
- §226.34(a)(4)(iv) - Exclusions from Presumption of Compliance
- §226.34(a)(4)(v) - Exemption
- §226.34(b) - Prohibited Acts or Practices for Dwelling-Secured Loans; Open-End Credit

§226.35, Prohibited Acts or Practices in Connection with Higher-Priced Mortgage Loans

- §226.35(a)(1) - A “higher-priced mortgage loan” is a consumer credit transaction secured by the consumer’s principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.
- §226.35(a)(2) - “Average prime offer rate” means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the uses to derive these rates.
- §226.35(a)(3) - Exceptions
- §226.35(b) - Rules for Higher-Priced Mortgage Loans
- §226.35(b)(1) - Repayment Ability
- §226.35(b)(2) - Prepayment Penalties
- §226.35(b)(3) - Escrows
- §226.35(b)(3)(i) - Failure to Escrow for Property Taxes and Insurance
- §226.35(b)(3)(ii) - Exemptions for Loans Secured by Shares in a Cooperative and for Certain Condominium Units
- §226.35(b)(3)(iii) - Cancellation
- §226.35(b)(3)(iv) - Definition of Escrow Account
- §226.35(b)(4) - Evasion; Open-End Credit

§226.36, Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Principal Dwelling

- §226.36(a) - Mortgage Broker Defined
- §226.36(b) - Misrepresentation of Value of Consumer's Dwelling
- §226.36(b)(1) - Coercion of Appraiser (Includes Examples of Actions that Do and Do Not Violate §226.36(b)(1))
- §226.36(b)(2) - When Extension of Credit Prohibited
- §226.36(b)(3) - Appraiser Defined
- §226.36(c) - Servicing Practices
- §226.36(d) - This Section Does Not Apply to a Home Equity Line of Credit Subject to §226.5b.

§226.39, Mortgage Transfer Disclosures

- §226.39(a) - Scope
- §226.39(a)(1) - Covered Person Defined
- §226.39(a)(2) - Mortgage Loan Defined
- §226.39(b) - Disclosure required
- §226.39(b)(1) - Acquisition Date
- §226.39(b)(2) - Multiple Consumers
- §226.39(c) - Exceptions
- §226.39(d) - Content of Required Disclosures
- §226.39(e) - Optional Disclosures

Examination Objectives

- Determine that appropriate policies, procedures, and internal controls relating to FRB Regulation Z have been established and evaluate their adequacy to ensure compliance with the regulation
- Evaluate adherence to established policies, procedures, and internal control guidelines.
- Determine that the disclosures prescribed by FRB Regulation Z are given on all loans subject to the regulation.
- Determine that the required disclosures were made timely and accurately in accordance with the regulation.

Examination Procedures

The following procedures are provided to facilitate an evaluation of an institution's compliance with FRB Regulation Z. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC Truth-in-Lending Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasize identifying violations of law and regulation; integrate those findings with the examination; and conclude on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of TILA and FRB Regulation Z.			
3	Determine whether the loan folder includes, as a minimum, the TIL Disclosure Statement, contractual documents, loan commitment, settlement statement, and, when applicable, the Right to Rescind/Cancel.			
4	Determine whether the required disclosures were provided to the applicants/borrowers and if the disclosures were timely.			
5	Determine whether the information provided in the disclosures was accurate, verify that the basic data is the same as other loan information and contractual documents, and the annual percentage rate. Compute amounts should be independently verified.			
6	If the loan was a residential mortgage loan subject to RESPA and early disclosure was required, determine whether the good faith estimates of the required disclosures were furnished within 3 business days of receipt of the application.			
7	If redisclosure was required, ascertain whether it was made prior to the consummation of the transaction.			
8	If the right of rescission was applicable, determine whether the disclosures and a rescission notice were provided to each party with a right to rescind the transaction and whether the funds were not disbursed prior to the expiration of the rescission period unless a valid waiver of the right to rescind was obtained.			
9	If the right of rescission was waived, determine			

MMC Truth-in-Lending Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	whether it was properly documented by a dated statement describing the personal financial emergency justifying the waiver. Note: Printed forms are not acceptable. NOTE: Testing of compliance with TIL on rejected applications is applicable only to rejected applications that were also subject to RESPA and should be done in the review of rejected applications for compliance with RESPA.			
10	Conclude whether the institution is adequately complying with FRB Regulation Z. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
11	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
12	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC Truth in Lending Act Exam Procedures](#)

Fair Credit Reporting Act

Authority and Purpose

The [Fair Credit Reporting Act](#) (FCRA) deals with the rights of consumers in relation to their credit reports and the obligations of credit reporting agencies and the businesses that provide information to them. The FCRA has been revised numerous times since it took effect in 1971, notably by passage of the Consumer Credit Reporting Reform Act of 1996, the Gramm-Leach-Bliley Act of 1999, and the Fair and Accurate Credit Transactions Act of 2003 (FACT Act).

The FACT Act created new responsibilities for consumer reporting agencies and users of consumer reports. It also created new rights for consumers including the right to free annual consumer reports and improved access to report information with the aim of making data in the consumer reporting system more accurate.

Applicability and Exemptions

The FCRA applies to information obtained primarily for purposes of consumer

lending and other consumer transactions. Thus, the consumer report user obligations of FCRA apply to institutions only with respect to credit transactions for personal, family, or household purposes. The obligation of institutions to comply with FCRA for consumer credit transactions is reflected applicable state laws and the multi-state mortgage examination protocol and agreement.

The FCRA also imposes a number of FCRA reporting notices and compliance obligations on consumer reporting agencies which compile, maintain, and disseminate consumer information. It is unlikely; however, that MMC institutions would be deemed consumer reporting agencies under FCRA. FCA Regulation 12 CFR § 618.8320 generally restricts the use of data regarding borrowers and loan applicants. In addition, FCRA permits unrestricted reporting of a business' own experience with a consumer, such as loan payment history, etc., so that MMC institutions could share such information with each other and outside organizations in accordance with FCA Regulation 12 CFR § 618.8320 without becoming consumer reporting agencies.

If, through its consumer lending activities, an MMC institution qualifies as a user of consumer reports, it must comply with § 615 of the FCRA. Section 615 of the FCRA requires that whenever a creditor reduces or denies the amount of, or increases the cost of, credit, either wholly or partly, because of information contained in a consumer report, this must be disclosed to the consumer. A statement, preferably in writing, that information in the report caused or contributed to the denial or increase in cost, and the name and address of the reporting agency must be given to the consumer. If the information is from a source other than a reporting agency, the creditor must inform the applicant of the applicant's right to make a written request for the information when the denial is made known to the applicant. If the applicant requests the information within 60 days after being notified of the adverse action, the creditor must disclose the nature of the information to the applicant.

To facilitate an understanding of FRB Regulation B, some of the pertinent provisions for citation purposes are listed without explanation but can be referenced in the regulation itself. Note that this is a summary of the regulation and is not comprehensive.

Coverage

Business entities that are consumer reporting agencies have significant responsibilities under the FCRA; business entities that are not consumer reporting agencies have somewhat lesser responsibilities. Generally, financial institutions are not considered consumer reporting agencies; however, those that engage in certain types of information-sharing practices can be deemed consumer reporting agencies. In addition, the FCRA applies to financial institutions that operate as:

- Procurers and users of information (for example, when granting credit, purchasing dealer paper, or opening deposit accounts),

-
- Furnishers and transmitters of information (by reporting information to consumer reporting agencies or other third parties, or to affiliates),
 - Marketers of credit or insurance products, or
 - Employers.

The following is a listing of pertinent sections of the law along with brief summaries of each section:

Definitions

The definitions section of the Act is §613.

§604, Permissible Purposes of Reports

- §604(a) - Consumer Reporting Agency May Furnish a Consumer Report under Certain Circumstances
- §604(a)(2) - With the Written Instructions of the Consumer
- §604(a)(3)(A) - To a Person it Believes Intends to Use the Information in Connection With a Credit Transaction Involving the Consumer on Whom the Information is to be Furnished and Involving the Extension of Credit to, or Review or Collection of an Account of, the Consumer.
- §604(a)(3)(B) - To a Person It Believes Intends to Use the Information for Employment Purposes
- §604(a)(3)(E) - To a Person It Believes Intends to Use the Information, as a Potential Investor or Servicer, or Current Insurer, in Connection With a Valuation of, or an Assessment of the Credit or Prepayment Risks Associated With, an Existing Credit Obligation.
- §604(b) - Conditions for Furnishing and Using Consumer Reports for Employment Purposes
- §604(c) - Furnishing Reports in Connection with Credit or Insurance Transactions Not Initiated by the Consumer
- §604(f) - Certain Use or Obtaining of Information Prohibited

§606, Disclosure of Investigative Consumer Reports

- §606(a) - May Not Procure an Investigative Consumer Report on Consumer Unless
- §606(a)(1)(A) - Disclosed in Writing that Consumer Report May be Obtained (Within 3 days of Request for Report)
- §606(a)(1)(B) - Includes Statement of Right to Receive Information Under §606(b) and §609(c)
- §606(a)(2)(A) - The Person Certifies to Reporting Agency that Disclosures Required by §606(a)(1) Were Made and
- §606(a)(2)(B) - The Person Will Comply with §606(b)
- §606(b) - Upon Written Request by Consumer, Person Ordering Report Will Disclose Nature and Scope of Request
- §606(c) - Violations of §606(a) and §606(b) (Preponderance of Evidence)
- §606(d) - Prohibitions

§609, Disclosures to consumers

- §609(a) - Reporting Agency Shall, Upon Request; and Subject §610(a)(1), Disclose to the Consumer:
- §609(a)(1) - All Information in the Consumer's File (With Exceptions)
- §609(a)(2) - Sources of the Information
- §609(a)(3) - Identification of Each Person that Procured a Consumer Report
- §609(a)(4) - Dates, Original Payees, and Amounts of Checks upon Which is Based any Adverse Characterization of the Consumer
- §609(a)(5) - Record of Inquiries Received by the Agency during the Past Year Not Initiated by the Consumer
- §609(a)(6) - If Credit File and Not Credit Score Requested, Must Disclose that Consumer may Request Credit Score
- §609(c) - Summary of Rights to Obtain and Dispute Information in Consumer Reports and to Obtain Credit Scores
- §609(d) - Summary of Rights of Identity Theft Victims
- §609(e) - Information Available to Victims
- §609(f) - Disclosure of Credit Scores
- §609(f)(1) – General
- §609(f)(2) - Definitions of “Credit Score” and “Key Factors”
- §609(f)(3) - Timeframe and Manner of Disclosure
- §609(f)(4) - Applicability to Certain Uses
- §609(f)(5) - Applicability to Credit Scores Developed by another Person
- §609(f)(6) - Maintenance of Credit Scores Not Required
- §609(f)(7) - Compliance in Certain Cases
- §609(f)(8) - Fair and Reasonable Fee
- §609(f)(9) - Use of Enquiries as a Key Factor
- §609(g) - Disclosure of Credit Scores by Certain Mortgage Lenders
- §609(g)(1) - User of Consumer Credit Score with Application Initiated by Consumer for Consumer Loan Secured by Residential Real Property Shall Provide
- §609(g)(1)(A) - Information Required Under §609(f)
- §609(g)(1)(B) - Disclosures in Case of Automated Underwriting System
- §609(g)(1)(C) - Disclosures of Credit Scores Not Obtained From a Consumer Reporting Agency
- §609(g)(1)(D) - Notice to Home Loan Applicants (Specific Wording)
- §609(g)(1)(E) - Actions Not Required Under this Subsection
- §609(g)(1)(F) - No Obligation for Content
- §609(g)(1)(G) - Person Defined as Excluding Enterprise
- §609(g)(2) - Prohibition on Disclosure Clauses Null and Void

§615, Requirements on Users of Consumer Reports

- §615(a) - Duties of Users Taking Adverse Actions on the Basis of Information Contained in Consumer Reports

- §615(a)(1) - Provide Oral, Written, or Electronic Notice of the Adverse Action to the Consumer
- §615(a)(2) - Provide to the Consumer Orally, in Writing, or Electronically:
- §615(a)(2)(A) - Specific Contact Information Concerning the Credit Reporting Agency
- §615(a)(2)(B) - Statement that Reporting Agency Did Not Make Credit Decision and Cannot Provide Specific Reasons for Action Taken
- §615(a)(3) - Provide the Consumer an Oral, Written, or Electronic Notice of the Consumer's Right to:
- §615(a)(3)(A) - Obtain Under §612, a Free Copy of Consumer Report from the Consumer Reporting Agency
- §615(a)(3)(B) - To Dispute, Under §611, with the Agency the Accuracy or Completeness of Information
- §615(b) - Adverse Action Based on Information from Third Parties Other Than Consumer Reporting Agencies
- §615(d) - Duties of Users Making Written Credit Solicitations Based on Information Contained in Consumer Files
- §615(e) - Red Flag Guidelines and Regulations Required to be Developed Jointly by the Federal Banking Agencies, the National Credit Union Administration, and the Commission
- §615(f) - Prohibition on Sale or Transfer of Debt Caused by Identity Theft
- §615(h) - Duties of Users in Certain Credit Transactions (Materially Less Favorable Terms Where Notice Not Required to be Given Under §615(a))

Examination Objectives

- Determine whether the institution makes the disclosures required of users of consumer reports when adverse action is based wholly or partly on information obtained from outside sources.
- Determine whether the institution's activities make it subject to the consumer reporting agency requirements of the FCRA, and, if so, ensure it is in compliance with those requirements.

Examination Procedures

The following procedures are provided to facilitate an evaluation of an institution's compliance with the FCRA. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC Fair Credit Reporting Act Exam Procedures

		Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	Examination Procedures			
1	Coordinate compliance examination activities			

MMC Fair Credit Reporting Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	with other members of the examination team and the examiner-in-charge (EIC). Emphasize identifying violations of law and regulation; integrate those findings with the examination; and conclude on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of the FCRA.			
3	Discuss with management the institution's activities related to collecting, reporting, supplying, and using credit information, and determine whether: a. The institution uses credit information obtained from credit bureaus or other outside sources in evaluating consumer credit applications; and b. The institution's activities make it subject to the consumer reporting agency requirements of the FCRA.			
4	If the institution uses information from credit bureaus or other outside sources in evaluating consumer credit applications, coordinate the testing for compliance with the testing of rejected applications, and determine that the institution makes the disclosures required by FCRA as users of credit information.			
5	Conclude whether the institution is adequately complying with the FCRA. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
6	Utilize discussions with managers, as needed, to gather information and discuss procedures and practices followed by institution personnel to ensure compliance with laws and regulations.			
7	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
8	Organize and compile, if necessary, violations of law and regulation into a Violation Summary			

MMC Fair Credit Reporting Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	Sheet.			

- [MMC Fair Credit Reporting Act Exam Procedures](#)

Fair Housing Act

Authority and Purpose

The [Fair Housing Act](#) (Title VIII of the Civil Rights Act of 1968, as amended) prohibits lenders from discriminating in making credit or other financial assistance available in residential real estate-related transactions because of race, color, religion, sex, handicap, national origin, or familial status (having one or more children under the age of 18). The term "residential real estate-related transactions" not only includes making loans or providing other financial assistance, but also purchasing loans secured by residential real estate, or extending credit for the purchase, construction, improvement, repair, or maintenance of a dwelling. The term also includes selling, brokering, or appraising residential real property. The prohibition against discrimination also applies to fixing the amount, interest rate, duration, or other terms or conditions of any residential real estate loan. In addition to the Fair Housing Act, residential real estate-related transactions are also subject to Housing and Urban Development (HUD) implementing regulations and, as credit transactions, the Equal Credit Opportunity Act (ECOA) which is implemented via Federal Reserve Board (FRB) Regulation B.

The purpose of the Fair Housing Act and ECOA is to forbid the imposition of different requirements and the use of standards that have a disparate effect on different borrowers. Neither the Fair Housing Act nor ECOA is intended to supplement or supplant the independent judgment of MMC institutions about what constitutes creditworthiness or sound economic practice in the credit marketplace. The MMC is fully committed to the enforcement of fair lending practices to eligible borrowers as an integral element of safety and soundness. Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce the Fair Housing Act over MMC institutions.

Applicability and Exemptions

The Fair Housing Act (FHAct) specifically applies to the financing of a loan secured by residential real estate. As noted in section 805 of the act, an institution may not deny a loan or other financial assistance for the purpose of

purchasing, constructing, improving, repairing, or maintaining a dwelling because of the race, color, religion, national origin, handicap, familial status, or sex of the

- Loan applicant,
- Any person associated with the loan applicant,
- Any current or prospective owner of the dwelling,
- Any lessees, or
- Any tenants or occupants.

The FHAct also makes it unlawful for a creditor to use a prohibited basis to discriminate in fixing the amount, interest rates, duration, or other terms of credit. In addition, because residential real estate–related transactions include any transactions secured by residential real estate, the Act’s prohibitions (and regulatory requirements in certain areas, such as advertising) apply to home equity lines of credit as well as loans to home purchase loans. These prohibitions also apply to the selling, renting, brokering, or appraising of residential real property and to secondary-mortgage-market activities. Consequently, a lender’s practices in the area of housing lending should be examined in a general way to ensure that they do not “otherwise make unavailable or deny” housing, even when no specific act or practice may violate any specifically named prohibition of the FHAct.

Exam Objectives

- Determine that policies, procedures, and internal controls have been established and implemented, and evaluate their adequacy to provide reasonable assurance of compliance with the nondiscrimination requirements of the Fair Housing Act.
- Evaluate the institution’s compliance with the regulatory requirements applicable to nondiscrimination in lending and housing.

Examination Procedures

The following procedures are provided to facilitate an evaluation of an institution’s compliance with the Fair Housing Act. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

Qualification

Examiners should begin the evaluation of an institution’s compliance with nondiscrimination regulations by determining whether:

1. The institution makes or purchases loans for the purchase, construction,

improvement, repair, or maintenance of a dwelling (rural residence);

2. The institution makes or purchases loans secured by residential real estate; or

3. The institution sells or appraises residential real property.

Examination

If the answers to all of the above are negative, then no further review is required for the purposes of evaluating compliance with the Fair Housing Act. However, if the answer to any of the above is affirmative, then examiners should consider the following procedures:

MMC Fair Housing Act Exam Procedures:

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasize identifying violations of law and regulation; integrate those findings with the examination; and conclude on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of the FHAct [Fair Housing Act].			
3	Through observation and interviews with management, determine whether it appears the institution's lending practices, especially those relative to residential lending, are discriminatory.			
4	Determine whether the institution is redlining (i.e., the practice of denying loans for housing in certain neighborhoods even though the individual applicant may be eligible for credit). (Remember that redlining is not unlawful when based on economic reasons such as whether an area lies on a fault line or in a flood plain.)			
5	Ascertain whether the institution has adequate policies, procedures, and internal controls in place to provide reasonable assurance of compliance with the nondiscriminatory regulations. Also, determine whether the policies are reviewed and updated periodically.			

MMC Fair Housing Act Exam Procedures:

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
6	Determine whether the institution prominently displays the Equal Housing Lender Poster in the lobby of each of its offices. Also, ascertain whether the size and text of the poster conform to the requirements of FCA Regulation 12 CFR § 613.3170.			
7	Determine whether the institution advertises the availability of rural residence loans. If so, determine whether advertisements include a facsimile of the Equal Housing Lender logotype and legend. Also, determine whether the advertisements are void of any words, phrases, symbols, directions, forms, or models that would express, imply, or suggest a discriminatory preference or policy of exclusion.			
8	Determine whether the institution rejected any loan applications. If so, ascertain whether those rejections were based solely on economic factors.			
9	Determine whether any complaints have been filed against the institution alleging discriminatory practices or acts. If so, ascertain their disposition.			
10	Conclude whether the institution is adequately complying with these nondiscriminatory regulations. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
11	Utilize discussions with managers as needed to gather information and discuss procedures and practices followed by institution personnel to ensure compliance with laws and regulations.			
12	Discuss items of concern, scope of work performed, and conclusions with the EIC			
13	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC Fair Housing Act Exam Procedures](#)

Real Estate Settlement Procedures Act

The [Real Estate Settlement Procedures Act of 1974](#) (RESPA) (12 USC §2601 *et seq.*) (The “Act”) became effective on June 20, 1975. The Act requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process. The Act also protects borrowers against certain abusive practices, such as kickbacks, and places limitations upon the use of escrow accounts. The Department of Housing and Urban Development (HUD) promulgated [Regulation X](#) (24 CFR §3500), which implements RESPA. The National Affordable Housing Act of 1990 amended RESPA to require detailed disclosures concerning the transfer, sale, or assignment of mortgage servicing. It also requires disclosures for mortgage escrow accounts at closing and annually thereafter, itemizing the charges to be paid by the borrower and what is paid out of the account by the servicer.

In October 1992, Congress amended RESPA to cover subordinate lien loans. HUD, however, decided not to enforce these provisions until Regulation X was amended to cover these loans. On February 10, 1994, Regulation X was amended to extend coverage to subordinate lien loans. The amendments were effective August 9, 1994. Exemptions from coverage of RESPA and Regulation X, set forth in section 3500.5(b), were effective March 14, 1994. Technical corrections and amendments to the rule were issued on March 30, 1994 and July 22, 1994.

On June 7, 1996, HUD amended Regulation X to clarify certain exemption provisions of RESPA, amend the controlled business disclosure requirements, and to address specific comments raised in the 1994 rule. These amendments became effective on October 7, 1996. Congress, when it enacted the Economic Growth and Regulatory Paperwork Reduction Act of 1996,¹ further amended RESPA to clarify certain definitions including “controlled business arrangement,” which was changed to “affiliated business arrangement.” The changes also reduced the disclosures under the mortgage servicing provisions of RESPA.

In 2008, HUD issued a RESPA Reform Rule (73 F.R. 68204, Nov. 17, 2008) that included substantive and technical changes to the existing RESPA regulations and different implementation dates for various provisions. Substantive changes included a standard Good Faith Estimate form and a revised HUD-1 Settlement Statement that are required as of January 1, 2010. Refer to [Supplement 3](#) for guidance on RESPA compliance for loans transferred before January 1, 2010. Technical changes, including streamlined mortgage servicing disclosure language, elimination of outdated escrow account provisions, and a provision permitting an “average charge” to be listed on the Good Faith Estimate and HUD-1 Settlement Statement, took effect on January 16, 2009. In addition, HUD clarified that all disclosures required by RESPA are permitted to be provided electronically, in accordance with the Electronic Signatures in Global and National Commerce Act (ESIGN).

Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce FRB Regulation X over MMC institutions.

To facilitate an understanding of FRB Regulation X, some of the pertinent provisions of the regulation for citation purposes are listed without explanation but can be referenced in the regulation itself. Note that this is a summary of the regulation and is not comprehensive.

General

Regulation X has a definitions section (§3500.2) and appendices with model forms. Official interpretations of the requirements of the Regulation are generally contained in HUD Mortgagee Letters, which can be found at the HUD website. However, HUD's "New RESPA Rule FAQs", also at the website, contains valuable information concerning changes to the regulation.

§3500.5, Coverage of RESPA

§3500.5(a) - Applies to all Federally Related Mortgage Loans (With Exemptions)

§3500.5(b) - Exemptions

§3500.5(b)(1) - Loan on Property of 25 Acres or More

§3500.5(b)(2) - Business Purpose Loans

§3500.5(b)(3) - Temporary Financing

§3500.5(b)(4) - Vacant Land (Unless Residence to be Constructed or Manufactured Home Placed within 2 Years)

§3500.5(b)(5) - Assumption without Lender Right to Approve

§3500.5(b)(6) - Loan Conversions (As Long as New Note Not Required)

§3500.5(b)(7) - Secondary Market Transactions

§3500.6, Special Information Booklet at Time of Loan Application

§3500.6(a) - Lender to Provide Special Information Booklet (With Exceptions)

§3500.6(a)(1) - Lender to Provide Unless Borrower Uses Broker, Timing, Exception

§3500.6(a)(2) - Requirements for Open-End Credit

§3500.6(a)(3) - Exceptions for Certain Types of Transactions

§3500.6(b) - Revision

§3500.6(c) - Reproduction

§3500.6(d) - Permissible Changes

§3500.7, Good Faith Estimate or GFE

§3500.7(a) - Lender to Provide

§3500.7(a)(1) - Within 3 Business Days of Receipt of Application or Information Sufficient to Complete Application

§3500.7(a)(2) - Delivery Methods

§3500.7(a)(3) - Denial or Withdrawal within 3 Business Days

§3500.7(a)(4) - Permissible Fees, No Fee as Condition for Issuing GFE, Timing of Fees, Delivery Date if Mailed

§3500.7(a)(5) - Collection of Information, No Verification of Information as Condition for Issuing GFE

§3500.7(b) - Broker to Provide

§3500.7(b)(1) - (Broker or Lender) Within 3 Business Days of Receipt of Application or Information Sufficient to Complete Application, Lender Responsible for Ascertaining Whether GFE Provided.

§3500.7(b)(2) - Delivery Methods

§3500.7(b)(3) - Denial (Broker or Lender) or Withdrawal within 3 Business Days

§3500.7(b)(4) - Permissible Fees, No Fee as Condition for Issuing GFE, Timing of Fees, Delivery Date if Mailed

§3500.7(b)(5) - Collection of Information, No Verification of Information as Condition for Issuing GFE

§3500.7(c) - Availability of GFE Terms (At Least 10 Business Days after Delivery, Exceptions)

§3500.7(d) - Content and Form of GFE (Appendix C)

§3500.7(e) - Tolerances for Amounts Included on GFE (Exceptions in §3500.7(f))

§3500.7(e)(1) - Zero Tolerance (Above, Can be Lower)

§3500.7(e)(1)(i) - The Origination Charge

§3500.7(e)(1)(ii) - While Borrower's Interest Rate is Locked, the Credit or Charge for the Interest Rate Chosen

§3500.7(e)(1)(iii) - While Borrower's Interest Rate is Locked, the Adjusted Origination Charge

§3500.7(e)(1)(iv) - Transfer Taxes

§3500.7(e)(2) - Ten Percent Tolerance (Above, Can be Lower) (Tolerance Applied to Sum of §3500.7(e)(2))

§3500.7(e)(2)(i) - Lender-Required Settlement Services (If Lender Selects Third Party Settlement Service Provider)

§3500.7(e)(2)(ii) - Lender-Required Services, Title Services and Required Title Insurance, and Owner's Title Insurance, When Borrower Uses Settlement Service Provider Identified by Loan Originator

§3500.7(e)(2)(iii) - Government Recording Charges

§3500.7(e)(3) - Charges for All Other Settlement Services on the GFE May Change at Settlement

§3500.7(f) - Loan Originator Bound to GFE Tolerances, Documentation of Revisions, Retention Period for Documentation

§3500.7(f)(1) - Changed Circumstances Affecting Settlement Costs, Timely Revision of GFE

§3500.7(f)(2) - Changed Circumstances Affecting Loan (Eligibility for Loan Terms), Timely Revision of GFE

§3500.7(f)(3) - Borrower-requested changes, Timely Revision of GFE

§3500.7(f)(4) - Expiration of Original GFE

§3500.7(f)(5) - Interest Rate Dependent Charges and Terms (Rate Locks and Rate Lock Expiration)

§3500.7(f)(6) - New Home Purchases (Anticipated Settlement in more than 60 Days)

§3500.7(g) - GFE is Not a Loan Commitment

§3500.7(h) - Home Equity Plans and Compliance with Regulation Z §226.5b

§3500.7(i) - Violations are Violations of Section 5 of RESPA, 30 Calendar Days to Cure Tolerance Violations

§3500.8, Use of HUD-1 or HUD-1A settlement statements

§3500.8(a) - Use by Settlement Agent (Broker or Lender Could be Settlement Agent)

§3500.8(b) - Charges to be Stated, Use of Appendix A, Originator to Transmit all Necessary Information

§3500.8(b)(1) - In General

§3500.8(b)(2)(i) - Average Charges and Total Amount Not to Exceed Average and Total Each Class of Transaction

§3500.8(b)(2)(ii) - Shall Define the Class of Transactions for Purposes of Calculating the Average Charge as all Transactions Involving Federally Related Mortgage Loans for:

§3500.8(b)(2)(ii)(A) - Period Not Less than 30 Calendar Days and Not More than 6 Months;

§3500.8(b)(2)(ii)(B) - Certain Geographic Area

§3500.8(b)(2)(ii)(C) - Certain Type of Loan

§3500.8(b)(2)(iii) - May Use Average in Same Class Calculated and Must Use for Every Transaction in Class

§3500.8(b)(2)(iv) - Average Charge Not Permitted if Charge Based on Loan Amount or Property Value (Examples)

§3500.8(b)(2)(v) - Retention Period for Documentation of Average Calculation

§3500.8(c) - No Violation if Revised Settlement Statement Issued within 30 Calendar Days

§3500.21, Reproduction of Settlement Statements

§3500.9(a) - Permissible Changes to HUD-1

§3500.9(a)(1) - May Insert Business Name and Logo in Section A, May Rearrange Other Section A Information

§3500.9(a)(2) - Lender and Settlement Agent Name, Address, and Other Information in Sections F and H

§3500.9(a)(3) - Lines 100-1400 Must Conform to Terminology, Sequence and Numbering of Line Items (Exceptions)

§3500.9(a)(4) - Insertion of Charges Not Listed on HUD-1

§3500.9(a)(5) - Variations in Layout and Format that do Not Require Prior HUD Approval

§3500.9(a)(6) - Borrower's Information and Seller's Information May be Provided on Separate Pages

§3500.9(a)(7) - Signature Lines May be Added

§3500.9(a)(8) - May be Translated into Languages Other Than English

§3500.9(a)(9) - Customary Recitals and Information Used Locally in Real Estate Settlements May be Added or Attached (Examples)

§3500.9(a)(10) - As Required by HUD/FHA in FHA-Insured Loans

§3500.9(a)(11) - As allowed by §3500.17, Relating to an Initial Escrow Account Statement

§3500.9(b) - Permissible Changes to HUD-1A Same as §3500.9(a) Except §3500.9(a)(3) and §3500.9(a)(6)
§3500.9(c) - Any Other Changes to HUD-1 or HUD-1A Permissible Only With Written Approval

One Day Advance Inspection of HUD-1 or HUD-1A Settlement Statement, Delivery; Recordkeeping

§3500.10(a) - Inspection One Day Prior to Settlement upon Request by the Borrower
§3500.10(b) - Delivery
§3500.10(c) - Borrower May Waive the Right to Delivery
§3500.10(d) - Exempt Transactions
§3500.10(e) - Recordkeeping

§3500.11, Mailing

§3500.12, No fee for Preparation and Distribution of Settlement Statement, Escrow Account Statements, or Statements Required by the Truth in Lending Act

§3500.14, Prohibition against Kickbacks and Unearned Fees

§3500.14 (a) - Violation of Subject to Enforcement under §3500.19
§3500.14(b) - No Referral Fees
§3500.14(c) - No Split of Charges Except for Actual Services Performed
§3500.14(d) - The Term "payment" Used in §3500.14 and §3500.15 as Synonymous with Giving or Receiving of "Thing of Value" and Does Not Require Transfer of Money
§3500.14(e) - Agreement for Referral Relating to Settlement Service Need Not be Written or Verbalized
§3500.14(f)(1) - Referral Includes Oral or Written Action Which Affirmatively Influences Selection
§3500.14(f)(2) - Also Referral When Person Required to Particular Provider
§3500.14(g)(1) - Permitted Payments:
§3500.14(g)(1)(i) - Payment to Attorney for Services Actually Rendered;
§3500.14(g)(1)(ii) - Title Institution Payment to Agent for Services Actually Performed in Issuing Title Insurance
§3500.14(g)(1)(iii) - Lender Payment to Agent or Contractor for Services Actually Performed in the Origination, Processing, or Funding of a Loan;
§3500.14(g)(1)(iv) - Payment of Salary or Compensation or Other Payment for Goods or Facilities Actually Furnished or for Services Actually Performed;
§3500.14(g)(1)(v) - Real Estate Brokerage Fees;
§3500.14(g)(1)(vi) - Fees for Promotional and Educational Activities Not Conditioned on Referral of Business and That do Not Involve the Defraying of Expenses; or
§3500.14(g)(1)(vii) - Employer's Payment to Own Employees for Referral Activities
§3500.14(g)(2) - Basis for Investigation of Fees, Relationship to Services Performed, May be Prohibited with No Increase in Charge

§3500.14(g)(3) - Payment for Multiple Services

§3500.14(h) - Recordkeeping

§3500.14(i) - Appendix B Demonstrates Some of the Requirements of this Section.

§3500.15, Affiliated Business Arrangements

§3500.15(a) - The term "affiliated business arrangement" means an arrangement in which (A) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and (B) either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.

§3500.15(b) - Affiliated Business Arrangement Not Violation if Conditions Satisfied

§3500.15(b)(1) - Prior to Making Referral Person Provides Affiliated Business Arrangement Disclosure Statement

§3500.15(b)(1)(i) - Where a Lender Makes Referral May Give Disclosure with GFE

§3500.15(b)(1)(ii) - When Attorney Requires Use of a Particular Title Insurance Agent, Disclosures no Later than When Attorney is Engaged

§3500.15(b)(2) - Person Making Referral has not Required the Use of any Particular Provider Except

- Lender, for requiring a buyer, borrower or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender or
- Attorney or law firm for arranging for issuance of a title insurance policy for a client, directly as agent or through a separate corporate title insurance agency that may be operated as an adjunct to the law practice of the attorney or law firm, as part of representation of that client in a real estate transaction.

§3500.15(b)(3) - Only Payment from the Arrangement is Listed in §3500.14(g) or is a Return on Ownership Interest or Franchise Relationship

§3500.15(b)(3)(i) - In an Affiliated Business Arrangement:

§3500.15(b)(3)(i)(A) - Capital or Equity Distributions from Ownership or Franchise Relationship

§3500.15(b)(3)(i)(B) - Business Loans and Capital or Equity Contributions for Ordinary Business Purposes

§3500.15(b)(3)(ii) - Return on Ownership Does Not Include:

§3500.15(b)(3)(ii)(A) - Payment With no Basis of Calculation or Apparent Business Motive Other Than Amount of Actual, Estimated or Anticipated Referrals;

§3500.15(b)(3)(ii)(B) - Payment Varying According to Relative Amount of Referrals among Recipients; or

§3500.15(b)(3)(ii)(C) - Payment on Ownership Share Which has been Adjusted on the Basis of Previous Relative Referrals among Recipients

§3500.15(b)(3)(iii) - Whether Payment Return on Ownership Determined on Case-by-Case Basis

§3500.15(b)(3)(iv) - Franchise Relationship Payment Must be According to Franchise Agreement and May Not Vary on the Basis of Previous Amount of Referrals

§3500.15(c) - Definitions as Used in This Section:

§3500.15(c)(1) - Associate

§3500.15(c)(2) - Affiliate Relationship

§3500.15(c)(3) - Beneficial Ownership

§3500.15(c)(4) - Control as Used in the Definitions of "Associate" and "Affiliate Relationship"

§3500.15(c)(5) - Direct Ownership

§3500.15(c)(6) - Franchise is Defined in 16 CFR 436.2(a)

§3500.15(c)(7) - Franchisor is Defined in 16 CFR 436.2(c)

§3500.15(c)(8) - Franchisee Defined in 16 CFR 436.2(d)

§3500.15(c)(9) - Person who is in a Position to Refer Settlement Service Business

§3500.15(d) - Recordkeeping

§3500.15(e) - Illustrations in Appendix B of this Part Demonstrate Some of the Requirements of This Section

§3500.17, Escrow Accounts

§3500.17(a) - General

§3500.17(b) - Definitions, as Used in This Section:

- Aggregate Analysis
- Annual Escrow Account Statement
- Cushion
- Deficiency
- Delivery
- Disbursement Date
- Escrow Account
- Escrow Account Analysis
 - Determine the appropriate target balances;
 - Compute the borrower's monthly payments for the next escrow account computation year and any deposits needed to establish or maintain the account; and
 - Determine whether shortages, surpluses or deficiencies exist.
- Escrow Account Computation Year
- Escrow Account Item Or Separate Item
- Initial Escrow Account Statement
- Installment Payment
- Payment Due Date
- Penalty
- Pre-Accrual
- Shortage
- Single-Item Analysis
- Submission (Of An Escrow Account Statement)
- Surplus

- System Of Recordkeeping
- Target Balance
- Trial Running Balance

§3500.17(c) - Limits on Payments to Escrow Accounts

§3500.17(c)(1) - Limit on Amount Required by Servicer (or Lender) to be Deposited into Escrow Account in Connection with a Federally Related Mortgage Loan:

§3500.17(c)(1)(i) - Charges at Settlement or Upon Creation of Escrow Account

§3500.17(c)(1)(ii) - Charges During Life of Escrow Account

§3500.17(c)(2) - Escrow Analysis at Creation of Escrow Account

§3500.17(c)(3) - Subsequent Escrow Account Analyses

§3500.17(c)(4) - Aggregate Accounting Required

§3500.17(c)(5) - Cushion

§3500.17(c)(6) - Restrictions on Pre-Accrual

§3500.17(c)(7) - Servicer Estimates of Disbursement Amounts

§3500.17(c)(8) - Provisions in Mortgage Documents

§3500.17(c)(9) - Assessments for Periods Longer than One Year

§3500.17(d)(1) - Methods of Escrow Account Analysis (Analysis Gives Maximum Balance)

§3500.17(d)(2)(i) - Target Balances May Not Exceed Balances Computed Using the Following Operations:

§3500.17(d)(2)(i)(A) - Project a Trial Running Balance Over the Next Computation Year (Assuming 12 Payments)

§3500.17(d)(2)(i)(B) - Adds to First Monthly Balance Amount Sufficient so the Lowest Monthly Balance is Zero (Adjust Other Monthly Balances Accordingly)

§3500.17(d)(2)(i)(C) - Adds to Cushion to Monthly Balances (Cushion Usually Two Months Escrow Payments)

§3500.17(d)(2)(ii) - Lowest Monthly Balance Usually Maximum of One Sixth Annual Escrow Payments (Appendix E Illustrates Steps)

§3500.17(e) - Transfer of Servicing

§3500.17(e)(1) - If New Servicer Changes Payment or Accounting Method Then Must Provide New Initial Escrow Statement Within 60 Days.

§3500.17(e)(1)(i) - If New Servicer Gives New Initial Escrow Statement Effective Date of Transfer Becomes Beginning of New Computation Year

§3500.17(e)(1)(ii) - No Changes in Payment or Accounting Method, New Servicer May Use Old Computation Year or Establish New Year with a Short-Year Statement, New Servicer to Provide Annual Escrow Account Statement

§3500.17(e)(2) - New Servicer to Follow §3500.17(f) Regarding Shortages, Surpluses and Deficiencies in Transferred Account

§3500.17(f) - Shortages, Surpluses, and Deficiencies Requirements

§3500.17(f)(1) - Escrow Account Analysis

§3500.17(f)(1)(i) - Upon Establishing Escrow Account and at Completion of Escrow Account Computation Year

§3500.17(f)(1)(ii) - If Shortage after Disbursement and Disbursement Not Result of Borrower Payment Default

§3500.17(f)(2) - Surpluses

§3500.17(f)(3) - Shortages (Less than Target Balance)

§3500.17(f)(4) - Deficiency (Amount of a Negative Balance)

§3500.17(f)(5) - Notice of Shortage or Deficiency in Escrow Account
§3500.17(g) - Initial Escrow Account Statement
§3500.17(g)(1) - Submission at Settlement, or Within 45 Calendar Days of Settlement
§3500.17(g)(1)(i) - Contents of Initial Escrow Account Statement
§3500.17(g)(1)(ii) - Initial Statement as Part of Settlement Statement or As Separate Document
§3500.17(g)(2) - Time of Submission for Escrow Account Established After Settlement
§3500.17(h) - Format for Initial Account Statement
§3500.17(i) - Annual Escrow Account Statements
§3500.17(i)(1) - Contents of Annual Escrow Account Statement
§3500.17(i)(1)(i) - Amount of Current Monthly Mortgage Payment and Portion Going to Escrow
§3500.17(i)(1)(ii) - Amount of Past Year's Monthly Mortgage Payment and Portion That Went to Escrow
§3500.17(i)(1)(iii) - Total Paid to Escrow During the Past Computation Year
§3500.17(i)(1)(iv) - Itemization of Amounts Paid From Escrow Over Same Period
§3500.17(i)(1)(v) - Ending Balance
§3500.17(i)(1)(vi) - Explanation of How Any Surplus is Being Handled
§3500.17(i)(1)(vii) - Explanation of How Any Shortage or Deficiency to be Paid
§3500.17(i)(1)(viii) - If applicable, Why Estimated Low Monthly Balance Not Reached
§3500.17(i)(2) - No Annual Statements in the Case of Default, Foreclosure, or Bankruptcy
§3500.17(i)(3) - May Deliver With Other Material
§3500.17(i)(4) - Short Year Statements
§3500.17(i)(4)(i) - Effect of Short Year Statement
§3500.17(i)(4)(ii) - Short Year Statement upon Servicing Transfer
§3500.17(i)(4)(iii) - Short Year Statement upon Loan Payoff
§3500.17(j) - Formats for Annual Escrow Account Statement
§3500.17(k)(1) - Servicer Must Make Timely Payments (Borrower Not Over 30 Days Past Due)
§3500.17(k)(2) - Servicer Must Advance Funds to Make Timely Payments (Deficiency)
§3500.17(k)(3) - Property Tax Payments (Installment of Annual)
§3500.17(k)(4) - Agreement to Different Disbursement of Property Tax Payments than Required by §3500.17(k)(3)
§3500.17(l) - System of Recordkeeping
§3500.17(l)(1) - Easily Retrievable, Contents of Records
§3500.17(l)(2) - Retention of Records
§3500.17(l)(3) - Investigations
§3500.17(l)(4) - Borrower Information Requests
§3500.17(l)(5) - Failure to Timely Reply to Regulator Request Relating to Whether Servicer Submitted Escrow Statement to Borrower is Considered Evidence of Failure to Submit the Statement to the Borrower
§3500.17(m) - Penalties
§3500.17(n) - Civil Penalties Procedures

§3500.17(o) - Borrower's Discretionary Payment (Such as Credit Life or Disability Insurance)

§3500.21, Mortgage Servicing Transfers

§3500.21(a) - Definitions, as Used in This Section:

- Master servicer
- Mortgage servicing loan
- Qualified written request
- Subservicer
- Transferee servicer
- Transferor servicer

§3500.21(b) - Servicing Disclosure Statement; Requirements

§3500.21(b)(1) - Format (Appendix MS-1)

§3500.21(b)(2) - Servicing Disclosure Statement Contents

§3500.21(c) - Servicing Disclosure Statement; Delivery

§3500.21(d) - Notices of Transfer; Loan Servicing

§3500.21(d)(1) - Requirement for Notice

§3500.21(d)(1)(i) - Each Transferor and Transferee Servicer Shall Deliver a written Notice of Transfer, Exceptions:

§3500.21(d)(1)(i)(A) - Transfers Between Affiliates

§3500.21(d)(1)(i)(B) - Transfers Resulting From Mergers or Acquisitions of Servicers or Subservicers

§3500.21(d)(1)(i)(C) - Transfers Between Master Servicers, Where the Subservicer Remains the Same

§3500.21(d)(1)(ii) - FHA is not Required to Deliver a Notice of Transfer Where Insured Mortgage Assigned to FHA

§3500.21(d)(2) - Time of Notice

§3500.21(d)(3) - Notices of Transfer; Contents

§3500.21(d)(3)(i) - Effective Date of the Transfer of Servicing

§3500.21(d)(3)(ii) - Contact Information for Transferee Servicer

§3500.21(d)(3)(iii) - Toll-Free or Collect-Call Telephone Number for Transferor Servicer

§3500.21(d)(3)(iv) - Date Transferor Servicer Will Stop Accepting Payments and Date New Servicer Will Begin (Must be Same or Consecutive Days)

§3500.21(d)(3)(v) - Effect on Optional Insurance and Actions Borrower Must Take to Continue Coverage

§3500.21(d)(3)(vi) - Statement that Transfer Affects Only Terms Directly Related to Servicing

§3500.21(d)(3)(vii) - Statement of Borrower's Rights in Complaint Resolution

§3500.21(d)(4) - Sample Notice in Appendix MS-2 (Minor Modifications May Be Made)

§3500.21(d)(5) - Consumer Protection During Transfer of Servicing

§3500.21(e) - Duty of Loan Servicer to Respond to Borrower Inquiries

§3500.21(e)(1) - Notice of Receipt of Inquiry

§3500.21(e)(2) - Qualified Written Request; Defined

§3500.21(e)(3) - Action With Respect to the Inquiry

§3500.21(e)(4) - Protection of Credit Rating

§3500.21(f) - Damages and Costs

§3500.21(f)(1) - Whoever Fails to Comply Shall be Liable to Borrower for Each Failure in the Following Amounts:

§3500.21(f)(1)(i) - Individuals

§3500.21(f)(1)(ii) - Class Actions

§3500.21(f)(1)(iii) - Costs

§3500.21(f)(2) - Nonliability

§3500.21(g) - Timely Payments by Servicer

§3500.21(h) - Preemption of State Law

Examination Objectives

- Determine that policies, procedures, and internal controls have been established and evaluate their adequacy to provide reasonable assurance of compliance with the requirements of Regulation X.
- Evaluate adherence to established policies, procedures, and internal control guidelines.

Examination Procedures

The following procedures (also included as Appendix 8) are provided to facilitate an evaluation of an institution's compliance with RESPA. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC HUD Regulation X - Real Estate Settlement Procedures Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasize identifying violations of law and regulation; integrate those findings with the examination; and conclude on management's compliance with law and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of RESPA.			
3	Determine whether the institution provides an applicant with a copy of the Booklet within 3 business days after receiving a written application for a federally related mortgage loan.			
4	Ascertain whether the institution provides an			

MMC HUD Regulation X - Real Estate Settlement Procedures Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	applicant with a Good Faith Estimate of settlement costs within three business days following the written application.			
5	Determine whether Good Faith Estimates provided to applicants bear a reasonable relationship to the charges the applicant will likely be required to pay or the applicant has incurred at settlement.			
6	Where the institution requires that a particular individual, firm, or institution be used to provide legal services, title examination services, or title insurance, or to conduct settlement, and requires the borrower to pay for any portion of the cost of such services, determine whether the Good Faith Estimates: a. Clearly indicate which estimated charge is to be provided by each designated provider; b. State the name, address, and telephone number of each designated provider and the fact the institution's estimate for the services is based upon the charges of the designated provider and c. State whether each designated provider has a business relationship with the institution.			
7	Ascertain whether the person conducting settlement also prepares the HUD-1 or HUD-1A settlement statement.			
8	Determine whether the institution permits the borrower, upon request, to inspect the HUD-1 or HUD-1A settlement statement one business day prior to the day of settlement.			
9	Determine whether the institution prepares the HUD-1 or HUD-1A settlement statement in accordance with Appendix A of the regulation.			
10	Unless waived or exempt, determine whether the HUD-1 or HUD-1A was delivered or mailed to the borrower and seller or their agents at or before settlement.			
11	Determine whether the institution retains a copy of the HUD-1 or HUD-1A settlement statement			

MMC HUD Regulation X - Real Estate Settlement Procedures Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	for 5 years from the date of settlement.			
12	Determine whether the institution refrains from charging a fee for the preparation and distribution of the HUD-1 or HUD-1A settlement statement or documents required under the Truth in Lending Act.			
13	Determine whether the institution provides applicants information about the likelihood that their mortgage servicing will be transferred.			
14	Determine whether the institution notifies borrowers in writing not less than 15 days before a mortgage servicing transfer becomes effective.			
15	Determine whether the institution is aware of and in compliance with the prohibitions against kickbacks and unearned fees.			
16	If the institution owns the property being sold, ascertain whether it requires title insurance or gives the impression that title insurance is required from a particular institution.			
17	Conclude whether the institution is adequately complying with RESPA. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
18	Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution's personnel to ensure compliance with law and regulations.			
19	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
20	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC RESPA Exam Procedures](#)

USA Patriot Act of 2001

Authority and Purpose

The [USA Patriot Act](#) (USAPA) signed into law on October 26, 2001, established new and enhanced measures to prevent, detect, and prosecute money laundering and terrorism. The regulation implementing section 326 of the Act requires each financial institution to implement a written Customer Identification Program (CIP) that includes certain minimum requirements and is appropriate for its size and type of business.

Applicability and Exemptions

Section 326 influences the duties placed upon mortgage lenders and mortgage brokers. Specifically, the law requires financial institutions, such as banks to implement what is known as a Customer Identification Program.

Section 326 of the USAPA and the CIP Implementing regulations found at 31 CFR 103.121, et seq., apply to banks, credit unions, and a broad range of other financial entities such as securities dealers, insurance companies, and check-cashers. These “financial institutions” include real estate closing or settlement agents, and loan or finance companies, See 31 USC 5312(a)(2); as well as, any person or entity acting as their agent (i.e. through the delegation of authority, such as when a mortgage broker sells a loan to a mortgage lender).

Financial institutions are required to implement a risk-based CIP that includes four minimum requirements. The CIP must be in writing and implemented as an integral part of the Institution Secrecy Act and Anti-Money Laundering programs within the financial institution. Secondly, the CIP will apply to all customer “accounts”, but not infrequent or occasional interactions such as check cashing or the sale of money orders, 31 CFR 103.121(a)(1). Thirdly, the CIP will be triggered anytime an individual or entity “customer” opens a new account with the financial institution. Existing customers who open a “new” account probably will not trigger the CIP provisions if the financial institution can form a reasonable belief that it knows the true identity of the customer, 31 CFR 103.121(a)(3). Lastly, financial institutions will not be required to verify the identity of account signatories.

There are four minimum requirements of a financial institutions’ CIP:

1. Create identity verification procedures,
2. Properly document the identity verification,
3. Provide notice to the customer, and
4. Compare verified identities with government lists.

Identity Verification Procedures

A financial institution’s CIP entails more than making a copy of a customer’s driver’s license. First, the customer must provide identifying information. Again, the financial institution must be able to form a “reasonable belief” that it knows the true identity of the customer, 31 CFR 103.121(b)(2). What is reasonable will vary based on many factors; such as, the types of accounts offered, the method

of opening an account (face-to-face or electronically), and the type of information available at the time of the encounter.

A CIP must outline the identifying information that new customers must be required to provide prior to establishing the new account and at a minimum, should include:

For Individuals:

- The full name,
- Date of birth,
- Residential or business street address, and
- Identification number.

Identification number generally means the IRS “Taxpayer Identification Number” associated with the customer such as a social security number for individuals, See 31 CFR 103.121(b)(2)(I)(A).

Once the financial institution obtains customers identifying information, the next step must be to verify the information within a reasonable amount of time after the account is opened. Generally, verification will occur by the use of documentary evidence; such as, driver’s licenses and passports for individuals. The authenticity of that document should be considered; any evidence of fraud or other indications that the document is not authentic; such as, document alterations or impersonations should be considered as well.

There is no absolute set of policies or procedures set forth under this law and no implementing regulations. A financial institution may undertake “non-documentary” methods of verification; such as, contacting the customer outside of the institution, checking references at other institutions or third party sources, or using software or other technology related solutions as needed.

Identity Verification Documentation

Otherwise known as the “record-keeping requirement”, a financial institution must keep a minimum of identifying information (name, date of birth, address, and TIN) for five years after the account is closed. All other information obtained must be retained for five years after the record is created. This other information must contain at least the following:

- A description of any document used to verify the customer identity, noting the type of document; the document identification number; the place of issuance; the date of issuance; and the document expiration date;
- A description of the methods and results of non-documentary measures used to verify identity, if any; and
- A description of any substantive discrepancy between the information provided by the customer and that found in identifying methods with notations as to how the discrepancy was resolved.

31 CFR 103.121(b)(3). Section 326 and the implementing regulations do not require financial institutions to keep copies of documents used to verify identity, such as, the driver's license or passport of the customer.

Notice to Customers

All CIP's must include procedures for providing customers with adequate notice that the financial institution is requesting information from them in order to verify their identity. This notice may be given to the customer individually, or in a manner reasonably designated to ensure that the customer is likely to view it (i.e. a sign in the lobby of the financial institution). In 31 CFR 103.121(b)(5), sample language is provided for financial institutions, as follows: IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, we will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

Compare Verified Identities with Government Lists

The fourth minimum requirement for the CIP program is to include procedures for determining whether a customer appears on any federal government list of known or suspected terrorist organizations. It is anticipated that most federal government agencies will utilize the Department of Treasury as the single source of information relating to the creation, compilation, and distribution of a "Section 326" list of suspected individuals for use by the financial institutions. Of course, this is viewed by many as an extremely burdensome requirement of the CIP, and most large financial institutions implement software based solutions to this required task.

Examination Objectives

- Determine that policies, procedures, and internal controls have been established and implemented, and evaluate their adequacy to provide reasonable assurance of compliance with the USAPA.

Examination Procedures

Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC is responsible for enforcing compliance with the USA Patriot Act of 2001.

The following procedures are provided to facilitate the evaluation of an institution's compliance with the Act. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC USA Patriot Act of 2001- Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasize identifying violations of law and regulation; integrate those findings with the examination; and draw conclusions on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of the USAPA.			
3	Determine if the institution has implemented a written risk-based CIP that includes four minimum requirements: 1. Identity verification procedures, 2. Properly document the identity verification, 3. Provide notice to the customer, and 4. Compare verified identities with government lists.			
4	Assess application of CIP.			
5	Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution's personnel to ensure compliance with laws and regulations.			
6	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
7	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC USA Patriot Act of 2001 Exam Procedures](#)

Gramm-Leach-Bliley Act

Authority and Purpose

The [Financial Modernization Act of 1999](#), also known as the "Gramm-Leach-Bliley Act" (GLB), includes provisions to protect consumers' personal financial information held by financial institutions. There are three principal parts to the privacy requirements: the Financial Privacy Rule, Safeguards Rule and pretexting provisions.

The GLB gives authority to eight federal agencies and the states to administer and enforce the Financial Privacy Rule and the Safeguards Rule. These two regulations apply to "financial institutions," which include not only banks, securities firms, and insurance companies, but also, companies providing many other types of financial products and services to consumers. Among these services are lending, brokering or servicing any type of consumer loan, transferring or safeguarding money, preparing individual tax returns, providing financial advice or credit counseling, providing residential real estate settlement services, collecting consumer debts and an array of other activities.

The Financial Privacy Rule governs the collection and disclosure of customers' personal financial information by financial institutions. It also applies to companies, whether or not they are financial institutions, who receive such information.

The Safeguards Rule requires all financial institutions to design, implement and maintain safeguards to protect customer information. The Safeguards Rule applies not only to financial institutions that collect information from their own customers, but also, to financial institutions "such as credit reporting agencies" that receive customer information from other financial institutions.

The pretexting provisions of the GLB protect consumers from individuals and companies that obtain their personal financial information under false pretenses, a practice known as "pretexting."

Applicability and Exemptions

The law applies to banks, brokerage firms, tax preparation companies, insurance companies, consumer credit reporting agencies and a wide variety of other financial services firms. The primary focus of the GLB is the protection of customer's personal financial information.

- **Section 6801** - Regulated organizations must insure the security and confidentiality of customer records and information.
- In **Section 6801** the law requires that access to all customer records be carefully controlled to prevent substantial harm or inconvenience to any customer.
- Any storage location that contains sensitive customer information must be protected by **strong access control** and **secure passwords**.

- In Section **6801 (b)(1)** companies must ensure that email messages are kept secure and encrypted when being transmitted over a link.
- Sensitive customer information must be **protected** in case of physical disaster or technological failure.

Examination Objectives

- Insure the security and confidentiality of customer records and information.
- Determine that the institution has established an adequate written information security program.
- Assess the quality of the institution's compliance management policies and procedures for implementing the privacy and safeguard regulations; specifically, ensure consistency between what the institution discloses to consumers in its notices about its policies and procedures and what the institution actually practices.

Examination Procedures

Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce the GLB Act over MMC institutions.

The following procedures are provided to facilitate an evaluation of an institution's compliance with the Act. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC Gramm-Leach-Bliley Act- Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Review and evaluate the adequacy of the institution's policies, procedures, practices, and internal controls to ensure compliance with the requirements of the GLB Act. Determine whether the institution's internal review process tests for compliance in these areas. If it does not, or if the review indicated areas of weakness, complete the following steps as necessary to determine compliance with the GLB Act.			
2	Evaluate management information systems, including the use of technology for monitoring, exception reports, and standardization of forms and procedures.			
3	Determine frequency and effectiveness of			

MMC Gramm-Leach-Bliley Act- Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	monitoring procedures.			
4	Evaluate adequacy and regularity of the institution's training program.			
5	Suitability that the compliance audit program provides for ensuring customer information: – the procedures address all regulatory provisions as applicable; – the work is accurate and comprehensive with respect to the institution's information sharing practices; – the frequency is appropriate; – conclusions are appropriately reached and presented to responsible parties; and – steps are taken to correct deficiencies and to follow-up on previously identified deficiencies.			
6	Determine knowledge level of management and personnel of the GLB.			
7	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
8	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC GrammlB Exam Procedures](#)

Home Ownership Protection Act

Authority and Purpose

The [Homeowners Protection Act of 1998](#) (Act) offers borrowers who secure loans with their primary homes three rights related to private mortgage insurance: disclosure, cancellation, and automatic termination. The Act requires lenders to inform mortgage borrowers of their rights under the Act. Also, the Act allows borrower-initiated cancellation of private mortgage insurance (PMI) and requires its termination by the lender when the borrower has accumulated a certain equity level in the home. The Act also requires special disclosures to borrowers who have existing mortgages on the effective date of the Act and to borrowers of loans carrying lender-paid PMI.

Applicability and Exemptions

The Act covers all lenders that grant "residential mortgages." A residential mortgage is defined as a mortgage, loan or other evidence of a security interest

created with respect to a *single-family dwelling* that is the primary residence of the borrower. A single-family dwelling is a residence consisting of one family dwelling unit. The Act also requires lenders that refinance or service home mortgages to comply with its terms. All the Act's terms apply to servicers except those relating to loan closing.

The Act covers adjustable-rate and fixed-rate home mortgages on primary residences. It does not cover loans secured by second homes or multifamily homes. Most provisions of the Act do not apply to home loans made before July 29, 1999 or to mortgages where the lender pays the mortgage insurance. However, special disclosure rules do apply to loans in these categories.

Examination Objectives

- Determine that institutions have established adequate policies, procedures, and internal controls to provide reasonable assurance of compliance with the Act.

Disclosures for Home Loans Closed on or After July 29, 1999

Disclosures Required at Loan Closing

Fixed-rate Mortgages — At loan closing for a fixed-rate mortgage, the lender must provide an initial amortization schedule with a written notice stating:

- the cancellation date, and
- the automatic termination date.

Cancellation Date - The cancellation date is the date the borrower may seek to cancel PMI and is based on the amortization schedule. The borrower may seek cancellation when the loan-to-value ratio reaches 80 percent of the original value of the property securing the loan. The disclosure must state that the borrower may accelerate the cancellation date by making additional payments that bring the loan-to-value ratio to 80 percent. However, the borrower's right to cancel PMI is limited by other rules, which are explained below.

Automatic Termination Date - The automatic termination date is the date the lender must terminate PMI, even if the borrower does not request termination. This date is based on the initial amortization schedule. A lender must terminate PMI when the loan-to-value ratio reaches 78 percent, provided the borrower is current on payments.

Adjustable-rate Mortgages — At loan closing for an adjustable-rate mortgage, the lender must provide borrowers with written notice explaining:

- their right to cancel PMI on the cancellation date, and

-
- the lender's duty to terminate PMI on the automatic termination date.

Cancellation Date - Congress recognized that at the closing of an adjustable-rate loan, a lender cannot adequately forecast the date on which the loan-to-value ratio will reach 80 percent. Thus, the notice must explain that (a) the borrower may seek to cancel PMI when the loan-to-value ratio reaches 80 percent, and (b) the lender will contact the borrower when the loan reaches that ratio. The disclosure must also state that the borrower may accelerate cancellation based on actual payments. However, as with fixed-rate mortgages, the borrower's right to cancel PMI is limited by other rules, which are explained below.

Automatic Termination Date - The lender must disclose that it will terminate PMI automatically when the loan-to-value ratio reaches 78 percent, provided the borrower is current on payments.

Disclosures Required After Loan Closing

There are five additional disclosure requirements after loan closing. The lender must:

Provide an annual statement: The lender must provide an annual statement detailing the borrower's cancellation and termination rights under the Act, including the address and telephone number of a contact person. The annual notice may be given as part of the annual escrow account statement required under the Real Estate Settlement Procedures Act (RESPA) or as part of the disclosure of interest payments required by the Internal Revenue Service. The Act permits the use of standardized forms for this purpose.

Inform the borrower when an adjustable-rate loan reaches the cancellation date: At the time of loan closing, it is difficult to predict when an adjustable-rate loan will reach its cancellation date. Thus, the lender must provide notice once the cancellation date has been reached. This rule applies only to borrowers with adjustable-rate mortgages because those with fixed-rate mortgages receive notice of their cancellation date in their initial disclosure documents.

Inform the borrower when the loan has reached the cancellation date based on actual payments: If a borrower accelerates repayment of the loan, the lender must notify the borrower when the loan reaches the cancellation date. This rule applies to both fixed- and adjustable-rate mortgages.

Disclose the reasons for denying a borrower's cancellation request or not granting automatic termination: A lender may deny a borrower's request to cancel PMI or refuse to terminate PMI. The rules vary for each action. When a lender denies a cancellation request, it must send written notice of the grounds for denial to the borrower. A lender may deny a borrower's written request for cancellation if the borrower lacks a "good payment history," fails to prove that the home's value has not depreciated, or fails to certify that it is unencumbered by a subordinate lien. A lender may refuse to automatically terminate PMI if the

borrower is not current on payments.

When a lender denies a borrower's request to cancel PMI, it must send the notice of denial not later than 30 days after the borrower's request or the borrower's satisfaction of the lender's evidence or certification requirements, whichever is later. If a lender refuses to terminate PMI on the termination date, it must send the borrower written notice of the grounds for refusal not later than 30 days after the termination date.

Provide notice to the borrower on cancellation or termination of PMI: Borrowers must be notified by the lender of cancellation or termination of PMI not later than 30 days after it occurs. The mortgage insurer then has 30 days to return any unearned premiums to the lender, who then has 45 days to return them to the borrower.

Disclosures for Home Loans Closed Before July 29, 1999

The Act's cancellation, automatic termination, or final termination protections do not extend to borrowers who entered into mortgages before the effective date of July 29, 1999. However, the Act does require lenders to provide these borrowers an annual notice that PMI may be canceled in certain circumstances and an address and telephone number that the borrower may use to inquire about canceling PMI. The Act does not preempt state laws offering greater protections for cancellation and termination of PMI; therefore, the annual notice should include disclosure of a borrower's right under applicable state law. Finally, the lender's policy on cancellation or termination of PMI should also be disclosed in the annual notice. This annual notice may be given as part of an annual escrow account statement required under RESPA or as part of the disclosure of interest payments required by the Internal Revenue Service. The Act permits the use of standardized forms for this purpose.

Disclosures for Loans with Lender-paid PMI

Lender-paid PMI is not subject to any cancellation or termination rules of the act, and the disclosure requirements vary. Before or on the date of loan closing, the lender must provide the borrower written notice detailing the differences between lender- and borrower-paid PMI. The lender must also send written notice to the borrower not later than 30 days from the date PMI would have been terminated under the Act had it been borrower-paid. This notice must include a statement that the borrower may wish to review financing choices that could eliminate the need for lender-paid PMI.

Cancellation of PMI

A lender must cancel a borrower's PMI when all of the following occur:

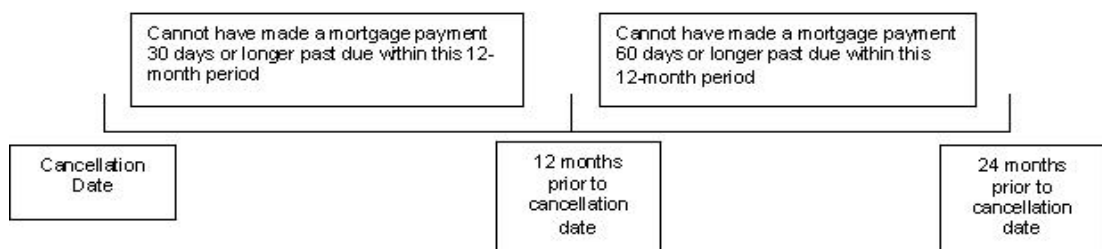
- The borrower's loan-to-value ratio reaches 80 percent;
- The borrower makes a written request;

- The borrower provides, upon the lender's request, information showing that the property has not declined in value and is not encumbered by any subordinate lien; and
- The borrower has a good payment history.

Upon receiving a borrower's written request for cancellation, a lender may require the borrower to prove that the property securing the mortgage has not declined in value and is unencumbered by any subordinate lien. If the property has depreciated or is subject to a subordinate lien, the Act does not compel the lender to cancel the PMI. In addition, the borrower must have a "good payment history," meaning he/she has neither:

- Made a mortgage payment that was 60 days or longer past due during the 12-month period beginning 24 months before the date on which the mortgage reaches the cancellation date, nor
- Made a mortgage payment that was 30 days or longer past due during the 12-month period preceding the date on which the mortgage reaches the cancellation date. (See diagram)

Good Repayment History



Termination of PMI

A lender must automatically terminate PMI when all of the following occur:

- The loan-to-value ratio reaches 78 percent; and
- The borrower is current on the payments required by the terms of the loan.

Automatic termination differs from cancellation in two important ways. First, the borrower need not have a good payment history; the payments must only be "current." Second, the lender may not consider whether the property has depreciated. The Act does not define the term "current;" therefore, it is left to the lender to determine how to track whether a loan is current as of the termination date. If the borrower's loan is not current on the termination date, as soon as the borrower is current, a lender must terminate PMI.

Regardless of the loan-to-value ratio, the lender must terminate PMI on the first day of the month after the mid-point of the loan's amortization period if that loan is current.

Examination Procedures

Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC is responsible for enforcing compliance with the Act. When examiners encounter a violation of the Act, they will notify the lender of the violation and require that it adjust the borrower's account to compensate for the violation. Corrective steps include requiring the lender to return any unearned PMI premiums to the borrower.

The following procedures are provided to facilitate an evaluation of an institution's compliance with the Act. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC Home Ownership Protection Act- Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Review and evaluate the adequacy of the institution's policies, procedures, practices, and internal controls to ensure compliance with the requirements of the Homeowners Protection Act of 1998. Determine whether the institution's internal review process tests for compliance in these areas. If it does not, or if the review indicated areas of weakness, complete the following steps as necessary to determine compliance with the Act.			
2	Review a sample of fixed-rate and adjustable-rate home loans closed since the last examination (or the effective date of the Act) to determine whether the institution made the required disclosures.			
3	Review a sample of existing home loans to determine whether annual statements detail the borrower's cancellation and termination rights under the Act along with an address and telephone number of a contact person.			
4	Determine whether borrowers with adjustable-rate loans are being informed when their loans reach the cancellation date.			
5	Determine if the institution is ensuring that affected loans with a loan-to-value ratio			

MMC Home Ownership Protection Act- Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	approaching 78 percent or loans approaching the mid-point of their amortizations are being tracked.			
6	Determine whether PMI is being terminated on loans where the loan-to-value ratio has reached 78 percent and the borrower is current on the payments or on loans where the mid-point of the amortization has been reached.			
7	Review a sample of loans where the borrower's request for cancellation of PMI has been rejected and loans where automatic termination has not been granted to determine whether the institution has provided the required notifications within the required timeframes.			
8	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
9	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

- [MMC Home Ownership Protection Act Exam Procedures](#)

Regulatory Compliance Component Rating

A rating of “1” indicates that compliance with federal laws and regulations is strong. Management has strong internal controls and monitoring for regulatory compliance. Policies are in writing, determined to be effective, and operations are tested for compliance. Management adheres to its regulatory compliance policies and plans. There is no evidence of regulatory compliance violations or practices resulting in repeat violations. Violations are promptly corrected by management. As a result, the institution gives no cause for supervisory concern. Management is pro-active in addressing areas of weakness.

A rating of “2” indicates that compliance with federal laws and regulations is satisfactory. Management has satisfactory internal controls and monitoring for regulatory compliance. Management generally adheres to its regulatory compliance policies and plans. There is no evidence of regulatory compliance violations or practices resulting in well-defined patterns of repeat violations.

Some areas of weakness may be noted but are not material in nature and are easily corrected.

A rating of “3” indicates that compliance with federal laws and regulations needs improvement. Management has less than satisfactory internal controls and monitoring for regulatory compliance. Management often ignores its regulatory compliance policies and plans. Regulatory compliance violations may be numerous. In addition, previously identified practices resulting in violations may remain uncorrected. The situation presents an undue risk to the institution’s operations if not corrected.

A rating of “4” indicates that compliance with federal laws and regulations is deficient. Management has a less than satisfactory level of internal control and monitoring in place for regulatory compliance. Material areas of operations do not have written policies and procedures or have ineffective policies and procedures. Numerous regulatory compliance violations are present. Often practices resulting in violations cited at previous examinations remain uncorrected. Immediate actions must be taken to preserve the viability of the institution.

A rating of “5” indicates that compliance with federal laws and regulations is critically deficient. Management has poor or no internal controls and monitoring in place for regulatory compliance. No regulatory compliance plans and policies are present. Management is substantially in noncompliance with the consumer laws and regulations. Management has demonstrated its unwillingness or inability to operate within the scope of consumer laws and regulations. Repeat violations are present. The risks present are to the degree that the institution may cease operations.

Dodd- Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the Dodd-Frank Act was signed into law. It should be noted that the Act will significantly re-organize consumer protection oversight and regulatory compliance responsibilities. The Act creates a Consumer Financial Protection Bureau (CFPB) which will assume from the other federal regulatory agencies all responsibility regarding consumer compliance laws. The Act will also force regulators to promulgate a significant number of mortgage related rules. A list of consumer compliance laws for which administration duties will be assumed by the CFPB can be viewed [here](#).

Supplement 1 - A Sample Trigger Point Determination of Rate Spread Home Loan

To determine if a loan is a rate spread loan the lender or broker will need to keep abreast of the market rates being offered. Therefore, it is suggested that one should check the published rates and then determine if the rate being quoted exceeds the base rate.

To be deemed a rate spread loan, a loan must meet or exceed two triggers:

Trigger 1. HMDA Rate Spread Trigger; and

Trigger 2. Conventional Mortgage Rate Trigger.

HYPOTHETICAL: Assume a loan application for a first mortgage loan is taken on the 15th of September, 2007 and is for a 30-year loan.

Step 1. HMDA Rate Spread Trigger:

To determine the first trigger, the APR on the loan must be equal to or greater than 3% over U.S. Treasuries with comparable periods of maturity for first liens and 5% over comparable Treasuries for second liens as of the 15th day of the month prior to the application.

Go to <http://www.federalreserve.gov/releases/h15/data.htm>, and look at the “Business Day” index for 30-year “Treasury constant maturities.” Look to the 15th day of the month prior to the application of the loan, in this case August. On August 15, 2007, the applicable rate was 5.00%. By adding 3.00% for first mortgages, one determines the HMDA Rate Spread Trigger to be 8.00%.

Step 2. Conventional Mortgage Rate Trigger

To determine the second trigger, the APR on the loan must be equal to or greater than 1.75% over the “conventional mortgage rate” for first liens and 3.75% over “conventional mortgage rate” for junior liens. For comparison purposes, one must examine the most recent “conventional mortgage rate” for the week preceding the week in which the rate on the loan is set. (The conventional mortgage rate is: Contract interest rates on commitments for fixed-rate first mortgages. Source: FHLMC)

Presuming for the sake of the hypothetical that the borrower’s rate is set on September 21, 2007, go to <http://www.federalreserve.gov/releases/h15/data.htm>, and look at the “Weekly (Thursday)” index for “Conventional mortgages.” Conventional mortgage contract rates for the prior week (09/13/2007) were 6.31%. By adding 1.75%, one determines the Conventional Mortgage Rate Trigger to be 8.06%

Step 3. Analysis

Thus, any loan with an APR equal to or exceeding 8.06% will be deemed a rate spread loan. **NOTE:** This is an APR determination, so if the note rate is something slightly less than 8.06%, AND the loan requires PMI or VA funding or FHA insurance, it is very likely that the APR will exceed the trigger and will be a rate spread loan. If so, one must reduce the rate or comply with the requirements applicable to a rate spread loan. Charging the borrower discount points to buy the note rate down may reduce the note rate, but will likely have little effect on the APR so that is not a recommended solution to this issue. Additionally, resetting the rate may be problematic if the trigger rate has been reduced in the

interim, so the conventional mortgage rate would need to be rechecked based on the reset rate and the date that occurred.

- [MMC Rate Spread Trigger](#)

Supplement 2 - Regulation Z § 226.4 Finance Charge Matrix

- [MMC Reg Z Finance Charge Matrix](#)

Supplement 3 – RESPA for Loans Transferred before January 1, 2010

Real Estate Settlement Procedures Act

Authority and Purpose

The Real Estate Settlement Procedures Act of 1974 (RESPA) became effective on June 20, 1975. The Real Estate Settlement Procedures Act Amendments of 1975 (RESPA Amendments) became effective on June 30, 1976, and the amendments made major substantive changes to the existing law. The Department of Housing and Urban Development (HUD) promulgated Regulation X which implements RESPA. HUD Regulation X is set forth in 24 CFR Part 3500.

Section 908 of the Housing and Community Development Act of 1992 amended RESPA and removed the first lien requirement by adding a new class of covered transactions (i.e., second and other subordinate mortgages such as home equity lines of credit, home equity loans, and home improvement loans secured by residential real estate). For the first time since 1976, HUD Regulation X was revised and clarified effective December 2, 1992. In addition to adding provisions for subordinate liens and refinances, the 1992 regulations omitted a long-standing regulatory exemption for property of 25 or more acres. Some of the other significant revisions included removing the transfer of title requirements, adding the Controlled Business Arrangement and Computer Loan Origination (CLO) disclosures, adding notice requirements concerning mortgage servicing transfers, limiting the size of escrow accounts, and increasing the severity of sanctions for certain violations. HUD Regulation X was subsequently amended in 1994 to exempt real property of 25 acres or more regardless of purpose and real property of less than 25 acres if the extension of credit was primarily for business, commercial, or agricultural purposes. The amendment became effective August 9, 1994, except that exemptions set forth in HUD Regulation 24 CFR § 3500.5(b) (including the 25-acre and business purpose exemptions) became effective March 14, 1994.

The purpose of RESPA is to provide borrowers with pertinent and timely disclosures regarding the nature and costs of real estate settlements. RESPA also prohibits certain abusive practices, such as kickbacks, and places limitations on the use of escrow accounts.

For additional information, refer to [Flow Chart 3](#).

Applicability and Exemptions

RESPA is applicable to all "federally related mortgage loans" which are defined as any loan (other than temporary financing such as a construction loan) which is secured by a first or subordinate lien on residential real property, including a refinancing of any secured loan on residential real property upon which there is either located, or following settlement, will be constructed using proceeds of the loan, a structure or structures (including a manufactured home) designed principally for the occupancy of from one to four families (including individual units of condominiums and cooperatives and including any related interests, such as a share in the cooperative or right to occupancy of the unit).

The following loans are **exempt** from RESPA:

- A loan for any purpose on property of 25 acres or more, regardless of whether the land is vacant or contains a residential structure;
- An extension of credit primarily for a business, commercial, or agricultural purpose; however, the exemption does not apply to any transaction in which one or more persons acting in an individual capacity place a lien on a one- to four-family residential property, whether used for occupancy or investment;
- Temporary financing such as a construction loan, except certain loans to finance construction of one- to four-family residential property;
- Vacant or unimproved property unless a structure or manufactured home will be constructed or placed on the property within 2 years from the date of settlement of the loan;
- Any assumption in which the lender does not have the express right to approve subsequent borrowers; however, any assumption in which the lender's permission is both required and obtained is covered by RESPA regardless of whether the lender charges a fee for the assumption. Any conversion of a federally related mortgage loan to different terms that are consistent with provisions of the original mortgage as long as a new note is not required, even if the lender charges an additional fee for the conversion; or
- A bona fide transfer of a loan obligation in the secondary market.

In general, RESPA (as well as the implementing HUD Regulation X) contains certain disclosure requirements and restrictions for settlements involving federally related mortgage loans which are briefly described as follows:

- Special Information Booklet--HUD Regulation 24 CFR § 3500.6 requires lenders to provide a Special Information Booklet (Booklet) by delivering it or placing it in the mail to the applicant not later than 3 business days after the application is received or prepared. However, the lender does not need to provide the Booklet if the borrower's application for credit is

denied before the end of the 3-day business period. In addition, the lender is not required to provide a Booklet for refinancing transactions, closed-end loans when the lender takes a subordinate lien, and reverse mortgages.

The intent of the regulation is that the applicant should receive the Booklet at the earliest possible date since the Booklet contains an explanation of the nature and costs of real estate settlement services. While there is no regulatory requirement, institutions should obtain an applicant's signature acknowledging receipt of the Booklet. The receipt provides evidence the institution complied with this particular provision of HUD Regulation X;

- Good Faith Estimate--HUD Regulation 24 CFR § 3500.7 requires lenders to provide a good faith estimate of settlement charges unless the loan is denied before the end of the 3-day business period by delivering it or placing it in the mail to the applicant not later than 3 business days after the application is received or prepared. The good faith estimate consists of an estimate, as a dollar amount or range, of each settlement charge the borrower is likely to incur in connection with the settlement. Each good faith estimate shall be made in good faith and bear a reasonable relationship to the charge a borrower is likely to be required to pay at settlement, and it must be based upon experience in the locality of the mortgaged property. As with the Booklet, it is recommended the institution obtain the applicant's signature acknowledging receipt of the good faith estimate. Also, HUD Regulation X does not provide parameters upon which to measure the reasonable relationship between settlement charges disclosed in the good faith estimate and those actually incurred and disclosed in the HUD-1 settlement statement. Examiners will have to use their own judgment in assessing the reasonableness of settlement charges incurred;
- Particular Providers of Service--HUD Regulation 24 CFR § 3500.7(e) stipulates that if a lender requires the use of a particular provider of settlement service, **other than the lender's own employees**, and also requires the borrower to pay any portion of the cost of such service, then the good faith estimate must clearly state that use of the particular provider is required; that the estimate is based on charges of the designated provider; give the name, address, and telephone number of each such provider; and describe the nature of any relationship between each such provider and the lender. See the regulation for examples of when a relationship exists.
- HUD-1 or HUD-1A Settlement Statements--HUD Regulation 24 CFR § 3500.8 requires that each settlement agent use the standard HUD-1 settlement statement in every settlement involving a Federally related mortgage loan in which there is a borrower and a seller. For transactions in which there is a borrower and no seller, such as refinancing loans or subordinate lien loans, the HUD-1 may be utilized by using the borrower's side only. Alternatively, the HUD-1A may be used for transactions without sellers. The HUD-1 or HUD-1A must be completed by the person conducting the settlement and must conspicuously and clearly itemize all

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- settlement charges imposed upon the borrower and seller, except those the borrower or seller contracts to pay for separate from the settlement. The HUD-1 or HUD-1A form must also indicate whether any title insurance premium included in the charges covers the lender's interest in the property, the borrower's interest, or both. The copy of the HUD-1 form supplied to the seller need not contain the information relating to the borrower's transaction, nor must the copy supplied to the borrower contain the information relating to the seller's transaction.
- HUD-1 or HUD-1A Settlement Statement Inspection--HUD Regulation 24 CFR § 3500.10 requires that, upon request from the borrower, the settlement agent must complete the items known to the settlement agent and permit the borrower to inspect the HUD-1 or HUD-1A settlement statement one business day prior to the day of settlement (usually referred to as loan closing).
 - Record Retention--HUD Regulation 24 CFR § 3500.10(e) requires the lender to retain each completed HUD-1 or HUD-1A and related documents for 5 years (2 years if settlement occurred before December 2, 1992) after settlement, unless the lender disposes of its interest in the mortgage and does not service the mortgage. However, if servicing is transferred to another owner or servicer, the original HUD-1 or HUD-1A must be forwarded as part of the transfer file and retained by such owner or servicer for the remainder of the original 5-year period.
 - Preparation Fees--HUD Regulation 24 CFR § 3500.12 requires that no fee be imposed or charge made upon any other person, as part of settlement costs or otherwise, by a lender for the preparation and distribution of the HUD-1 or HUD-1A settlement statement, escrow account statements, or statements required by the Truth in Lending Act.
 - Kickbacks and Unearned Fees--HUD Regulation 24 CFR § 3500.14 states that no person shall give and no person shall accept any fee, kickback, or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a settlement servicing involving a federally related mortgage loan shall be referred to any person. In addition, no person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for actual services performed. Section 3500.19 provides that violators of this section shall be fined not more than \$10,000 or imprisoned for not more than one year, or both, for each violation. Also, violators shall be jointly and severally liable to the borrower in an amount equal to three times the amount of any settlement charge paid.
 - Controlled Business Arrangements--HUD Regulation 24 CFR § 3500.15 defines a controlled business arrangement as an arrangement where a person is in a position to refer business incident to or a part of a real estate settlement servicing involving federally related mortgage loans, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services. This person directly or indirectly refers such

business to that provider or affirmatively influences the selection of that provider. A controlled business arrangement is not a violation if the person making each referral has provided to each person whose business is referred a written disclosure in the format of the Controlled Business Arrangement Disclosure Statement in Appendix D of HUD Regulation X. The penalties for violating § 3500.15 are the same as those for violating § 3500.14 above.

- Title Companies--HUD Regulation 24 CFR § 3500.16 provides that if the lender holds legal title to the property being sold, the lender (seller) is prohibited from requiring the borrower, either directly or indirectly, to use a particular title insurance institution. Any violations of this section entitle the buyer to an amount equal to three times all charges made for the title insurance from the seller.
- Escrow Accounts--While the regulatory section has been reserved for future promulgation, § 10 of RESPA, 12 U.S.C. § 2609, provides that the amount of money the lender can require a borrower to place in an escrow account is limited to the first full payment of taxes, insurance premiums, and other charges, plus 1/6 of the charges to be paid during the following 12 months. A monthly escrow payment can be no larger than 1/12 of the amount anticipated to be paid for such charges during the following 12 months, plus the amount necessary to maintain a balance not to exceed 1/6 of the amount of charges to be paid during that period.
- Mortgage Servicing Transfers--HUD Regulation 24 CFR § 3500.21 provides that mortgage lenders are required to give applicants information about the likelihood that their mortgage servicing will be transferred. This information must be in a disclosure statement given to and acknowledged by the applicant at the time of application. Before consummation, the lender must have in its files a disclosure statement signed by each applicant. Not less than 15 days before a mortgage servicing transfer becomes effective, the current mortgage servicer must notify all borrowers in writing.

Examination Objectives

- Determine that policies, procedures, and internal controls have been established and evaluate their adequacy to provide reasonable assurance of compliance with the requirements of RESPA.
- Determine that disclosures required by RESPA were made on transactions subject to RESPA and that such disclosures were timely and accurate.

Examination Procedures

Pursuant to the applicable state law and the National Cooperative Protocol and Agreement, the MMC has specific authority to enforce compliance with Regulation X.

The following procedures are provided to facilitate an evaluation of an institution's compliance with RESPA. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures based on the particular circumstances of the institution.

MMC Real Estate Settlement Procedures Act Exam Procedures

	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
1	Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasize identifying violations of law and regulation; integrate those findings with the examination; and conclude on management's compliance with laws and regulations.			
2	Review and evaluate the adequacy of policies, procedures, and internal controls to ensure the identification of applicable applicants and compliance with the requirements of RESPA.			
3	Determine whether the institution provides an applicant with a copy of the Booklet within 3 business days after receiving a written application for a federally related mortgage loan.			
4	Ascertain whether the institution provides an applicant with a Good Faith Estimate of settlement costs within three business days following the written application.			
5	Determine whether Good Faith Estimates provided to applicants bear a reasonable relationship to the charges the applicant will likely be required to pay or the applicant has incurred at settlement.			
6	Where the institution requires that a particular individual, firm, or institution be used to provide legal services, title examination services, or title insurance, or to conduct settlement, and requires the borrower to pay for any portion of the cost of such services, determine whether the Good Faith Estimates: a. Clearly indicate which estimated charge is to be provided by each designated provider; b. State the name, address, and telephone number of each designated provider and the fact			

MMC Real Estate Settlement Procedures Act Exam Procedures

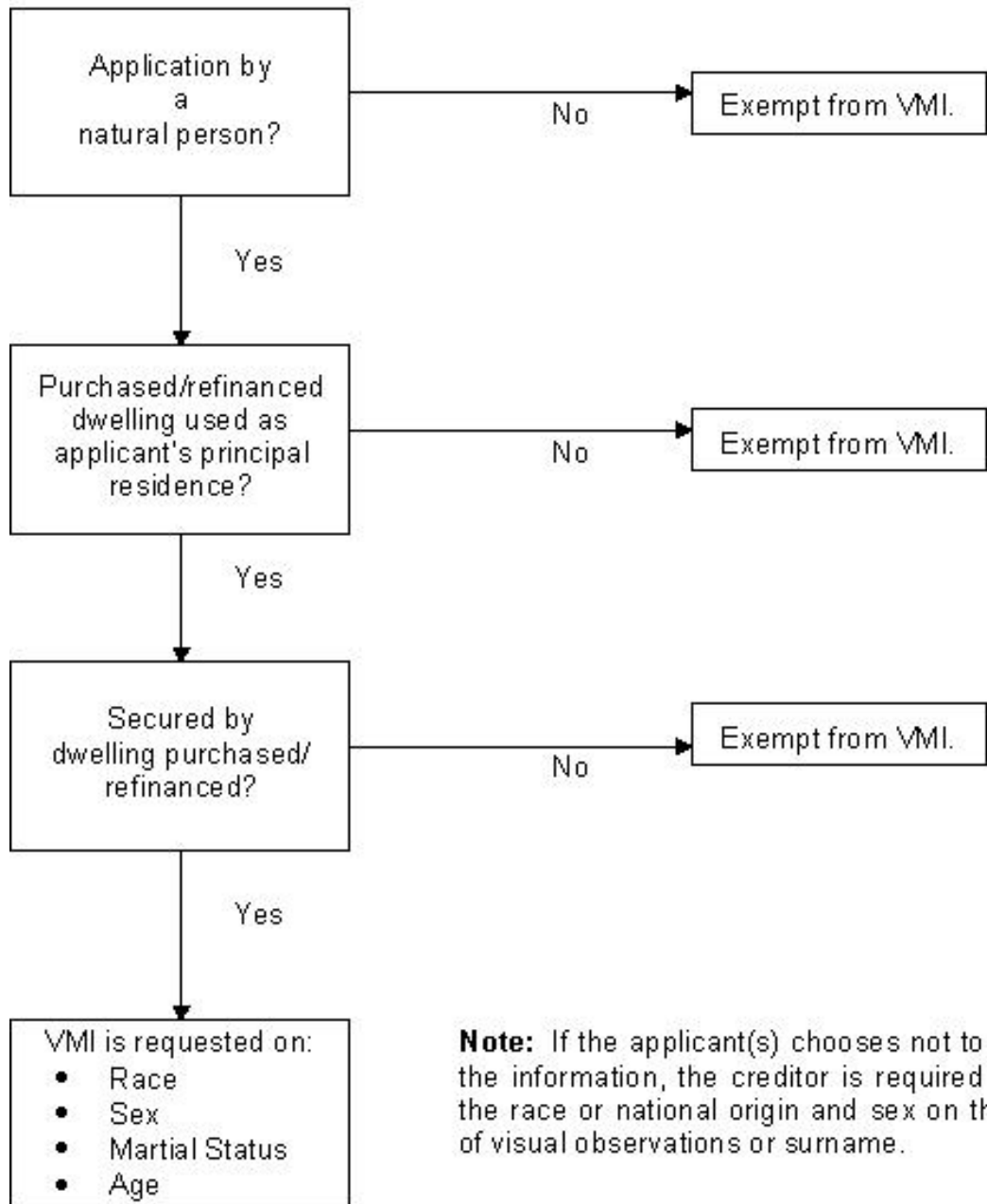
	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	the institution's estimate for the services is based upon the charges of the designated provider and c. State whether or not each designated provider has a business relationship with the institution.			
7	Ascertain whether the person conducting settlement also prepares the HUD-1 or HUD-1A settlement statement.			
8	Determine whether the institution permits the borrower, upon request, to inspect the HUD-1 or HUD-1A settlement statement one business day prior to the day of settlement.			
9	Determine whether the institution prepares the HUD-1 or HUD-1A settlement statement in accordance with Appendix A of the regulation.			
10	Unless waived or exempt, determine whether the HUD-1 or HUD-1A was delivered or mailed to the borrower and seller or their agents at or before settlement.			
11	Determine whether the institution retains a copy of the HUD-1 or HUD-1A settlement statement for 5 years from the date of settlement.			
12	Determine whether the institution refrains from charging a fee for the preparation and distribution of the HUD-1 or HUD-1A settlement statement or documents required under the Truth in Lending Act.			
13	Determine whether the institution provides applicants information about the likelihood that their mortgage servicing will be transferred.			
14	Determine whether the institution notifies borrowers in writing not less than 15 days before a mortgage servicing transfer becomes effective.			
15	Determine whether the institution is aware of and in compliance with the prohibitions against kickbacks and unearned fees.			
16	If the institution owns the property being sold, ascertain whether it requires title insurance or gives the impression that title insurance is required from a particular institution.			
17	Conclude whether the institution is adequately complying with RESPA. If not, ascertain whether			

MMC Real Estate Settlement Procedures Act Exam Procedures

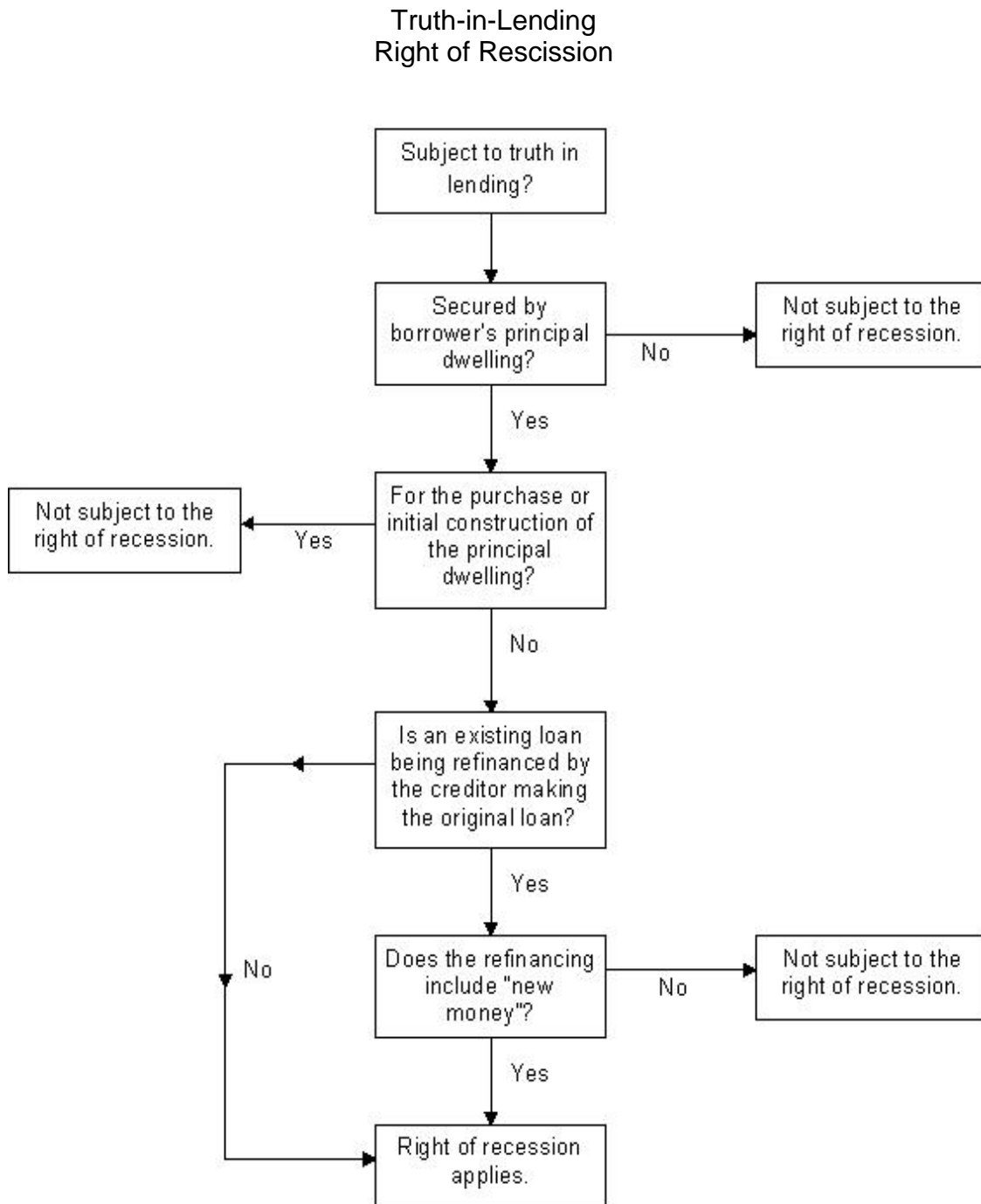
	Examination Procedures	Yes	No	Examiner Notes [Document supporting evidence and note determinations and findings made.]
	the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.			
18	Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution's personnel to ensure compliance with laws and regulations.			
19	Discuss items of concern, scope of work performed, and conclusions with the EIC.			
20	Organize and compile, if necessary, violations of law and regulation into a Violation Summary Sheet.			

Flow Chart 1 - Equal Credit Opportunity Act Collection of Voluntary Monitoring Information

Equal Credit Opportunity Collection of voluntary Monitoring Information (VMI)

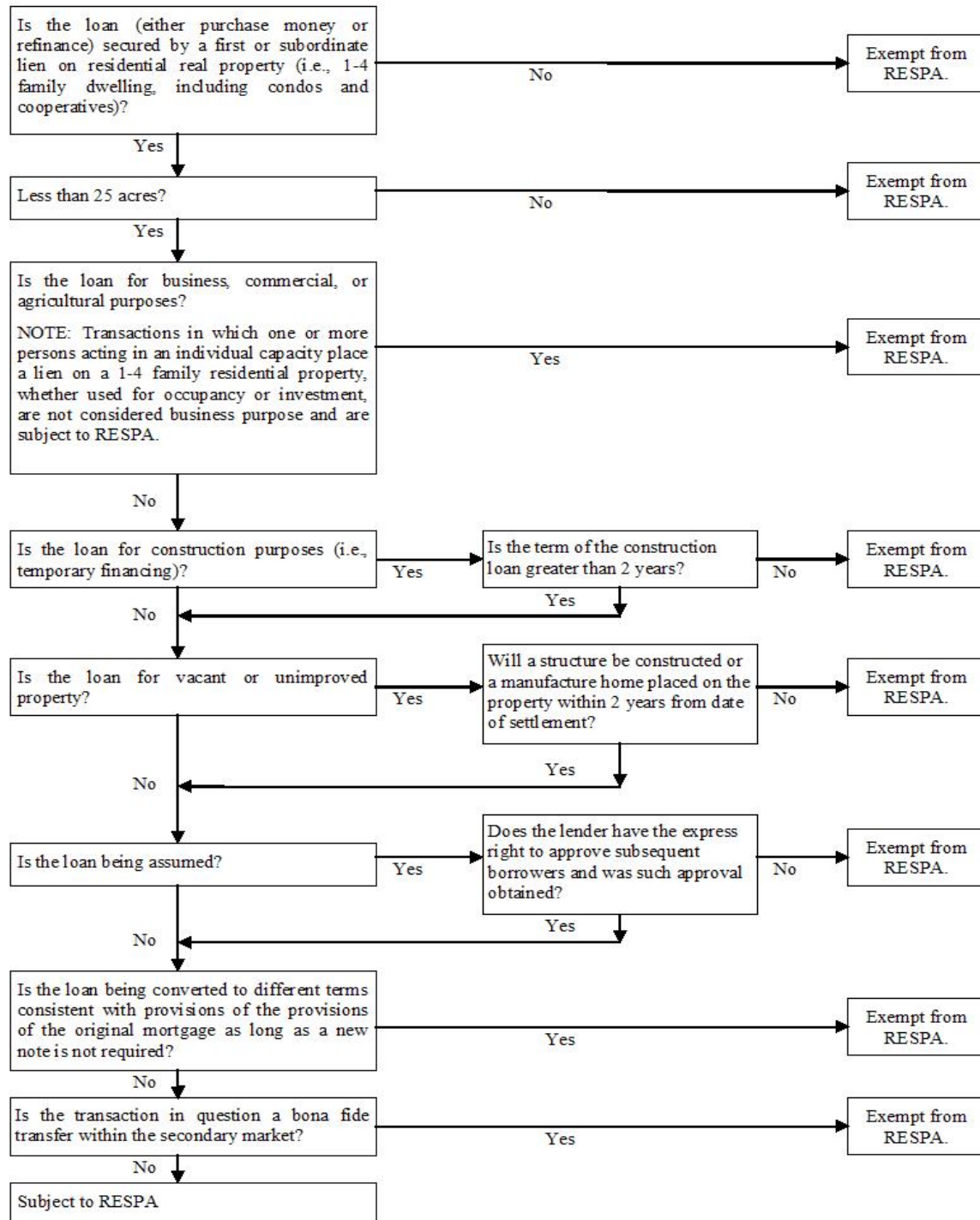


Flow Chart 2 - Truth-in-Lending Right of Rescission



Flow Chart 3 - Real Estate Settlement Procedures Act

REAL ESTATE SETTLEMENT PROCEDURES ACT



Consumer Protection

Introduction

For our purposes, consumer protection relates directly to protecting the rights of consumers in mortgage transactions, and covers not only the federal consumer protection regulations, but practices that may present harm to the consumer. In contrast, “compliance” is the state of being in conformance with laws, regulations or established guidelines. For state regulators, compliance is generally associated with specific state and federal laws and regulations, including the interpretations and guidance thereunder.

State mortgage examiners most often refer to compliance in terms of “consumer compliance,” meaning compliance with specific consumer protection laws and regulations that cover the mortgage lending activity of the institution. These laws and regulations cover disclosure requirements, as well as prohibitions on discrimination and other unacceptable conduct or practices. Mortgage lenders, brokers and loan originators are also held to strict compliance with licensing, bonding and reporting requirements. Depending on an institution’s business model, compliance may also be necessary under government-sponsored enterprise (Fannie Mae/Freddie Mac), or FHA and VA requirements. Finally, an institution must be concerned with compliance under any contractual arrangements it has entered.

Although the terms compliance and consumer protection share many characteristics, the terms are not the same. In fact, compliance is often confused with consumer protection because lack of attention or failure in one will frequently lead to a failure in the other. For instance, if an institution is in violation of the disclosure requirements of RESPA or TILA (compliance failure), the result is very likely consumer harm (consumer protection).

However, examiners need to be careful not to assume that apparent compliance equates to good consumer protection. Some of the largest predatory lending cases (consumer protection) were against institutions whose loan files did not reveal technical violations of consumer protection laws (compliance). For example, the TIL disclosure in a loan file may be completed correctly and delivered in a timely manner, however, if the borrower is misled about what the disclosure tells them, we have a consumer protection problem.

Consumer protection is a key aspect of the MMC exam process. Consumer protection standards are largely based on the practices that have been deemed unfair and deceptive by the FTC and state and federal regulatory bodies. Under standards endorsed by all of the federal financial institution regulatory agencies and the FTC, an act or practice is unfair where it:

- Causes or is likely to cause substantial injury (usually monetary) to consumers;
- Cannot be reasonably avoided by consumers; and

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- Is not outweighed by countervailing benefits to consumers or to competition.

Under standards endorsed by all of the federal financial institution regulatory agencies and the FTC, an act or practice is deceptive in the following circumstances:

- There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.
- The act or practice must be considered from the perspective of the reasonable consumer.
- The representation, omission, or practice must be material.

When reviewing consumer protection issues within institutions, examiners should use the following items as a guide for review:

- FTC Act, Section 5 Policy Statements on Unfairness and Deception
- [UDAP Procedures](#)

FTC Act, Section 5

Section 5 of the [Federal Trade Commission Act](#) (FTC Act) declares that unfair or deceptive trade practices are illegal. The FTC Act is applicable to state licensed mortgage lenders and mortgage brokers. While Section 5 does not grant additional state authority or replace the authority under your state's specific mortgage law, the FTC Act and Federal Trade Commission interpretations of unfair or deceptive acts or practices can provide examiners with valuable instruction in identifying abusive sales practices by mortgage brokers or lenders. The essence of what examiners need to know about unfair or deceptive acts in Section 5 of the FTC Act is contained in the first full sentence:

(1) "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."

The remainder of Section 5 applies to the FTC's authority and enforcement powers. While Section 5 itself does not provide examiners much instruction on abusive sales practices, or unfair or deceptive practices, two letters written to Congress by the FTC in 1980 and 1983 are very instructive for examiner purposes:

- [FTC Policy Statement on Unfairness](#)
- [FTC Policy Statement on Deception](#)

FTC Policy Statement on Unfairness:

"Rather than merely reciting the law, we have attempted to provide the Committee with a concrete indication of the manner in which the Commission

has enforced, and will continue to enforce, its unfairness mandate. In so doing we intend to address the concerns that have been raised about the meaning of consumer unfairness, and thereby attempt to provide a greater sense of certainty about what the Commission would regard as an unfair act or practice under Section 5.”

Reaching a standard of fairness has been an evolutionary process for the FTC. It was Congress’ intent to frame Section 5 in very general terms and leave it to the FTC to develop the standard over time. By 1964, the FTC had established three factors or tests for the standard of unfairness:

1. Whether the practice injures consumers.
2. Whether it violates established public policy.
3. Whether it is unethical or unscrupulous.

In establishing consumer injury, the FTC provides even further instruction:

1. It must be substantial.
2. It must not be outweighed by any countervailing benefits to consumers or competition that the practice produces.
3. It must be an injury that consumers themselves could not reasonably have avoided.

FTC Policy Statement on Deception:

“Certain elements undergird all deception cases. First, there must be a representation, omission or practice that is likely to mislead the consumer. Practices that have been found misleading or deceptive in specific cases include false oral or written representations, misleading price claims, sales of hazardous or systematically defective products or services without adequate disclosures, failure to disclose information regarding pyramid sales, use of bait and switch techniques, failure to perform promised services, and failure to meet warranty obligations.”

In addition to misleading the consumer, the FTC policy statement examines two additional criteria for a finding of deception:

1. How a consumer or particular group could reasonably be expected to act under the circumstances, and
2. The “materiality” or effect the act or practice is likely to have on the consumer’s decision with regard to a product or service.

“Thus, the Commission will find deception if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment.”

Unfair and Deceptive Acts or Practices (UDAP) Exam Procedures

In May of 2010, the Office of Thrift Supervision publicly released amended examination procedures for evaluating if an institution has engaged in unfair or deceptive acts or practices (UDAPs) in violation of Section 5 of the Federal Trade Commission Act.

The states, through the State Liaison Committee and their involvement with the Federal Financial Institutions Examination Council (FFIEC), contributed to the content of the examination procedures. While the FFIEC ultimately determined not to issue the procedures as an FFIEC document, the states have determined that the procedures can aid examiners tremendously in determining whether an institution is deficient in consumer protection related areas.

The guidance set forth in these exam procedures outlines:

- The standards that the federal regulatory agencies and the states use to assess whether an act or practice is unfair or deceptive;
- The process for determining whether an institution is engaging in UDAPs; and
- Examples of enforcement actions taken under the FTC Act.

The guidance set forth in this handbook section also clarifies that acts or practices that violate the FTC Act may also violate other statutes, such as the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, and the Fair Debt Collection Practices Act.

Exam Objectives:

- Determine if the institution adheres to the principles established in FTC Act Section 5
- Utilize the Unfair and Deceptive Acts and Practices Exam Procedures to determine the adequacy of an institution's consumer protection practices.

Exam Procedures:

- Utilize the Unfair and Deceptive Acts and Practices Exam Procedures

Consumer Protection Component Rating

A rating of "1" indicates that the institution has strong consumer protection controls in every regard. Evidence of unfair or deceptive acts or practices is nonexistent.

A rating of “2” indicates that the institution has satisfactory consumer protection controls. Evidence of unfair or deceptive acts or practices is minimal.

A rating of “3” indicates that the institution has less than satisfactory controls over consumer protection. Evidence of unfair or deceptive acts or practices is present.

A rating of “4” indicates that the institution’s controls over consumer protection are deficient. Evidence of unfair or deceptive acts or practices is prevalent.

A rating of “5” indicates that the institution’s controls over consumer protection are critically deficient. Evidence of unfair or deceptive acts or practices is pervasive.

Report of Examination

Reports

Introduction

The purpose of the Report of Examination (ROE) is to provide the MMC and institution’s management with a clear, concise, and objective evaluation of the institution’s overall condition. The ROE is the principal vehicle used by the MMC to communicate to the institution the examination findings and the need for corrective actions. Furthermore, the ROE and examination work performed establish the basis for actions taken by the MMC to enforce laws and regulations and ensure safe and sound operations.

This section provides guidance on ROE content, format, and style. It also includes suggestions for developing a quality ROE and describes the interrelationship of reporting with other examination phases. While this section provides overall guidance on ROE content and format, the judgment of the examiner-in-charge (EIC) and the nature of problems in the institution examined should be the primary considerations in determining the specific content and format of the ROE.

ROE Development

Because the ROE’s effectiveness as a communication tool is largely determined by ROE quality, ensuring quality is a critical component of ROE development. There are three primary elements for a quality ROE:

- Well-designed examination planning documents;
- Effective development of findings; and
- An effective quality assurance program.

Planning--The quality of the ROE is typically heavily influenced by the quality of examination planning. Developing examination planning documents requires careful analysis of information from a number of sources much of which is

gathered through the ongoing monitoring of an institution.

During the planning process, the significant risks in the institution should be identified and prioritized. The scope and approach described in the plan outlines the process for examining the highest risk areas in order to achieve the examination objectives. As such, the scope and approach must include sufficient steps to determine the significance, causes, and effects of the problems discovered.

Development of Findings--It is critical that findings and conclusions are adequately developed during the examination. Comments addressing the key elements of an examination finding for each area examined and/or each objective established in the plan are essential to a quality ROE. A violation summary sheet (VSS) may be used to develop and document findings. As discussed in the workpapers section in the General Module of this manual, VSSs are a tool to promote examination effectiveness by simplifying the ROE writing process and ensuring a logical, systematic, and organized documentation process. Additionally, VSSs help ensure the elements of an examination finding are identified. The key elements of an examination finding are described below.

Condition is the evidence, such as observations and statistical data, supporting the conclusion.

Criteria are the specific applicable standards, such as laws, regulations, bylaws, policies, procedures, generally accepted accounting principles, and sound banking practices, against which the condition is evaluated.

Management Response, if applicable, includes management's observations on the conditions, and actions planned to correct the problem discovered.

Conclusions are the final results of the examination.

In addition, corrective action should be recommended. Care should be taken to influence an effort, but to refrain from a specific method of correction.

Recommendations are especially important when management's response is inadequate to correct the weakness or when failure to take action could have a significant adverse impact on the institution. All elements of an examination finding and the need for corrective action must be developed and stated so that management is sufficiently knowledgeable and persuaded to take appropriate corrective action.

Communication is essential to the proper development of examination findings and overall conclusions. The EIC should ensure that adequate communication exists among all examination participants so that areas of potential risk are adequately investigated and possible interrelationships of findings are sufficiently analyzed. The EIC and supervisors should discuss preliminary conclusions prior to the exit conference to ensure a consistent message and promote more efficient ROE development. The ROE is enhanced by periodic examiner meetings and conferences during the on-site activities. Additionally, examiners

should communicate with the institution throughout the examination process. Such communication ensures institution management is not surprised by the tone or message of the final ROE.

The EIC must also assimilate findings from all areas of the examination to arrive at overall conclusions regarding the present and expected future condition of the institution. Formulating overall conclusions is essential in conducting the exit conference and developing comments for the ROE.

Quality Assurance--A quality assurance program is crucial for ensuring the integrity of the examination process and the issuance of quality ROEs. Although an effective quality assurance program consists of a number of processes, two of the primary processes are cross-referencing and report review. The ROE is cross-referenced to supporting workpapers in order to verify the accuracy of facts. In addition, the ROE is reviewed to ensure conclusions and recommendations are logical and flow from the facts presented. The EIC is responsible for ROE accuracy and quality. The Quality Assurance section of this manual contains additional guidance on this topic.

[Supplement 1](#) provides a series of questions the author should ask when reviewing the ROE.

ROE Structure

The ROE should clearly present conclusions that are well supported by facts obtained during the examination. The ROE is directed toward the institution's management and the MMC, who are mainly interested in an overall evaluation of the areas examined rather than in a detailed technical analysis. The nature and depth of the ROE will vary depending on the identified risk. However, all ROEs should emphasize clarity and conciseness and should not overwhelm the reader with statistics, technical terminology, or jargon.

ROEs are written deductively. This approach facilitates reader comprehension by stating the main idea of a section first, followed by supporting details. Within each ROE section, a lead or charge paragraph should provide an overview to unify the report section. All paragraphs that follow the charge paragraph should support, explain, and substantiate the message of the charge paragraph. A charge paragraph should summarize the section to follow, including:

- Summarize the findings. In most circumstances, the paragraph should include condition, cause, criteria, effect, and management response; however, judgment should be used to determine whether all five elements are appropriate;
- Set the tone for the section;
- Establish the sequence of supporting evidence to follow;
- Be concise. It should not include supporting information or irrelevant background material; and

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- Use simple, nontechnical language.
 - Refer to the FDIC's ROE Grammar and Punctuation Guide in [Supplement 2](#) to review ROE grammar and punctuation protocols.
 - Refer to the MMC Uniform ROE in [Supplement 3](#) to guide ROE construction.

Supplement 1 - Report Review Checklist

Report Review Checklist

The following questions may be used as a guideline by the report author when reviewing the report prior to submitting it for supervisory review. The questions also may be beneficial to the supervisor when reviewing the report. A "no" answer indicates additional work may be necessary to ensure the issuance of a quality Report of Examination.

- Is the report convincing?
- Is the tone appropriate for the condition of the institution? Is the tone objective and does it encourage a positive reaction to MMC's findings and recommendations?
- Does the report focus on the important issues?
- Has the EIC filled out each section of the report and has it been reviewed?
- Does the report establish the significance of the conditions? That is, does the report convey not only that the conditions exist, but also it conveys the degree of seriousness?
- Does the report provide a proper perspective of the strengths and weaknesses in the institution?
- Are findings adequately developed (condition, criteria, cause, effect)?
- Will recommendations, if followed, resolve the problems identified?
- Is each area identified in the scope section addressed in the body of the report?
- Does the summary section provide the results of the examination findings and their significance without specific detail?
- Does each section have a charge paragraph?
- Is the level of detail in the sections sufficient to convince readers of the problem, but not so minute as to hinder the message?
- Do all paragraphs contain topic sentences (umbrella statements) that summarize the main idea of the paragraph?
- Do all sentences within each paragraph have both unity and coherence?

-
- Are sentences sufficiently short and clear to allow readers to understand them on a first reading?
 - Is the language simple, nontechnical, and clear? Has the report been written so that all management can understand the terms, concepts, and relationships?
 - Are tables and graphs appropriately used to support conclusions?
 - [MMC Report of Review](#)

Supplement 2 – FDIC Report of Examination Grammar and Punctuation Guide

- [Grammar and Punctuation Guide](#)

Supplement 3 – MMC Uniform Report of Examination

- [MMC Report of Examination](#)

Other Examination Tools

Standard Examination Procedures

- [MMC Standard Exam Procedures](#)

Branching Examination Procedures

- [MMC Net Branching Exam Procedures](#)

Appraisal Review Procedures

- [MMC Appraisal Review Procedures](#)

Conducting the Multistate Exam

The *Conducting the Multi-State Exam* module outlines the process for conducting an MMC multi-state mortgage exam. Described below is the exam process on a week-by-week basis.

Prior to Week 1:

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- Multistate Mortgage Committee (“MMC”) has identified the target institution to be examined.
 - MMC notifies states through the Single Point of Contact (SPC) of the examination and surveys states on participation, optimum examination month, and available resources.
 - MMC selects an Examination Liaison (Liaison) to oversee the examination for the MMC.
 - The Examiner In Charge (“EIC”) State will be selected by the MMC.
 - The institution’s Home State will be given strong consideration by the MMC.
 - The EIC State will consult the MMC on the EIC selection.
 - The Liaison and EIC determine onsite versus offsite states and the number of examiners to be assigned by states from the available resources for recommendation to the MMC.
 - MMC holds an initial “purpose and mission” meeting with the EIC.
 - EIC and Liaison hold discussions with the MMC to include the initial scope of the examination, the anticipated length of examination, and the composition of the participating states and examination team. [Note: this meeting may be combined with the preceding meeting.]
 - MMC communicates the exam staff selection to the participating states and directs states to provide an examination contact directly to the EIC.
 - EIC and Liaison communicate with the examination states and establish an examination contact list and a roster of examiners, and provide the list and roster to the MMC.
 - EIC in conjunction with the Liaison determines the actual start date of the examination and the on-site week(s). The Liaison will provide the dates to the MMC and the participating states.
 - MMC and/or the EIC communicate the names of the examination staff and the anticipated start date of the examination to the Travel Coordinator. (EIC to facilitate travel in lieu of a travel coordinator.)

Note-The EIC has the opportunity to request a conference call to discuss any protocol outlined in this agreement. Also, the MMC and specifically the Protocol and Staffing Group (“PSG”) can coordinate a conference call with any prior EIC to discuss the process and to handle any questions or concerns. The EIC will be expected to maintain frequent ongoing dialogue with the Liaison.

Week 1:

- MMC obtains electronic signatures authorizing the examination from all participating states.
- MMC provides the EIC with the Exam Notification Letter (or Cover Letter) and the Initial Multistate Information Request. EIC distributes the [MMC Exam Notification Letter](#) and the [MMC Initial Information Request](#) letter to the examination states for review using the examination state contact list.
- Obtain the state specific requests for the participating states which will be included as part of the Initial Information Request (see Week 3).

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- EIC to contact the examination states to facilitate an expedited return of the requests. The document is expected to be completed and received by the end of Week 2.
 - EIC requests institution profile and history information via the [MMC Examination State Compliance Form](#) from all participating states. The document is expected to be completed and received by the end of Week 2.
 - Additionally, EIC reviews reports of financial condition and management weaknesses notes in exams.
 - EIC to request from the examination states the examiner information/profile for the examiners that are participating on the examination. The [MMC Examiner Profile Document](#) is expected to be completed and received by the end of Week 2.

Week 2:

- EIC will begin review of any and all applicable databases and information in preparation for the multistate examination. Databases to include but not be limited to:
 - NMLS
 - Individual state databases
 - FTC Consumer Sentinel database
 - FFIEC-LAR Data
 - Neighborhood Watch
 - Google
 - SAR data
 - SNL (through CSBS)
- EIC to follow-up with the examination states for the information requested in Week 1.
- By the end of Week 2, EIC should have received from each participating state the following:
 - Examiner Profile
 - State Compliance Form
 - State Specific Information Requests
- Conference call with MMC or Liaison Team (if needed).
- EIC to prepare institution Executive Summary for Liaison.
- Liaison to report Executive Summary to MMC.
- [MMC ABC Loans Executive Summary](#)

Week 3:

- EIC to continue the review of all applicable databases and information in preparation for the multistate examination. EIC reviews each state specific request list and consolidates for duplicate requests.
- EIC finalizes the Cover Letter and the Initial Information Request document by adding signatures, due dates, and state specific requests.

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- EIC distributes the Cover Letter, the Initial Information Request, and the State Specific request documents to the participating states and MMC via email.
 - EIC emails Cover Letter and the Initial Information Request to the institution.
 - EIC and Liaison conducts conference call with the institution. Discussion items include:
 - Liaison will briefly explain the multistate examination purpose and process and the expected lines of communication.
 - EIC to confirm location and operating hours.
 - EIC to communicate States represented for the Multistate examination.
 - EIC will provide contact information for each state participating on the exam.
 - EIC to reiterate the protocol, as instructed in the Initial Information Request, for future communication with the multistate examination team. EIC to obtain and document institution's commitment to communication process.
 - EIC to communicate beginning date and starting time of examination.
 - EIC to communicate expected length of examination.
 - EIC to communicate on-site requirements (space needed; access to key contacts; access to files, policies and procedures).
 - EIC to request and obtain information relating to convenient hotels and other travel related requirements.
 - EIC will document the date/time/discussion items/name of contact for examination report.
 - EIC to explain the contents of the Cover Letter and Initial Information Request.
 - Agree that any necessary modifications to the Cover Letter and Initial Information Request will be sent following conference call.
 - EIC discusses and agrees with the institution to use electronic copies (data disks) and/or electronic delivery of information whenever practical institution
 - EIC directs the institution to send the state specific information directly to each participating state via overnight mail or other electronic means as agreed.
 - At the end of Week 3, the Liaison will have a conference call with the EIC and the examination team to discuss the multistate exam process.

Week 4:

- EIC reviews all State Compliance Forms, financial condition reports, and Management Policies and Procedures and prepares a summary of issues.
- EIC distributes the summary of the State Compliance forms to the Liaison and participating states via email. Additionally, EIC distributes any material

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- financial issues or management weaknesses to the Liaison and participating states.
- EIC and Liaison schedule conference call with examiners from the participating states. Discussion items to include but not be limited to:
 - Confirm date of onsite portion of the examination.
 - EIC to discuss strategy for offsite portion of the examination.
 - EIC to discuss strategy for onsite portion of the examination.
 - EIC to discuss examination logistical requirements.
 - EIC to discuss summary of issues and listen to feedback from states.
 - EIC follow up conference call with the institution to discuss the following (include Liaison if needed or desired):
 - EIC to answer any questions regarding the Initial Information Request.
 - EIC to follow protocol regarding state specific questions. [Note: Protocol is still in development. In general, EIC should use discretion and prudence in handling matters for other states. When uncertain, the EIC should consult the state before making decisions or giving assurances. If necessary, EIC may request a meeting between a particular state and the institution to clarify issues.]
 - EIC to remind institution of upcoming due dates for request items including RegulatorConnect uploads (where applicable) and Loan Logs.
 - EIC must document the date/time/discussion items/name of contact for examination records.
 - If necessary, EIC to email the participating states and the Liaison summarizing the issues identified as a result of conference call. Note: the EIC may want to consider a conference call instead of an email with the Liaison if major issues developed during Week 3 or Week 4.

Week 5:

- No Request items expected to be received this week. If some requested items are received, the EIC will begin the review of information and ensure that all participating states have received the information from the institution.
- EIC working with the institution and participating states on ongoing issues and concerns.
 - updates
 - delays
 - concerns
- Conference call with Liaison (if needed).
- Conference call with examiners from the participating states (if needed).
- EIC to update Executive Summary and deliver to Liaison.
- Liaison to provide Executive Summary and briefing if advised to MMC.

Week 6:

- Request items to be received from the institution are the state specific requests and the general examination requests.
- RegulatorConnect data to be uploaded to *ComplianceAnalyzer®* and report reviewed.
- EIC to inventory state specific request items and general examination request items.
- If the requested information is received from the institution via email to the EIC, the EIC should distribute via email all information received from institution to the participating states. Note: See Week 3 - it is recommended to have the institution put as much information as practical on disk and have the institution send the requested information directly to each participating state via overnight mail.
- EIC to contact institution for any missing documentation.
- If required documentation is received early in Week 6, the formal review of the information should begin during Week 6.
- Conference call with Liaison (if needed)
- Conference call with examiners from the participating states (if needed) to discuss any updates, delays or concerns.

Week 7 through Week 11:

- EIC to review and organize the received request items in preparation for the onsite portion of the examination. The participating states should begin reviewing the information received from the institution.
- During Week 7, each participating state should select and email the EIC the selected loan files for review.
- During Week 7, the EIC must email the institution the selected loan files to be reviewed by each state. Instruct the institution to put the loan files on disk and mail directly to the participating states. Give the institution one week to complete.
- EIC to contact institution for any clarification on request items
- EIC provides states with any additional requested items that are received from the institution.
- EIC should allocate responsibilities regarding financial condition and management review in addition to the review of the loan sample for compliance issues.
- Each week (if needed) have a conference call with the participating states.
- Each week (if needed) have a conference call with the Liaison.
- During Week 9, each state should have received the selected loan files on disk from the institution. The EIC and participating states should begin reviewing the selected loan files for compliance issues. Additionally, examiners should review the financial condition, policies and procedures, and consumer protection practices of the institution.
- During Week 11 have a conference call with the participating states finalizing the logistics for the onsite exam.
- During Week 11 have a conference call with institution finalizing the logistics for the onsite exam.

Week 12 OnSite (not limited to one week – adjust schedule accordingly):

- Upon arrival at the institution, the EIC does the following:
 - Confirm that the examiners have access to work station, copy machine, printer, telephone, and examination records.
 - EIC revisits scope and expectations of the examination with the team of examiners.
 - EIC meets with designated contact and confirms all outstanding request items are available for review.
 - EIC and examiners get a tour of the institution.
 - EIC to determine the institution's key contacts and the responsibilities of each contact. The EIC should discuss with the institution and the examiners the protocols for access to the key contacts during the onsite week.
 - Schedule meetings with various contacts of the institution to discuss general information and any issues.
- Examination begins.
- EIC to brief Liaison on status of exam.
- EIC should have daily meetings with the participating states (both onsite and offsite) to discuss any findings, issues, outstanding requests, possible meetings with institution, etc.
- Meet with members of management and key contacts.
- Last day onsite:
 - EIC should have a meeting with participating states to determine outstanding requests and the procedures for the remainder of the examination.
 - EIC should have a meeting with the Institution to discuss the outstanding items and the events that will occur the next few weeks.
 - EIC to update Liaison. Liaison to update MMC.

Week 13 and Week 14 (following onsite examination):

- Each participating state will complete the state specific report which includes federal and state violations, comments, etc. Each state must submit their supervisor approved state specific report to the EIC by the end of Week 14. [Note: The EIC should give instructions for the format of the state specific report to the participating states.]
- Conference call with Liaison to provide an update from the onsite week and any issues.
- EIC to update Executive Summary and provide to Liaison.
- Liaison to provide Executive Summary and briefing to MMC.
- Conference call with examiners from the participating states (if needed) to discuss any remaining issues from onsite week. Time and frequency to be determined as a result of the issues developed at time of examination.
- If states cannot meet deadline by end of Week 14, EIC is to discuss with select members of the examination team and the Liaison. Liaison to consult with MMC and receive advice on state deadlines.

Week 15 and Week 16:

- EIC will review each state specific report.
- EIC will prepare the multistate report:
 - EIC will write the introduction, scope, confidential comments, and summarize the multistate findings of the report.
 - EIC will include the state specific findings from each of the participating states into the multistate report.
- By end of Week 16, the completed multistate report should be reviewed by the EIC's supervisors and/or the Liaison.
- [MMC Report of Examination](#)

Week 17:

- At the beginning of Week 17 (Monday), the EIC will email the completed multistate report to the participating states.
- The participating states will have 5 days to review and send any edits/comments to the EIC.
- If necessary, the EIC will make the states' requested changes to the multistate report.

Week 18 and Week 19:

- Once all of the states' requested changes are made to the multistate report, the EIC will email the report to the Liaison for review and delivery to the MMC.
- After the MMC reviews the report, a conference call will be scheduled with the EIC, the Liaison and the MMC to discuss the edits/comments.
- If edits are required per the MMC, the EIC will make the required changes and resubmit to the Liaison and MMC for approval.
- EIC submits approved report to the participating states for final review with a two day turnaround request.
- After participating states approval of the report, the EIC state will submit a cover letter and the report to the institution via email.
 - The cover letter will provide instructions for the institution, specifically giving the institution two weeks to request a conference call with the MMC and the EIC to discuss the report.
 - The institution will have approximately 4 weeks from the date the report was sent by the EIC state to respond to the report in writing.
- Once the institution's written comments are received, the states will begin to determine what remedial actions may be necessary, if any.
- The MMC will determine the lead on any enforcement related to the multistate exam.
- Participating states to provide separate examination billings to institution.
- Liaison to survey participating examiners on the multistate experience and report results to MMC.

Technology for Portfolio Review

The *Technology for Portfolio Review* module provides guidance to examiners on how to utilize aspects of ComplianceEase® to aid the compliance monitoring process.

Introduction

Automated compliance tools make the examination of mortgage loans more effective and uniform. With their ability to process large amounts of data quickly, these tools allow examiners to scope a portfolio of loans and focus their review efforts on those loans exhibiting the highest risk characteristics. Automated loan review tools are a supplement to the procedures outlined in this manual. As such, these tools do not replace traditional examiner review and judgment.

The primary electronic examination (e-Exam) tool used by state regulators is known as ComplianceAnalyzer® (ComplianceAnalyzer) and is made available to state regulators through an agreement between CSBS and LogicEase, Inc (dba ComplianceEase®). Additional e-Exam tools include HMDA Analyzer™, RESPA Auditor™, Examination Dashboard™, and are made available through this same agreement. Throughout this manual, these tools may be referred to as the ComplianceEase® suite. ComplianceEase's suite is available to both regulators and licensees. It is important to recognize that there are many commercially available compliance solutions from which licensees may choose. The use of ComplianceEase® tools by CSBS and AARMR should not be viewed as an endorsement of these products. However, because the ComplianceEase® suite was selected by the CSBS and AARMR as the regulatory tools for use by state regulators, the steps below explain how these e-Exam tools may be incorporated into an examination.

ComplianceAnalyzer uses both internal and external data to complete its compliance analysis. The external data is provided by licensees or institutions while the internal data is embedded within the system. The external data received from the licensee must be provided in a specific format. This format is known as the Licensee Examination File (LEF) format and is available for license on www.regulatorconnect.org. Once registered, a licensee can obtain the necessary information to generate their data in LEF format. This same site also facilitates the file exchange between the regulator and the licensee. Once the licensee has generated the requested data in LEF format, the data can be delivered electronically to the regulatory agency. The online portal www.regulatorconnect.org provides more detail on how a license can produce an LEF and using the RegulatorConnect™ system to delivery loan information.

Using ComplianceAnalyzer® for Portfolio Audit

Examination Notification:

The use of ComplianceAnalyzer® in an examination begins with the notification of an upcoming examination. The licensee should be informed that the

examination will use an e-Exam process to review loan data. A licensee's first step in preparing for this process is to check with their existing software vendor(s) to see if the vendor(s) supports an LEF export. Many software vendors in the mortgage origination industry already provide this functionality. If their vendor does not provide the ability to export data in LEF format, the licensee should visit www.regulatorconnect.org and follow the steps to generate their data in LEF format.

Delivery of Loan Data:

Once a licensee's data has been generated in the LEF format, the licensee can transmit that data electronically to regulators via www.regulatorconnect.org. The regulator will receive an email notification once the licensee's LEF data has been submitted into the RegulatorConnect system.

Note: Licensees already using ComplianceAnalyzer can use a built-in feature within ComplianceAnalyzer called RegulatorDirect® to submit the loan data to regulators.

Processing the data:

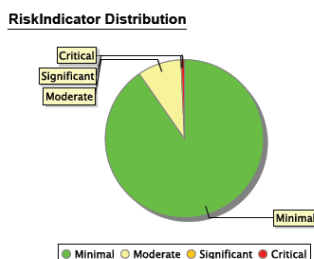
Licensee data is processed through a function of ComplianceAnalyzer® known as AutoBatch™. This function accepts the data in LEF format provided by licensees and processes the entire file automatically. The resulting output from AutoBatch™ is a series of loan-level audits, as well as high-level reports that summarize a licensee's entire portfolio.

Interpreting audit reports—the Examination Dashboard:

Loan-level audit reports and the Examination Dashboard contain the results of a ComplianceAnalyzer AutoBatch™ audit. These reports contain information to assess a portfolio's compliance with laws, and regulations.

The Examination Dashboard displays portfolio level data, allowing examiners to assess the types of loans and risks present in the entire portfolio, as well as the pass/fail rates for the various tests performed by ComplianceAnalyzer. Exhibit 1 is an example of a risk distribution chart found within the dashboard.

Exhibit 1



Further, the dashboard provides general portfolio information such as loan-type distribution, lien-type distribution, property-type distribution, and lending program distribution. This data allows examiners to not only locate loans with a particular compliance risk profile, but also to gain an understanding of the types of loans an institution is originating.

Interpreting Audit Reports—the Mortgage Compliance Analysis Report:

While the Examination Dashboard provides portfolio data, the system also allows a review of an individual loan's compliance results. The *Mortgage Compliance Analysis Report* displays the risk level and compliance test results for each loan processed. Exhibit 2 shows the different risk indicators provided by the system. For detail on the causes of a particular risk indicator, examiners should refer to the *Findings Summary Report*, which explains which failed test(s) cause a particular risk indicator. Examiners are encouraged to expand examination procedures for loans with a risk indicator of moderate and above.

Exhibit 2

Risk Indicator	Risk Classification
 Critical	
 Significant	
 Moderate	
 Elevated	
 Minimal	

Because each loan in a batch is processed individually through the AutoBatch™ process, you may select any loan from audit report to view a more detailed analysis. The detailed analysis of each loan will provide information on the specific lending tests performed, and whether or not the loan passed these tests. Tests for which a loan does not pass will be designated with the word *Fail* or a red X next to them, while loans that pass will be designated with a green *Pass* or a green checkmark. If the word *Alert* is next to a test, the loan will require additional verification by the examiner. *Alert* represents a non-quantifiable risk. If a particular lending test is not performed on the selected loan, *not tested* will appear next to that test.

Further Analysis:

When an examiner clicks on the blue question mark icon in a particular section of an audit report, the ComplianceAnalyzer system provides a more detailed explanation of how to interpret the audit results in that section. To learn more about a particular test result, an examiner can click on the heading within the relevant section of a report to learn more about the regulation that triggered the lending test failure, pass, or alert. For example, if a loan fails the RESPA GFE Disclosure Date test, the examiner can select the *Federal RESPA* link found in the header line of that section of the report. ComplianceAnalyzer will display the language found in that section of the Federal RESPA regulations that triggered that loan's failure. Similar functionality exists for state and local lending regulations. In this manner, the system serves as an effective lending regulations database that is easily accessible to examiners.

Using ComplianceAnalyzer® to Scope a Loan Portfolio

Once ComplianceAnalyzer has processed a portfolio of loans, an examiner can use the resulting reports to select loans for examiner review. The audit reports and Examination Dashboard identify loans and types of loans that an examiner may wish to include in the examination's scope. It is recommended examiners review all loans with Critical, Significant, or Moderate RiskIndicator risk levels. These loans exhibit characteristics that warrant additional examiner review. Loan numbers and other identifying information can be easily found within the audit reports. Examiners may also want to select a sample of loans that have been assigned Minimal and Elevated RiskIndicator levels, in order to perform general verifications on the data integrity of the loan information in the portfolio.

Using ComplianceAnalyzer® for Single Loan Audits

ComplianceAnalyzer® can be used to analyze an individual loan file without going through the batch audit (AutoBatch™) process explained above. To begin, the examiner should select the appropriate link from ComplianceAnalyzer®'s main menu, depending on the type of loan to be reviewed (conventional mortgage loan or HELOC) and when the loan was originated (pre-1/1/2010 or post-1/1/2010). From here, the process is straightforward. Examiners complete the onscreen form with data found in the loan file. To complete a review of most mortgages, examiners will need to refer to (1) the note, (2) the Good Faith Estimate or HUD-1 settlement statement, (3) the Truth in Lending disclosure, and (4) the mortgage insurance certificate. From these four documents, the examiner will be able to enter the necessary loan information into ComplianceAnalyzer for processing. If an examiner needs clarification on a particular data field, selecting the blue question mark in the upper right corner of that section will display additional information on the data collected within that particular section. Once entered, examiners should select the *Save and Check* option to save and process the entered data. The result of a single loan audit is the *Mortgage Compliance Audit Report*. Interpretation of this report and the terms used within it is explained above.

Using RESPA Auditor™ for Single Loan Audits

The RESPA Auditor system complements ComplianceAnalyzer by focusing on post-2010 RESPA compliance and fee tolerance and reimbursement reviews. Using loan data from ComplianceAnalyzer and the final GFE, examiners can check any individual loan against the appropriate fee tolerances. Each RESPA Auditor report will return a RiskIndicator™ similar to ComplianceAnalyzer along with both qualitative and quantitative results, allowing the examiner to easily identify transactions that require additional review. Exhibit 3 explains the different RiskIndicator levels reported by the RESPA Auditor. It is recommended that examiners review all loans that have been assigned any RiskIndicator level other than Minimal.

The RESPA Auditor RiskIndicator scale consists of three horizontal bars, each with 15 colored triangles pointing right. The first bar is labeled 'Significant' and has 10 orange triangles followed by 5 dark orange triangles. The second bar is labeled 'Moderate' and has 10 yellow triangles followed by 5 light yellow triangles. The third bar is labeled 'Minimal' and has 5 green triangles, 5 purple triangles, and 5 light green triangles.

The HMDA Analyzer system is a separate tool that examiners can employ to analyze, review and investigate both published HMDA data from the FFIEC and ongoing, current (non-filed) HMDA data from an institution. Import functionality allows loan application data to be loaded into the system and collected into “files,” either as a single large file or a set of smaller files as required by the examiner. HMDA Analyzer files can be truncated, merged, and extended. The data within them can then be evaluated and modified as needed. Search features let examiners quickly locate a particular loan record or filter to a set of records. Numerous static report templates are available directly within HMDA Analyzer for examiners to dissect and study trends and areas of potential non-compliance. Additional custom or user-defined reports are available based on the data within the system and data from the U.S. Census and other sources. The edit checks function allows an entire portfolio of loan applications to be analyzed for compliance with the latest FFIEC reporting requirements.

The *Fraud* module identifies the various characteristics of mortgage fraud including: common participants, common types, common mechanisms, red flags, and resources for identifying, deterring, and investigating mortgage fraud. The module provides guidance for examining for mortgage fraud and reporting mortgage fraud when present.

In 2009, the continuing deterioration of the real estate market and the dramatic rise in mortgage delinquencies and foreclosures helped fuel the financial crisis and exposed fraudulent practices that were prevalent throughout the mortgage industry. Weak underwriting standards and unsound risk management practices, which had allowed mortgage fraud perpetrators to exploit lending institutions and avoid detection, became evident once the housing market began declining in 2006.

MMC Exam Manual

These misstatements, misrepresentations, or omissions are indicative of mortgage fraud and include the following:

- Inflated Appraisals
- Fictitious/Stolen Identities
- Nominee/Straw Buyers
- False Loan Application
- Fraudulent Supporting Loan Documentation
- Kickbacks

Although there are many different types of schemes, mortgage fraud can be summarized as a form of institution robbery where the institutions not even aware it has been robbed until months or years later. Mortgage fraud perpetrators often obtain loans based on falsely representing the value of the collateral or their qualifications to receive the loan and steal the proceeds without an intention of repaying the borrowed funds. Lending institutions are subsequently left holding the inflated collateral and incurring significant losses.

Although not entirely inclusive, there are generally two types of fraud within the mortgage industry: fraud for property and fraud for profit. Fraud for property generally involves material misrepresentation or omission of information with the intent to deceive or mislead a lender into extending credit that would likely not be offered if the true facts were known. The motivation behind fraud for profit is money. Fraud for profit is often committed with the complicity of industry insiders such as mortgage brokers, real estate agents, property appraisers, and settlement agents (attorneys and title examiners).

As outlined in the FFIEC White Papers linked in the final section of this module, examining for fraud is critical for protecting the various parties that may be involved with a mortgage transaction.

Common Participants in Fraud

Various individuals participate in mortgage fraud schemes. The following list consists of common participants in such schemes and each is linked to the glossary:

[Appraiser](#)

[Processor](#)

[Borrower](#)

[Real Estate Agent](#)

[Buyer](#)

[Seller](#)

[Closing/Settlement Agent](#)

[Title Agent](#)

[Loan Servicer](#)

[Underwriter](#)

[Originator](#)

[Warehouse Lender](#)

While fraud is often perpetrated by an individual or entity, it can also be the result of several actors. While some of the parties involved may not be acting maliciously, negligence related to fraud is not indicative of a healthy operation. Examiners should refer back to the *Management* and *Asset Quality* sections of this manual to review how fraud should be worked into an institution's rating. Lenders that underwrite fraudulent loans may be at serious risk for asset quality, and ultimately liquidity issues. Thus, while it may be that a lender is not consciously committing fraud, weak controls that allow fraud to infiltrate loan operations should have a negative effect on an institution's management and potentially financial condition rating.

Examiners should also be aware that systemic negligence of fraudulent activity on the part of a lender may be fraud in and of itself. Thus, examiners should investigate a lender's practices when fraud is more prevalent than just a few isolated instances in a lending operation.

Common Types of Fraud

There are a variety of "schemes" by which mortgage fraud can take place. These schemes can involve individuals inside the financial institution or third parties. Various combinations of these schemes may be implemented in a single fraud. The descriptions provided below are examples of traditional and emerging schemes that are used to facilitate mortgage fraud.

Builder Bailout:

This scheme is used when a builder, who has unsold units in a tract, subdivision, or condominium complex, employs various fraudulent schemes to sell the remaining properties.

Buy and Bail:

This scheme typically involves a borrower who is current on a mortgage loan, but the value of the house has fallen below the amount owed. The borrower continues to make loan payments, while applying for a purchase money mortgage loan on a similar house that cost less due to the decline in market value. After obtaining the new property, the borrower "walks" or "bails" on the first loan.

Chunking:

Chunking occurs when a third party convinces an uninformed borrower to invest in a property (or properties), with no money down and with the third party acting as the borrower's agent. The third party is also typically the owner of the property or part of a larger group organizing the scheme. Without the borrower's knowledge, the third party submits loan applications to multiple financial institutions for various properties. The third party retains the loan proceeds,

leaving the borrower with multiple loans that cannot be repaid. The financial institutions are forced to foreclose on the properties.

Double Selling:

Double selling occurs when a mortgage loan originator accepts a legitimate application and documentation from a buyer, reproduces or copies the loan file, and sends the loan package to separate warehouse lenders to each fund the loan.

Equity Skimming:

Equity skimming is the use of a fraudulent appraisal that over-values a property, creating phantom equity, which is subsequently stripped out through various schemes.

Fictitious Loan:

A fictitious loan is the fabrication of loan documents or use of a real person's information to apply for a loan which the applicant typically has no intention of paying. A fictitious loan can be perpetrated by an insider of the financial institution or by external parties such as loan originators, real estate agents, title companies, and/or appraisers.

Loan Modification and Refinance Fraud:

This scheme occurs when a borrower submits false income information and/or false credit reports to persuade the financial institution to modify or refinance the loan on more favorable terms.

Mortgage Servicing Fraud:

This fraud is perpetrated by the loan servicer and generally involves the diversion or misuse of loan payments, proceeds from loan prepayments, and/or escrow funds for the benefit of the service provider.

Phantom Sale:

This scheme generally involves an individual or individuals who falsely transfer title to a property or properties and fraudulently obtain funds via mortgage loans or sales to third parties.

Property Flip Fraud:

A fraudulent property flip is a scheme in which individuals, businesses, and/or straw borrowers, buy and sell properties among themselves to artificially inflate the value of the property.

Reverse Mortgage Fraud:

Reverse Mortgage Fraud involves a scheme using a reverse mortgage loan to defraud a financial institution by stripping legitimate or fictitious equity from the collateral property.

Short Sale Fraud:

Fraud occurs in a short sale when a borrower purposely withholds mortgage payments, forcing the loan into default, so that an accomplice can submit a “straw” short-sale offer at a purchase price less than the borrower’s loan balance. Sometimes the borrower is truly having financial difficulty and is approached by a fraudster to commit the scheme. In all cases, a fraud is committed if the financial institution is misled into approving the short-sale offer, when the price is not reasonable and/or when conflicts of interest are not properly disclosed.

Two additional fraud schemes, which are briefly addressed below, are debt elimination and foreclosure rescue schemes. While these schemes are typically not perpetrated directly on financial institutions, and therefore not expanded upon to the same degree as the above-mentioned schemes, the end result of the scheme can have a negative impact on the financial institution.

Debt Elimination Scheme:

Debt elimination schemes are illegal schemes that offer to eliminate a borrower's debt for an up-front fee. The organizers of these schemes create phony legal documents based on the borrower’s loan(s) for presentment to the borrower’s financial institution or other lending institution in an attempt to falsely satisfy the loans.

The threat this fraud scheme presents to a financial institution is the borrower’s cessation of loan payments. Financial institutions may find that the use of the false documents complicates the collection process and may temporarily prevent any final action against the borrower.

Foreclosure Rescue Scheme:

Foreclosure rescue schemes prey upon homeowners in financial distress or facing foreclosure, with the promise to help save their home. There are multiple variations of this scheme, often charging up-front fees and/or convincing the homeowner to deed the property to the fraudster, with the premise that the homeowner can rent or buy the property back once the individual’s credit has improved. The goal of the fraudster is to collect fees or mortgage payments that are intended for the lender, but are not delivered, usually resulting in the loan going into default and ultimately foreclosure, causing loss to the financial institution.

Common Mechanisms of Mortgage Fraud

A single mortgage fraud scheme can often include one or more mechanisms and may involve collusion between two or more individuals working in unison to implement a fraud. The following is a list of common mechanisms used to perpetrate mortgage fraud schemes:

Asset Rental:

Cash or other assets are temporarily placed in the borrower's account/possession in order to qualify for a mortgage loan. The borrower usually pays a "rental" fee for the temporary "use" of the assets.

Fake Down Payment:

In order to meet loan-to-value requirements, a fake down payment through fictitious, forged, falsified, or altered documents is used to mislead the lender.

Fraudulent Appraisal:

Appraisal fraud can occur when an appraiser, for various reasons, falsifies information on an appraisal or falsely provides an inaccurate valuation on the appraisal with the intent to mislead a third party.

Fraudulent Documentation:

Fraudulent documentation consists of any forged, falsified, incomplete, or altered document that the financial institution relied upon in making a credit decision.

Fraudulent Use of Shell Company:

A business entity that typically has no physical presence, has nominal assets, and generates little or no income is a shell company. Shell companies in themselves are not illegal and may be formed by individuals or business for legitimate purposes. However, due to lack of transparency regarding beneficial ownership, ease of formation, and inconsistent reporting requirements from state to state, shell companies have become a preferred vehicle for financial fraud schemes.

Identify Theft:

Identity theft can be defined as assuming the use of another person's personal information (e.g., name, SSN, credit card number, etc.) without the person's knowledge and the fraudulent use of such knowledge to obtain credit.

Straw/Nominee Borrower:

An individual used to serve as a cover for a questionable loan transaction.

Common Indicators of Fraud

Red Flags:

Examiners may encounter red flags indicating potential supervisory issues. The mere existence of red flags does not mean that actual abuses are present, but they should not be ignored. In many instances, a combination of several red flags represents more compelling evidence that a problem does in fact exist. In other cases, warning signs in and of themselves represent actual deficiencies requiring corrective action. When red flags are evident, the examiner should question management and/or staff relative to the issue involved.

Examiners should consult with the appropriate level of Agency management prior to any expansion of scope. This is particularly important when another regulated institution or regulatory agency is involved, e.g., another institution is a purchaser of the loans. Any additional actions taken should be in accordance with the examiner's respective agency guidelines. Also, this is important when a law enforcement agency is involved. Please refer to the resources under the "Resources for Fraud Detection, Deterrence, and Investigation" portion of this module for recommended tools that examiners may use during the examination process when fraud is suspected or discovered.

Although this list is certainly not inclusive (Fraud Red Flags are examined much more thoroughly in the "Resources" section of this module), some common indicators of mortgage fraud are:

- Loan Participants/Motivations
- Information Discrepancies
- SSN Discrepancies
- Documentation Discrepancies
- Significant Cash Proceeds
- Undisclosed Mortgages

Tips about Red Flags:

- Learn to recognize red flags.
- Use a common sense approach when reviewing a loan file –If it doesn't make sense keep looking!
- Review pertinent documents individually for red flags.
- Compare documents to each other for inconsistencies.
- Use third party resources to verify key information in the file if it is questionable.
- Inconsistencies may seem legitimate when reviewed separately, but when taken as a whole, a pattern of deception may begin to emerge and require further investigation.
- If a loan application sounds too good to be true -it may be.
- A few inconsistencies in a loan file does not mean that the file contains fraud or misrepresentation.

Resources for Fraud Detection, Deterrence, and Investigation

The documents hyperlinked in this section were developed by the Federal Financial Institutions Examination Council (FFIEC) and issued in 2005 and 2010 respectively. The first document deals with third party fraud specifically, while the second document deals with fraud more generally. They provide detailed guidance to examiners about detecting and reporting fraud. Additionally, they provide an in depth analysis of the various types of fraud and red flags associated with each of those. Examiners should review these documents thoroughly in order to appropriately understand the nature and characteristics of fraud and the methods for handling fraud issues:

- [The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper](#)
- [The Detection and Deterrence of Mortgage Fraud against Financial Institutions: A White Paper](#)

Examiners should be aware that if fraud is present, it should be reported to the proper law enforcement agency, as outlined in the resources.

Reverse Mortgage Lending

The purpose of the *Reverse Mortgage* module is to outline additional information on Reverse Mortgage products and to provide tools and references for examiners to use when reviewing an institution's reverse mortgage practices.

Introduction

Reverse mortgage products enable eligible borrowers to exchange the equity in their homes for cash without requiring borrowers to repay the loan while they live in their homes. Reverse mortgage proceeds may be used for a variety of purposes. According to a recent GAO study, the most common uses of reverse mortgage proceeds are for paying off an existing mortgage, home repairs or improvements, or improving quality of life. For many borrowers, a reverse mortgage may provide the only funds available to pay for health care needs and other living expenses. As a result, reverse mortgages, if offered appropriately, could become an increasingly important mechanism for financial institutions to address the credit needs of an aging population.

The need to provide consumers with adequate information about reverse mortgages and to ensure appropriate consumer protections is high. Reverse mortgages are complex loan products that present a wide range of complicated options to borrowers. Moreover, they are typically secured by the borrower's primary asset – his or her home.

Reverse Mortgage Products

The reverse mortgage market currently consists of two types of products: proprietary products offered by individual lenders and FHA-insured reverse mortgages offered under HUD's HECM program. Reverse mortgage loans were introduced in the market in 1989 with the U. S. Department of Housing and Urban Development ("HUD") sponsored, FHA-insured, Home Equity Conversion Mortgage ("HECM"). The HECM is one of the most common types of reverse mortgage loan.

- As of October 4, 2010 the following types of HECM reverse mortgage are available:
 - HECM Standard
 - HECM Saver- Available as of October 4, 2010 (this product has not been approved in many states)
 - HECM for purchase which was introduced into the market on October 20, 2008 allows borrowers to purchase a primary residence if they are able to use cash on hand to pay the difference between the HECM proceeds and the sales price plus closing costs for the property they are purchasing. Borrower can opt for the HECM standard or HECM saver when taking out a HECM for purchase.

A HECM loan is subject to HUD regulations that establish a range of consumer protections and other requirements. Reverse mortgages generally are nonrecourse, home-secured loans that provide one or more cash advances to borrowers and require no repayments until a future event. Both HECMs and proprietary reverse mortgages generally must be repaid only when the last surviving borrower dies, all borrowers permanently move to a new principal residence, or the loan is in default. For example, repayment would be required when the borrower sells the home or has not resided in the home for a year. A borrower may be in default on a reverse mortgage when the borrower fails to pay property taxes, fails to maintain hazard insurance, or lets the property fall into disrepair.

When a reverse mortgage becomes due, the home must be sold or, alternatively, the borrower (or surviving heirs) may repay the full amount of the loan including accrued interest. If the home is sold, however, the borrower or estate generally is not liable to the lender for any amounts in excess of the value of the home.

To obtain a reverse mortgage, the borrower must occupy the home as a principal residence and generally be at least 62 years of age. Reverse mortgages are typically structured as first lien mortgages and require that any prior mortgage be paid off either before obtaining the reverse mortgage or with the funds from the reverse mortgage. The funds from a reverse mortgage may be disbursed in several different ways:

- A single lump sum that distributes up to the full amount of the principal credit limit in one payment;

-
- A credit line that permits the borrower to decide the timing and amount of the loan advances;
 - A monthly cash advance, either for a fixed number of years selected by the borrower or for as long as the borrower lives in the home; or
 - Any combination of the above selected by the borrower.

Generally, the amount of money the consumer may borrow will be larger when the consumer is older, the home is more valuable, or interest rates are lower. Interest rates on a reverse mortgage may be fixed or variable.

Most reverse mortgages have been structured as open-end lines of credit. For example, in fiscal year 2008, 89 percent of HECM borrowers chose to receive money solely as a line of credit and another 6 percent chose to receive a line of credit combined with a monthly payment. Generally, those choosing a line of credit withdrew about 60 percent of their funds at account opening. In addition, most HECMs have had variable interest rates. However, in 2008 HUD issued a mortgagee letter regarding the availability of fixed-rate HECMs. Since then, originations of fixed-rate HECMs have grown and in recent months have been the majority of HECM originations. Fixed-rate HECMs are generally structured as closed-end credit and borrowers usually may receive loan proceeds only as a lump sum of the full principal amount at closing.

Some Differences in the Products

The HECM saver which was introduced to the market on October 4, 2010 is available to those borrowers that want lower upfront closing costs, however those borrowers that opt for the HECM saver will be qualify for less money than borrowers that opt for the HECM standard. A HECM Saver has an initial mortgage insurance premium fee of .001% of the maximum claim amount paid at closing or settlement. Borrowers are also charged an annual mortgage insurance premium of 1.25% of the loan balance.

A HECM standard has an initial mortgage insurance premium Fee of 2% of the maximum claim amount which is paid at closing or settlement. Borrowers are also charged an annual mortgage insurance premium that is 1.25% of the outstanding loan balance.

There are also reverse mortgages referred to as “Proprietary Reverse Mortgages” these are different from HECM loans primarily because they do not have insurance.

There are “Term Reverse Mortgages” that are reverse mortgages that are fixed for a set term.

Interest Rate and Mortgage Insurance Premium

- Interest Rate:

-
- HECM borrowers can choose an adjustable interest rate or a fixed rate. If a borrower chooses an adjustable interest rate, the interest rate may adjust monthly or annually.
 - Lenders may not adjust annually adjusted HECMs by more than 2 percentage points per year and not by more than 5 total percentage points over the life of the loan.
 - The monthly adjusting HECM does not have an interest rate cap however, in the past secondary market investors generally only purchased these loans if the rate was capped at 10% over the initial rate charged on the loan. This may be subject to change if more investors begin purchasing HECM loans.
 - Mortgage Insurance Premium:
 - The HECM insurance guarantees that you will receive expected loan advances. The insurance also guarantees that, if you or your heirs sell your home to repay the loan, your total debt can never be greater than the value of your home.

Characteristics of a HECM

- Non-recourse loan
- Mortgage amount based on:
 - Age of the youngest borrower
 - Current interest rate
 - Lesser of appraised value or HUD HECM Lending Limit.
- Financial Requirements:
 - No income or credit qualifications are required from borrower.
 - No repayment as long as the property is the primary residence.
 - Closing costs may be financed in the mortgage.
 - Lender must be in first lien position.
- Payment Options:
 - **Tenure** - equal monthly payments as long as at least one borrower lives and continues to occupy the property as a principal residence.
 - **Term** - equal monthly payments for a fixed period of months selected.
 - **Line of Credit** - unscheduled payments or in installments, at times and in amounts of borrower's choosing until the line of credit is exhausted.
 - **Modified Tenure** - combination of line of credit with monthly payments for as long as the borrower remains in the home.
 - **Modified Term** - combination of line of credit with monthly payments for a fixed period of months selected by the borrower.
- When is the loan Due?:
 - The last living borrower dies.
 - Heirs sell or payoff loan

-
- The borrower sells the property.
 - The property ceases to be the principal residence of the borrower (over consecutive 12-months).
 - Property may be foreclosed on if borrower does not upkeep property and pay property taxes.
 - The borrower may prepay the loan at any time without a penalty.
 - Fees:
 - A typical reverse mortgage loan has up front fees and costs, which should be reviewed carefully. These fees may amount to thousands of dollars and increase the amount owed on the loan. Therefore, understand the total costs associated with the loan by asking questions and insisting on answers.
 - Typical fees include:
 - Origination Fees: 2 percent of the first \$200,000 borrowed and 1 percent for any amount after that. The origination fee must not exceed \$6,000.
 - Mortgage Insurance Premium Fees
 - HECM Standard: Equal to 2 percent of the maximum claim amount, or home value, whichever is less, plus an annual premium thereafter equal to 1.25 percent of the loan balance.
 - HECM Saver: Equal to .001 percent of the maximum claim amount, or home value, whichever is less, plus an annual premium thereafter equal to 1.25 percent of the loan balance.
 - Service Fees: amount of money deducted from the available loan proceeds at closing to cover the projected costs of servicing the account.
 - Typical monthly fee ranges between \$30-\$35.
 - Closing Costs: appraisal fee, Credit report fee Recording fee, etc.

Reverse Mortgage Market Trends

The volume of reverse mortgages has grown considerably over the years. HECM originations, which account for over 90 percent of the market, have grown from 157 loans in fiscal year 1990 to more than 112,000 loans in fiscal year 2008. A substantial portion of this growth has occurred in recent years, with HECM originations nearly tripling between 2005 and 2008. A secondary market for HECMs exists, with Fannie Mae having purchased 90 percent of HECM loans as of 2008. In addition, in 2007 Ginnie Mae developed and implemented a HECM mortgage-backed security with issuance growing to \$1.5 billion for 2009. Proprietary reverse mortgages have also experienced growth, but that growth has stalled in the last few years due to market conditions. A key feature of

proprietary reverse mortgages is that they generally offer loans in amounts greater than the HECM loan limits. The Housing and Economic Recovery Act of 2008 raised the HECM loan limit. As a result, at least one lender, Fannie Mae, discontinued its proprietary reverse mortgage product in 2008. However, a report by the GAO in 2009 found that most lenders with proprietary products planned to offer them again, depending on the availability of funding in the secondary market.

The following points outline some reasons why reverse mortgages are so popular in today's economic environment:

- Growth in home equity
 - In 2007, Americans age 62 or older hold an estimated \$4.3 trillion of home equity according to the NRMLA/Hollister Reverse Mortgage Market Index.
 - Projecting as much as \$37 trillion in home value by 2030.
 - The average home equity in a senior-owned household is estimated to be about \$230,000 according to the Hollister Group.
- Increase in number of retirees
 - 2008 is the year in which the first members of the 77 million "Baby Boomer" generation turns 62.
- Distressed economic times
 - Provides financial security for those who are "house rich and cash poor."

Some additional statistics regarding reverse mortgages:

- More than 90% of reverse mortgages are HECMs. Grew from 7,781 in 2001 to 107,558 in 2007.
- According to HUD, since 2001, reverse mortgages have grown tenfold to a \$25 billion dollar industry.
- Less than 2% of the market is tapped.
- Expecting 20 to 30% growth in future
- Although declining, these loans are also being securitized.

Current Reverse Mortgage Requirements

TILA

TILA Section 103(bb) defines the term "reverse mortgage transaction" as a nonrecourse transaction in which a mortgage, deed of trust, or equivalent consensual security interest is created against the consumer's principal dwelling securing one or more advances. 15 U.S.C. 1602(bb). In addition, the payment of any principal, interest and shared appreciation or equity is due and payable (other than in the case of default) only after the transfer of the dwelling, the consumer ceases to occupy the dwelling as a principal dwelling, or the death of the consumer. TILA Section 138 requires disclosures for reverse mortgages in addition to the other disclosures required by TILA. 15 U.S.C. 1648. Specifically,

TILA Section 138 requires disclosure of a good faith estimate of the projected total cost of the reverse mortgage to the consumer expressed as a table of annual interest rates, to be provided at least three business days before consummation. Each annual interest rate in the table is to be based on a projected total future credit balance under a projected appreciation rate for the dwelling and a term for the mortgage. The statute calls for at least three projected appreciation rates and at least three credit transaction periods as determined by the Board. The periods are to include a short-term reverse mortgage, a term equaling the consumer's life expectancy, and a longer term as the Board deems appropriate. The disclosure must also include a statement that the consumer is not obligated to complete the reverse mortgage transaction merely because the consumer has received the disclosure or signed an application.

Under TILA Section 138, the projected total cost of the reverse mortgage used to calculate the table of annual interest rates includes all costs and charges to the consumer, including the costs of any associated annuity that the consumer will or is required to purchase as part of the reverse mortgage. The projected total costs also includes any shared appreciation or equity that the legal obligation entitles the lender to receive, and any limitation on the liability of the consumer under the reverse mortgage, such as nonrecourse limits and equity conversion agreements. In addition, the total cost projection also reflects all payments to and for the benefit of the consumer. If the consumer purchases an annuity (whether or not required by the lender as a condition of making a reverse mortgage), any annuity payments received by the consumer and financed from the proceeds of the loan are considered the payments to the consumer, rather than the reverse mortgage proceeds that were used to finance the annuity.

Regulation Z

Sections 103(bb) and 138 of TILA are implemented in §§ 226.31(c)(2) and 226.33 of the Federal Reserve Board's Regulation Z. Section 226.31(c)(2) requires the creditor to furnish the disclosures for reverse mortgages at least three business days before consummating a closed-end credit transaction or the first transaction under an open-end credit plan. Section 226.33 contains the statutory definition of "reverse mortgage transaction" and the content of the reverse mortgage disclosures. Under Section 226.33, the reverse mortgage disclosures must include a statement that the consumer is not obligated to complete the transaction, a good-faith projection of the total cost of credit expressed as a table of "total-annual-loan-cost rates" (TALC rates) and an explanation of the table. The disclosures must also include an itemization of loan terms, charges, the age of the youngest borrower, and the appraised property value. Appendix K to Regulation Z provides instructions on how to calculate the TALC rates required to be disclosed, based on the calculation method used in Appendix J for the closed-end APR, and provides a model and sample disclosure form. Appendix L to Regulation Z contains the loan periods creditors must use in disclosing the TALC rates and a table of life expectancies that must be used to determine loan periods based on the consumer's life expectancy.

Section 226.33 requires that the table show TALC rates for assumed annual appreciation rates of 0%, 4%, and 8%. It also requires that TALC rates be provided for the assumed loan periods of: two years; the consumer's actuarial life expectancy; and the consumer's actuarial life expectancy multiplied by a factor of 1.4. In addition, at the creditor's option, the table may contain a fourth assumed loan period based on the consumer's actuarial life expectancy multiplied by 0.5.

The commentary to § 226.33 contains a number of clarifications. Comment 33(a)-1 clarifies that a transaction must be nonrecourse to meet the definition of a reverse mortgage in section 226.33(a). That is, the consumer's liability must be limited to the proceeds from the sale of the home. Comment 33(a)-1 clarifies, however, that if a closed-end reverse mortgage does not limit the consumer's liability to the proceeds of the sale of the home, and the transaction meets the definition of a high-cost mortgage loan under § 226.32, the transaction is subject to all the requirements of §§ 226.32 and 226.34. Comment 33(a)(2)-1 clarifies that the term "default" is not defined by the statute or regulation, but rather by the legal obligation and state or other applicable law. Comment 33(a)(2)-2 clarifies that to meet the definition of a reverse mortgage transaction, a creditor cannot require principal, interest, or shared appreciation or equity to be due and payable (other than in the case of a default) until after the consumer's death, transfer of the dwelling, or the consumer ceases to occupy the dwelling as a principal dwelling. This comment further clarifies that the reverse mortgage obligation may state a specific maturity date or term of repayment and still meet the definition of a reverse mortgage, as long as the maturity date or term will not cause maturity prior to the occurrence of any of the maturity events recognized in the regulation. For example, the obligation could state a term but automatically extend the term for consecutive periods if no recognized maturity event has occurred. Comment 33(c)(1)-1 clarifies that all costs and charges the consumer incurs in a reverse mortgage are included in the projected total cost whether or not the cost or charge is a finance charge under §226.4. Current comment 33(c)(1)-2 clarifies that the amount paid by the consumer for an annuity is a cost to the consumer. Comment 33(c)(1)-3 clarifies that costs incurred in connection with the sale or transfer of the property subject to the reverse mortgage are not included in the cost to the consumer.

Comment 33(c)(2)-1 clarifies that certain contingent payments to the consumer are excluded from the total cost projection. Comments 33(c)(3)-1 and 33(c)(4)-1 clarify that shared appreciation or shared equity, and limitations on the consumer's liability, respectively, are included in the projected total cost. Comment 33(c)(4)-2 provides a uniform assumption that, if the consumer's liability is limited to the "net proceeds" from the sale of the home, the costs associated with selling the dwelling should be assumed to be 7 percent of the projected total sale price, unless another amount is specified in the legal obligation.

Commentary to Appendix K and Appendix L provides further guidance on calculating TALC rates and on the clear and conspicuous standard for the model disclosure form.

Current Open-End and Closed-End Disclosures

Reverse mortgages are subject to the disclosure requirements for other home-secured credit. § 226.31(a). Reverse mortgages structured as open-end credit are subject to the provisions in Subpart B of Regulation Z, including the provisions in §§ 226.5b and 226.6 applicable to HELOCs. Closed-end reverse mortgages are subject to Subpart C of Regulation Z. The current disclosures required for HELOCs and closed-end mortgages require creditors to provide information about costs and repayment amounts that must be calculated using a specific loan term. For example, even though reverse mortgages are single-payment transactions, they are currently subject to the requirements to disclose the payment schedule for closed-end loans under § 226.18(g), or the repayment example for a \$10,000 HELOC draw under § 226.5b(d)(5)(iii). To disclose the single payment amount, the creditor must know when the loan will become due in order to calculate the amount of interest that will be charged. Yet reverse mortgage creditors must base these disclosures on an assumed repayment period, because the exact date that a reverse mortgage will become due and payable is unknown. The current commentary provides guidance on assumptions creditors must use. See comments 5b(d)(5)(iii)- 4, 5b(d)(12)(xi)-10 and 17(c)(1)-14. For instance, creditors are instructed to base disclosures on the term of the reverse mortgage if a definite term exists, even though the consumer may not actually repay the loan at the end of the term. If no term exists, the disclosures must be based on the consumer's life expectancy.

Tools for Examiners

CSBS-AARMR Reverse Mortgage Examination Guidelines (RMEGs)

CSBS and AARMR developed the RMEGs as a comprehensive set of examination guidelines designed specifically for reviewing the business practices and operations of lenders and brokers selling reverse mortgage loans to seniors. They cover all aspects of operations from policies and procedures to marketing, underwriting, quality control and servicing of a reverse mortgage portfolio. The RMEGs take a two-pronged approach of regulatory compliance and sound management practices to achieve the dual goal of consumer protection and institutional stability.

Examiners should use the RMEGs as the exam procedures for reviewing reverse mortgages. The RMEGs can be viewed here: [Reverse Mortgage Examination Guidelines \(RMEGs\)](#).

Interagency Supervisory Guidance

In December 2009, the federal banking agencies, through the Federal Financial Institutions Examination Council (FFIEC), published proposed supervisory guidance on reverse mortgage products (Proposed Reverse Mortgage Guidance). The FFIEC finalized this Guidance in August 2010 (Final Reverse Mortgage Guidance or Guidance). The Final Reverse Mortgage Guidance is designed to help financial institutions ensure that their risk management and

consumer protection practices adequately address the compliance and reputation risks raised by reverse mortgage lending. The Guidance addresses the consumer protection concerns raised by reverse mortgages, and focuses on the need for banks, thrifts, and credit unions to provide clear and balanced information to consumers about the risks and benefits of reverse mortgages while consumers are shopping for these products. Specifically, the Final Reverse Mortgage Guidance states that lenders offering proprietary products should require counseling from “qualified independent counselors” before a consumer submits an application or pays an application fee for a reverse mortgage product. The Guidance also states that institutions should take steps to avoid any appearance of a conflict of interest. Accordingly, the Guidance advises institutions to adopt clear policies stating that borrowers are not required to purchase other financial products to obtain a reverse mortgage. Institutions are also advised to guard against inappropriate compensation or incentive policies that encourage loan originators to link reverse mortgage products to other financial products.

The guidance can be viewed here: [Reverse Mortgage Guidance](#).

HUD Reverse Mortgage Mortgagee Letters

The HECM mortgagee letters attachment is a spreadsheet with hyperlinks to all of the HECM mortgagee letters that have been issued since 1989, with cross references to those that may have been superseded. This spreadsheet was developed by the state of Massachusetts. Examiners should use it as a reference for reviewing the various HUD positions and policies regarding the HECM.

The spreadsheet can be viewed here: [HECM Mortgagee Letters](#).

“Disclosure Requirements for Reverse Mortgages”

A 2009 article written by Alan Dombrow and Ken Shim of the Federal Reserve Bank of NY detailing TILA/Reg Z Reverse Mortgage Compliance and TALC calculations.

The article can be viewed here: “[Disclosure Requirements for Reverse Mortgages](#).”

Investigation, Enforcement, and Criminal Referral

The *Investigation, Enforcement, and Criminal Referral* module provides guidance on the process of investigating institutions that demonstrate practices which warrant enforcement action and the process for referring criminal activity to law enforcement agencies.

Introduction

The process outlined below provides guidance for investigation, enforcement, and criminal referral at the state regulatory department level. The MMC manual is meant to serve as guidance for states in their own department as well as the process by which the MMC conducts examination and enforcement related activities. Thus, while the process below is geared toward the departments on a state by state basis, the process for the MMC is essentially the same. If the institution under investigation is an MME, and the MMC is examining the institution, then the MMC will appoint a lead investigator (“Financial Investigator” below) to conduct and coordinate the investigation. The lead investigator will be assigned a team to aid him or her in the investigation. The MMC itself serves as the “Enforcement Division” and the MMC chairman serves as the “Enforcement Director.” The lead investigator will present the findings of the investigation to the MMC, which will determine whether enforcement action is necessary. This process is very similar to the individual state process outlined below. Where the processes differ (although not by much) is in the enforcement stage. In the case of MMEs, the MMC must coordinate enforcement actions between all the participating states. If and when the participating states sign the enforcement action, the MMC will deliver the enforcement action to the institution.

There are many variations of the manner in which an investigation may be taking place. An investigation may take place as a standalone investigation, not connected to an exam. Additionally, an investigation may take place in concert with an exam. Perhaps the most common scenario is that an exam has taken place and has revealed certain practices within an institution and an investigation ensues.

Barring the differences explained above, the process outlined below governs the investigation, enforcement, and criminal referral process for the MMC.

Investigations

The Enforcement Divisions of the various state regulatory departments conduct investigations on those entities and individuals who fall under the state regulatory authority. Any questions regarding whether an individual or organizational entity falls within the jurisdictional guidelines of each applicable state for investigative purposes should be directed to the state’s Enforcement Division Legal Advisor.

Sources of Investigations

The Enforcement Division receives its investigations from a variety of sources. Case investigations are initiated from:

- Consumer complaints
- Financial crimes intelligence
- Referrals from other law enforcement and regulatory agencies
- Referrals from other divisions within the department
- Referrals from state licensees

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- Spin off cases from current investigations

Initiation of Investigations

All information concerning possible new investigations for the Enforcement Division should be forwarded to the Enforcement Director for consideration to determine whether an investigation should be opened and assigned to a Financial Investigator. Factors which are considered in determining whether an Enforcement Division investigation is warranted include:

- Is the subject in question under the state's regulatory authority?
- Is it a matter that requires an investigation or pro-active steps for resolution requiring the attention of a Financial Investigator?
- Is this a case where the state agency's management and/or division, or a regulated licensee requested specific assistance from the Enforcement Division?
- The significance and impact of the case in consideration of limited resources.

The Enforcement Director should gather and review all available information on a potential investigation and make a determination based on the previous factors cited as to whether an investigation should be opened by the Enforcement Division and assigned to a Financial Investigator.

After the decision has been made to open a case, the Enforcement Director will forward the information to the Enforcement Division Financial Analyst with instructions to open an investigation and which Financial Investigator will be assigned the case. Instructions will also be provided on the classification level of the case whether it is to be a "High," "Medium" or "Low" level case. The prioritization of the investigation is at the discretion of the Enforcement Director. Some factors in determining the prioritization level of the investigation include the following:

- Whether the individual or entity is currently active and licensed.
- Whether the matter under consideration has criminal and/or administrative issues.
- The severity or seriousness of the criminal and/or administrative issues.
- The actual and/or potential economic financial loss involved in the case.
- The number of victims involved in the case.
- The urgency of the matter to avoid future potential damage to the public.

After the Financial Analyst has received guidance and instructions in opening an investigation, the Financial Analyst will then enter all applicable and available information regarding the case into the Investigative Management System and provide any other information to the appropriate Financial Investigator.

Background Research for Investigations

The Financial Analyst should research any appropriate and available databases for additional information on the investigative subject(s). Some of the databases which should be searched include:

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- Complaint Tracking System (CTS)
 - Mortgage Licensing System (MLS),
 - Check Cashing System (CCS)
 - Investigation Management System (IMS)
 - Administrative Office of Courts (AOC) Check
 - From Mortgage Division request:
 - copy of LO license file
 - copy of company license file
 - copy of latest examination report
 - National Mortgage Licensing System
 - Public information sources
 - Secretary of State Website
 - Real Estate Commission Website
 - Appraisal Board Website
 - Google search of business
 - Any other appropriate databases.

Any information the Financial Analyst obtains regarding the new case subject (s) will be provided to the Financial Investigator. The Financial Analyst will advise the Financial Investigator that a new investigation has been assigned.

Assignment of Investigations

The Enforcement Director determines case assignments for the Enforcement Division. The following are some of the factors that will be considered in the assignment of cases to Financial Investigators:

- Current case load of Financial Investigator.
- Geographical area of investigation for cost efficiency.
- Specialized knowledge or skills the Financial Investigator may have in a particular type of investigation.
- Related investigation to one already assigned to the Financial Investigator.
- Financial Investigator had previously been assigned to the investigation.
- Specific requests from management or prosecutors for Financial Investigator.
- Other miscellaneous reasons.

Preparation by Financial Investigator to Conduct Investigations

Upon assignment of a new investigation to the Financial Investigator, that Financial Investigator will review the initial information provided and ascertain the priority level of the investigation. Financial Investigators will generally endeavor to investigate cases with the highest priority first and in the order which they are assigned. Deviations from this policy require the approval of the Enforcement Director. High Priority cases should have a preliminary review completed within five to ten business days of the initial case assignment, and the investigation should be completed as soon as possible. If the Financial Investigator determines that the investigation may exceed 90 days to complete, he must notify the Enforcement Director and update targeted completion date monthly via

case status report until case is completed. Case is considered closed when it has been closed in the Investigative Management System and a written report has been submitted for review. Medium and Low Priority cases should have a preliminary review completed within fifteen business days of the initial case assignment, and the investigation should be completed within 90 days unless approval to extend the investigation has been granted.

Conducting the Investigation

There are several basic steps in any investigation that should be conducted. Each investigation may vary in the approach taken. Unless specific instructions are provided by the supervisor, the investigative approach, plan and timing are the responsibility of the Financial Investigator to develop and the Enforcement Director is responsible for consultation as necessary. The following are some of the normal investigative steps which are part of the process of completing an investigation:

- Review the case file and any of the applicable state's available records and public information.
- Develop an investigative plan. The plan is the written outline of how one intends to carry out the investigation. The investigative plan should be documented in the IMS within 10 days of the opening of the case by the Financial Investigator. Upon completion of the investigative plan, the Financial Investigator should e-mail the Enforcement Director of the completion of the investigative plan and request approval. The investigative plan should include but not be limited to:
 - The relevant policy, regulations or statutes under which the investigation is being conducted.
 - The precise issues to be investigated.
 - How the investigation will be conducted.
 - The proposed time frame for completion of investigation.
 - The method (s) of investigation.
 - Who is to be interviewed and in what sequence.
 - The evidence is needed to prove or disprove allegations.
 - Who will receive a copy of the completed investigative report.

After the Financial Investigator has determined the investigative plan, it should then be implemented. During the course of the investigative process, there can be several deviations in the plan due to the vagaries of any investigation. The Financial Investigator should regularly update the plan in the Investigative Management System and also the completed steps in the investigation which reflect any changes as the investigation progresses.

Documenting the Completion of Investigations

During the investigation, the Financial Investigator should be documenting weekly all investigative activities in the Investigative Management System. The Financial Investigator should aim to complete the investigations and produce a report as quickly as possible. However, this must not be to the detriment of a full and thorough investigation. At the logical conclusion of the investigation, the

Financial Investigator should determine the necessity of the preparation of an investigative report and a determination as to the outcome of the investigation. A formal investigative report is necessary if the Financial Investigator determines that there should be some sort of prospective action taken on the case or the Financial Investigator determines a prosecutor should review the case for a legal opinion on a course of action.

Upon completion of an investigation, the Financial Investigator will notify the Enforcement Director by e-mail that the investigation is complete and request that the case be placed in review status. The investigative report should then be forwarded to the Enforcement Director for review and approval for any recommended action. The Enforcement Director will then review the investigative report and make a determination if the investigation is adequate and complete, and then he will forward the investigative report to the Enforcement Division for their review and approval. After all approvals have been obtained, the investigative report will then be forwarded to the appropriate recipients.

If the Financial Investigator determines that an investigative report is not necessary, which usually occurs when the allegations of a case are disproved or the evidence is insufficient, the Financial Investigator should discuss the facts of his investigative findings with the Enforcement Division to confirm that no action on the case is appropriate. These legal opinions should be documented in the Investigative Management System. The Financial Investigator then should e-mail the Enforcement Director requesting that the investigation be closed. The Enforcement Director will review the case in the Investigative Management System to confirm that closing the case is warranted and that full documentation of the investigation is conducted. If appropriate, the Enforcement Director will close the case in the Investigative Management System.

Interviewing

Who Should be Interviewed in the Investigation?

One of the key components of any investigation is the interviews of witnesses and the subject(s) who are involved in the case. The investigation is incomplete if all the witnesses, subject(s) and complainant have not been interviewed.

Proficiency in interviewing ensures a high degree of accuracy in fact development, proves or disproves the allegations or issues, prevents surprise testimony later, and may impeach witnesses who change their stories. The purpose of the interview is to gather information. The investigator does this through a process of asking and answering questions. The investigator has one goal through the interview process which is the reporting of the objective truth.

While formulating his investigative plan, the investigator will determine who is to be interviewed and in what order. The order in which individuals are interviewed is often determined by the circumstances and characteristics of each individual case. A reasonable order for conducting interviews is:

- The complainant or the person who is making the allegation.
- Any witness(es) in the case.

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- The subject(s) in the case.

Preparing for the Interview

Prior to conducting the interview, the Financial Investigator should prepare for the interview by reviewing all information available about the interviewee and the subject of the interview. The Financial Investigator should also prior to the interview determine the location of the interview, the methods to be employed in the interview, outline the goals and objectives of the interview, the number of investigators and other parties in the interview and the manner of recording the interview.

The Financial Investigator should pick a location for the interview which is a setting that provides confidentiality, minimizes distractions, maintains the comfort level of the witness and is mutually convenient for the interviewee and the interviewer.

The Financial Investigator should also determine the manner of the interview whether it will be an innocuous interview or an interrogation, whether the interviewee will be asked to prepare for the interview or bring evidence to the interview, or whether the interviewee will be shown documents or confronted with other witness testimony.

Prior to the interview, the Financial Investigator should have an outline of the goals and objectives of the interview. The Financial Investigator may not want to write out a list of questions to be asked or topics to be discussed during the interview. Only one person at a time should be interviewed. If the interviewee has a companion in the interview, it should be only someone who will not be a witness in the case.

Conducting the Interview

Whenever possible, all interviews, especially interviews of subjects, should be conducted by two investigators. If another investigator is unavailable, then other law enforcement or state personnel should be used as a witness to the interview. Having two interviewers in the interview allows one interviewer to concentrate on asking questions and observing body language while the other interviewer can take notes. With two interviewers, there is a witness to what the interviewee is stating and minimizes later any contradictions as to what the interviewee said in the interview. With two investigators, one will be the primary questioner that asks most of the questions while the other investigator assumes a secondary role in the interview.

The normal method of recording the interview is note taking. Notes should be taken contemporaneously at the time of the interview when a particular statement is made. If notes cannot be taken during the interview, they should be written down soon after. Notes should state who wrote them, when and for what purpose. They should contain as much information as possible. The notes should be accurate, factual, objective, complete, concise and clear. If a quote is

recorded in the interview, it should be denoted as such in the notes. Notes from interviews should be retained as evidence in the case file. This is especially important if the case results in a criminal prosecution as the investigator notes are discoverable.

Other methods of recording interviews are audio and video taping. These methods should especially be utilized if the Financial Investigator is unable to have a second interviewer in the interview process. The person being interviewed should be advised that the interview is being taped recorded and needs to sign a consent form if possible. The fact that the interviewee was advised that the interview was being taped should be documented in the report of the interview. The tape of the interview should be maintained as evidence and the interviewer should be cognizant that everything stated in the interview is a permanent record and normally undisputed.

When conducting the actual interview Financial Investigators should introduce themselves, identify themselves as Financial Investigators from the applicable state office and if they want to establish credibility and air of formality produce their official credentials to the interviewee. The interviewee should also be advised of the purpose of the interview and when and how they can review their statement. The Financial Investigator should conduct a complete, efficient, and effective interview of the witness. Whenever possible, the Financial Investigator should obtain a signed notarized affidavit interview. The following is a list of recommended interviewing guidelines which should lead to a productive interview:

- Greet the person to be interviewed in an appropriate manner.
- Define or state the purpose of the interview.
- Establish rapport.
- Maintain control; do not let the interviewee interview you.
- Encourage the witness to volunteer information without prompting.
- Encourage the witness to report all details even if they seem trivial.
- Caution the witness not to guess.
- Ask open ended questions (who? what? where? when? why?).
- Avoid leading questions.
- Caution the witness not to guess.
- Encourage nonverbal communications (e.g., drawings, gestures, objects).
- Avoid interrupting the witness.
- Encourage the witness to contact the Financial Investigators when additional information is recalled.
- Be an active listener.
- Do not argue.
- Try to evaluate each piece of information or allegation on its own merit.
- Maintain strict impartiality and keep an open mind, receptive to all information.
- Ensure you understand what the speaker is trying to convey.
- Listen before taking action.
- Make no promises.
- Use silence when appropriate to elicit a response.

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- Review your notes and information to confirm agreement as to what was said.
 - Ask if there is any other information or issues to cover.
 - Set up time for continuation if necessary.
 - Extend your appreciation.
 - Close the interview appropriately.

Subject Interviews

The principal interviewing techniques generally hold true for both subject and witness interviews. However, subject interviews tend to be more adversarial and conflicting, therefore, it is highly recommended that Financial Investigators always interview subjects of investigations with another investigator, law enforcement officer or other state representative. If a second individual is unavailable to conduct the interview of a subject, then the Financial Investigator should tape record the interview with the subject to avoid any disagreements regarding the contents of the interview at a later date. Whenever possible, subject interviews should be conducted at the state's office or other public locations to ensure the safety of the Financial Investigator. Despite the possible inflammatory and hostile nature of the subject interviews, each member of the Enforcement Division is a representative of their state and is expected to conduct all interviews with the highest professional standards and each member is expected to display the highest respect for the subject licensee. A subject licensee investigation should not automatically be construed to be an adversarial event. A subject licensee should be assured that the purpose of the investigation is to gather factual information regarding the operation of the licensee's business which may or may not affect the status of the licensee's current license. The focus of the investigation must be directed towards completing an impartial evaluation of the licensee's business dealings with state consumers. Enforcement Division staff members must not exhibit any personal feelings towards the licensee's perceived business practices during the course of the investigation.

Enforcement Division personnel should not threaten any subject with any particular action or outcome or represent to the subject any possible outcomes without prior approval from the Enforcement Director.

It is expected that a subject licensee will sometimes express concern regarding the potential criminal exposure to business acts perpetrated by themselves, managers, or employees. A subject licensee should be informed that Enforcement Division staff members are not sworn law enforcement officers under applicable state law. A subject licensee should be advised that Enforcement Division personnel are engaged in a regulatory investigation and that the subject licensee is obligated to fully cooperate with Enforcement Division personnel according to the terms of their license and the relevant law. However, a subject licensee should be advised that the Enforcement Division will on occasion make criminal referrals to federal, state, or local law enforcement agencies when Enforcement Division personnel uncover compelling evidence

that the licensee, managers or employees, have knowingly and willingly violated key provisions of state or federal law.

Refusal of Entry into Licensee Business

Refusal as used in the context of the Banking Acts means refusing to permit entrance to the licensee's place of business and prohibiting Enforcement Division personnel from obtaining information to which the applicable state is entitled under the law.

In the case of a refusal, Enforcement Division personnel must show their conduct was reasonable, fair, and that the Financial Investigators exercised reasonable precaution to avoid refusal. Financial Investigators must have displayed Enforcement Division identification and notified the responsible individual which particular section of the relevant law grants access to the subject licensee's premises and records.

Financial Investigators members must obtain the name of the individual who refused access to the premises and/or licensee's business records. If possible, Financial Investigators should obtain the title of the subject licensee's manager or employee who refuses office access and the names of any employees who witness the subject licensee's representative who refused to grant access. On occasion, Financial Investigators may be requested to wait while subject licensee or representative calls a higher level manager or the subject licensee's attorney for advice or counsel. Financial Investigators should take note of the names of the person or persons being contacted. Financial Investigators should wait a reasonable length of time for the issue to be resolved by someone in authority.

When it becomes apparent that a Financial Investigator has been denied access to the licensee's business, a telephone call should be initiated informing the Enforcement Director who will inform legal counsel of the licensee's refusal and will instruct investigation staff of next steps.

Interviews of Employees

Financial Investigators should be prepared to conduct personal interviews of the subject licensee, licensee managers, and relevant licensee employees early during the onsite investigation. Ideally, the subject licensee will furnish a private office or area in which the personal interviews may be held. Current employees of the subject licensee should be guarded in their responses. The Financial Investigator should ask an employee if he or she would be more comfortable being interviewed at a different time and location. Financial Investigators should provide the employee with a business card in the event that the employee wishes to initiate subsequent contact. An employee should be advised that the state cannot guarantee the confidentiality of the information that they provide during their initial interview. Interviews should be documented on the Investigative Management System interview report as soon as possible after the completion of the interview.

Whenever possible, a signed sworn statement of the subject should be obtained and placed in the investigative case file. If the subject(s) is willing to swear to the truthfulness of his or her statement, then the Financial Investigator should prepare an affidavit and have the subject review the affidavit and make any corrections. The voluntary witness statement or a similar form should be used to obtain the subject statement. The subject affidavit should then be dated and signed by the subject, a witness, and the Financial Investigator and notarized. A handwritten signed statement from the subject is permissible in situations where it is inconvenient or problematic to obtain a typed statement. A written statement should be dated, signed by the subject, the Financial Investigator and a witness and also notarized if possible.

Witness Interviews

Generally, the same interviewing techniques that are utilized in subject interviews are used in witness interviews. Witness interviews tend to be less confrontational and more congenial. Interviews of witnesses are more cooperative, informal meetings where the interviewer approaches the witness and encourages their cooperation, allowing them to relate observations without interruption. Witness interviews usually are less authoritative and formal in their approach than subject interviews. The purpose of the witness interview is to facilitate an accurate recollection of events, of conversations or of any other facts relating to the investigation. The goal of the witness interview is to determine if the individual being interviewed has significant information that will assist in corroborating or debunking the allegations which are being investigated in the case. The interview of the witness should elicit as much of the relevant, useful information and material as possible. Witness information depends on recall and perception, both of which are affected by the passage of time. To improve the quality of the information obtained from witnesses, it is best to interview all available witnesses as soon as possible.

Generally, on "friendly" prosecution witnesses, it would not be necessary to obtain a signed sworn statement of the witness. However, it is advised that a signed affidavit be obtained to confirm the witness statement and also in situations where the witness would be unavailable to testify at a hearing at a later date. If the witness(es) is willing to swear to the truthfulness of his or her statement, then the Financial Investigator should prepare an affidavit and have the witness review the affidavit and make any connections. The voluntary witness statement or a similar form should be used to obtain the witness statement. The witness affidavit should then be dated, signed by the witness, the Financial Investigator, an independent witness to the signature and also be notarized. A handwritten signed statement from the witness is permissible in situations where it is inconvenient or problematic to obtain a typed statement. A written statement should be dated, signed by the witness, the Financial Investigator, and an independent witness to the signature, and also notarized if possible.

Telephonic Interviews

Financial Investigators should endeavor to do face-to-face interviews of subjects and witnesses whenever possible. For the most part, telephone interviews should

be avoided, especially in the case of subjects and important witnesses. Some reasons to do telephone interviews would be the fact that the interviewee is out of state or a great distance away and the time and cost factors make it more advantageous to do a telephone interview. The foregoing considerations, notwithstanding, telephone interviews should be limited to routine witness interviews of individuals whose testimony would be such as providing background information or confirming minor facts or laying the foundation for a face to face interview.

The cost and time efficiencies of utilizing telephone interviews versus in person interviews should be compared in determining the most efficient means of completing the investigation. The general guidelines and principals for a telephonic interview are similar to those of a face to face interview with a few specific differences. The main difference with a telephonic interview is that it is difficult to confirm the identity of the person that is being interviewed over the telephone. The Financial Investigator should place the call to the interviewee at a telephone number that is known to belong to the interviewee. The Financial Investigator should confirm the identity of the interviewee by asking and having the interviewee confirm some identifying information such as their date of birth, Social Security Number and/or birth place. The Financial Investigator may also request that the interviewee facsimile or mail a copy of their driver license to the Financial Investigator. Some effort should be made to confirm the identity of the interviewee over the telephone. The interviewee should be informed if the Financial Investigator is recording the telephone interview, and this should also be documented in the recording and on any written record of the telephone interview.

The Financial Investigator also should have a second interviewer listen on the telephone interview by the conference call function or on a second a separate extension as a witness. Some techniques that are different on a telephone interview include getting call back numbers for a possible continuation of the interview, reviewing investigative notes with the interviewee more frequently to ascertain that the information obtained is accurate, and using video conferencing whenever available.

Some other disadvantages of telephone interviews include the fact that in telephone interviews, the parties do not truly "communicate." It is important that the Financial Investigator be an "active listener" in order to obtain all the facts and information that is being passed over the telephone. It is also more difficult to evaluate the credibility and reliability of the witness in a telephone interview and the Financial Investigator cannot evaluate the non-verbal aspects of the interviewee.

Interviewee Rights

Enforcement Division personnel are not law enforcement officers in their official state regulatory capacity and have no power to detain or arrest individuals. Consequently, Enforcement Division personnel have no obligation to provide Miranda warnings to interviewees. Licensees, licensee managers, licensee

employees, subjects and witnesses in investigations may sometime inquire if they should obtain legal counsel prior to submitting to an interview. Financial Investigators should respond by stating that the decision to obtain legal counsel rests solely with that individual. Financial Investigators will refrain from voicing any opinion as to whether the individual should seek legal counsel. Rather, it is strictly the decision of the individual to submit to an interview. Financial Investigators should not lead the individual to believe that the individual will receive preferential treatment if they submit to an interview rather than agreeing to be interviewed at a later date. Financial Investigators should inform the individual that they are free to contact the Financial Investigator and make arrangements to be interviewed at a later date. Financial Investigators will accommodate any individual who agrees to be interviewed in the presence of an attorney.

Investigation Report

The determination that an investigative report is required will be based on the Financial Investigator's decision in consultation with the Enforcement Director on what course of action is required regarding the investigation. If the allegations that were investigated were proven to be unfounded or unsubstantiated, then an investigation report would not be required.

If the Financial Investigator determines in consultation with the Enforcement Director that an investigation report is required because the investigation determined: (1) Regulatory, civil or criminal violations on the part of the subject; or (2) A report is necessary to obtain a prosecutive opinion or review of the case for possible prosecution, then an investigation report should be prepared.

The following are parts of the [MMC Report of Investigation](#):

- Confidential Cover Sheet should be on the front of all investigation reports.
- Investigation Report Cover sheet which lists case number, date of report, name of subject(s), name of Financial Investigator and state regulatory department address.
- Investigation Report Table of Contents.
- Summary of Investigation which is a concise synopsis of the investigation.
- Statute Violations which is a list of local, state or federal violations which the investigation determined were violated.
- Subject(s) of Investigation which list the subject(s) of the case and identification information that the case determined had made violations.
- Subject Statements which contains all interview statements, affidavits or depositions made by the subject (s) of the investigation.
- Witness Statements which contains all interview statements, affidavits or depositions made by the witnesses of the investigation.
- Evidence which contains all direct evidence in the investigation.

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- Diagram, exhibits etc. which contains any charts, diagrams, spreadsheets and other exhibits prepared for in the investigation that could be used as evidence.
 - Additional Information which is any other data or information that the Financial
 - Investigator determines should be in the investigations report.

Writing the Investigation Report

Upon the completion of a case, the Financial Investigator should determine whether an investigation report should be prepared on the completed case. A report will be required if the Financial Investigator determines that the state needs to pursue some sort of enforcement action against the subject(s) and/or a criminal case referral will be made to another law enforcement agency or prosecutors office.

The investigation report is the basis for evaluating the investigation and its conclusions. The purposes of investigations reports are:

- To document whether the allegations that were investigated were substantiated or unsubstantiated.
- To organize and summarize the investigative information so that anyone can read and understand the investigation report with referring to other material.
- To document the findings of the investigation in an accurate and unbiased manner and provide information to the state agency management and/or law enforcement and prosecutive authorities to take administrative, regulatory or civil and criminal actions.

Some of the qualities of a well-written investigation report include the following:

- The investigation report should be well-written and will "tell a story" and answer the questions about the case: who, what where, when, why, how, and how much.
- The investigation report should state the allegations and which particular subject committed which violations and when.
- The investigation report should state the facts accurately, clearly, and completely.
- The investigation report should state the violations and apply them to the facts of the investigation.
- The investigation report should be a "stand alone" document for which the intended party can make an informed decision based on what is in the report.
- The investigation report should convince the reader that recommendations or conclusions are correct.
- The investigation report should be complete with all logical investigative steps taken.
- The investigation report should use clear, direct, logical and concise language.

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- The investigation report should utilize the proper style (simple & direct) and tone (non-emotional & non-value-laden).
 - The investigation report should not contain redundant and irrelevant information.
 - The investigation report should address conflicting evidence.
 - The investigation report should be written with the correct diction, grammar, spelling and structure.
 - The investigation report should include mitigating circumstances and facts that do not support the conclusion or recommendation.

Other Investigation Report Technology:

Note that many states use investigative technology like Investigative Management System (IMS), an online case management system, to track investigative findings.

Referral of the Investigation Report

Upon completion of the investigation report, the Financial Investigator will submit the report to the Enforcement Director for review and approval of recommended action. The Enforcement Director will review the investigation report for accuracy, completeness, and content to determine whether the report is sufficient to be referred to the state agency's upper management and or outside agency for whatever appropriate action. If the Enforcement director reviews the report and determines deficiencies, then the report is returned to the Financial Investigator for corrections. After the corrections have been made, the report can be resubmitted for approval.

If the Enforcement Director approves the report, then the Investigation Report Routing Memorandum is placed on the Investigation Report for routing to:

- The Enforcement Division Legal Advisor for review of any legal issues.
- The appropriate state Division Manager for review of any administrative or regulatory issues.
- The appropriate for Non-Depository Institutions for review and final approval to refer the investigative report to the appropriate entity.
- Upon the approval of the appropriate manager, the report is returned to the Enforcement Director for dissemination.

The Enforcement Director would then return the report to the Financial Investigator for referral to the appropriate individual or agency. It is highly recommend that the Financial Investigator personally hand-deliver the investigation report to the prosecutive entity and have a meeting with the prosecutor with a briefing on the investigation. The briefing should include information that the Financial Investigator will provide any further assistance necessary for the prosecution of the case.

Prior to the investigation report being delivered, the Financial Investigator should maintain one copy of the report in his investigative file. The Financial Investigator

should periodically contact the prosecutor to determine the ultimate outcome of the investigation. The delivery of the investigation report and contacts with the prosecutor, and the ultimate outcome of the case should be documented in IMS (if being used).

MMC Investigation Report

The MMC Investigation Report template can be viewed here: [MMC Report of Investigation](#).

Servicing

The purpose of the *Servicing* module is to explain the nature of loan servicing and how examiners can review a loan servicing operation.

Introduction

Loan servicing is the collection of interest and principal payments from mortgage borrowers. Originating institutions will often sell mortgage servicing rights (MSR) to another institution that has the appropriate functions to collect payments from consumers. Bank of America, Citigroup, Wells Fargo, JP Morgan Chase, and Ally Financial are the largest mortgage servicers in the country. A mortgage servicer collects payments from borrowers and then remits those payments, usually on a monthly basis through Automated Clearing House (ACH), to the owners of record. If the full mortgage is being held on the books of a lending institution, the servicer will forward those payments to the lender. If the mortgage has been securitized into mortgage backed security (MBS) pools, then the servicer forwards the payments to the pool's trustee, as the pool is the owner of record, who is in charge of parsing out the correct amounts to the various security holders.

Full loan servicing exams are in the early stages for the few states that conduct them, and are non-existent for the majority of states. Given that and the low volume of loan servicing conducted in state regulated institutions, the mortgage servicing module and exam procedures are not incorporated into the core portion of the MMC exam process. Mortgage servicing rights, where present, should be reviewed by examiners when investigating an institution's asset quality, general financial condition, and operations. However, a full mortgage servicing exam is a separate process from the MMC exam process and will be employed as needed. The MMC will determine when a mortgage servicing exam is to occur.

In late 2010, some of the largest mortgage servicers in the country identified errors in their own loan servicing procedures. It was determined that some of the procedures in place for processing servicing paperwork in these institutions were inadequate. In many cases, institution employees signed foreclosure affidavits without reviewing the documents, a practice that has been termed "robo-signing."

Scoping

A servicing exam should begin by sending an exam notification letter to an institution requesting a register back up of all the loans that the institution services. Before picking a sample of loans to examine, the EIC should review any existing complaints or litigation. If complaints or litigation exists for certain categories of loans, such categories should represent a higher percentage of the loan sample. The selection of loans for use should be based, to a degree, on what issues the institution is mostly dealing with in a given period. For example, if an institution is processing a heavy number of foreclosures, examiners should employ some target specificity and review loans near foreclosure. The size of the loan sample should reflect the size and complexity of the institution.

Loan Level Review

Once examiners have selected a loan sample, they should utilize the MMC Servicing Worksheet to review each loan in the sample. The worksheet provides a detailed guide for reviewing loans for servicing compliance requirements: [MMC Servicing Worksheet](#).

Servicing Procedures

Given the now apparent issues with procedural policies that some of the largest servicers have demonstrated, it is important that servicing exams not only focus on loan level review, but also the policies and procedures that management has in place for performing the servicing function. Examiners should foster an open communication with management about the loan servicing procedures. Examiners should survey the actual servicing facility and observe employees in each area (collections, loss mitigation, foreclosures, bankruptcy, etc.), in order to ensure that the institution has adequately trained employees. Additionally, examiners should request that management verbally communicate the institution's policies and procedures even if the examiner already received them, in order to ensure that management is very familiar with the company's own plans for maintaining a successful operation.

Below is a detailed outline of the process examiners should follow when engaging in a servicing/foreclosure related exam:

Pre-Examination Review

- Establish on-site presence at institution
- Prepare and submit an initial request of information
- Introductory meetings with company management
- Legal Presentation: Define nature and extent of the foreclosure affidavit process and company action taken to date to rectify this issue

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- Servicing Presentation: Overview presentation on the structure and various functions of the servicing area.
 - Detailed review of Foreclosure Business Unit to identify structure and specific work responsibilities
 - Physical tour of the Referred to Foreclosure – Back End Unit including meetings with team leaders within the unit.
 - A detailed analysis of an actual foreclosure transaction through all relevant company business units.
 - Webex Presentation: Detailed analysis to include a review of applicable servicing system screen shots applicable to the foreclosure process.
 - Present final scope of foreclosure review to include informational updates to AG and other states regulatory agencies.

Targeted Operational Review

Conduct a comprehensive review of the delinquency, loss mitigation and foreclosure functions at the institution over a certain period to ensure that these activities were conducted in full regulatory compliance and with fairness to existing homeowners.

Conduct Department Level Meetings:

Meetings with out of state servicing centers will be conducted via conference calls.

- a) Collections:
- b) Loss Mitigation:
- c) Foreclosure Referrals – Front End:
- d) Referred To Foreclosure – Back End:

1. Policies and Procedures:

- Review of all policies and procedures utilized within these business units.
- Review any recent revisions to these policies and procedures.
- Determine what specific changes were made, why the changes were made and the effective dates.
- Determine process and control of granting exceptions to policies and procedures.
- Test to determine level of compliance with these policies and procedures.

2. Staffing Levels:

- Review Staffing levels for the identified business units.
- Review any recent changes to staffing levels within these units.
- Determine reason for changes, effective dates and who authorized.

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- Determine how the institution maintains adequate staffing and servicing levels including capacity planning
 - Review specialized training provided to personnel for these business units.
3. Servicing Portfolio:
- Obtain information on the various residential loan products serviced by the company
 - Identify serviced loans which were initially originated by the institution including a breakdown of company owned versus sold loans with retained servicing.
 - Obtain a listing of investors for which the company conducts servicing for including copies of servicing agreements.
4. Servicing Systems:
- Gain an understanding of the servicing systems utilized by the institution.
 - Identify sources of information that delinquency, loss mitigation and foreclosure personnel utilize in conducting their activities.
 - Review system and management controls over the Accrual, Customer Service and Collections Areas.
 - Review any internal and external audits and testing of these systems to determine accuracy of information.
 - Obtain and review various screen shots of the servicing systems on selected loan files.
5. Loan File Review:
- Conduct a loan file servicing review of a sampling of foreclosure loans to determine compliance with federal and state statutes.
 - Sample Loan listing to be formatted as outlined in the loan servicer questionnaire.
 - Modified the Loan Servicing Exam Worksheet will be completed on each loan reviewed with focus on foreclosure items.
 - Review to be based on the selected sections of the Loan Servicing Exam Reference Sheet with special emphasis on foreclosure activities.
 - Review servicing notes to ensure department communication with consumers was properly documented.
 - Review monthly payment statements to determine level of information provided including loan balances and payment details.

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- Determine if interest rate adjustments were calculated accurately and timely.
 - Conduct payment history analysis on selected loan files to determine accuracy of the flow of funds.
 - Payment history review to include timely posting of payments including:
 - Partial payments
 - Late charges
 - Escrow balances
 - Forced insurance
 - Legal fees
 - Determine if payoff requests were issued in a timely manner and contain required information. No charge assessed for the first request.

Foreclosure Affidavit Process

Review of foreclosure activity conducted by the institution within the specific state with specific emphasis on the foreclosure affidavit process.

1. Review of all the state's foreclosure complaints filed by the institution within the identified review period.
2. Review of all foreclosure affidavits completed in these foreclosure loans including the utilization of all substitute and supplemental affidavits.
3. Review of foreclosure policies and procedures to include the gathering of loan information, preparation of documents, approval and filing of complaints within the court system.
4. Review of foreclosure reports for the unit including daily exceptions and errors report.
5. Determine any recent revisions to these policies and procedures and identify the reasons for change.
6. Gain an understanding of the utilization and support received from external legal entities in the foreclosure process.
7. Review the specific responsibilities of staffing and supervision within the foreclosure business units.
8. Determine recent changes in specific staffing levels and reasons for changes
9. Determine if any financial incentives are available to this unit based on volume or deadlines in the completion of their work.
10. Does the unit operate under a Risk Score Card or other performance rating system?
11. Conduct a loan file review of a sampling of foreclosure loans to determine handling of activities specific to the foreclosure process.

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- Sample Loan listing to be formatted as outlined in the loan servicer questionnaire.
 - Modified Loan Servicing Exam Worksheet will be completed on each loan reviewed with focus on foreclosure items.
 - Calculation of amount in arrears
 - Reporting of delinquency amount in an itemized format
 - Title search review
 - Completion and mailing of breach letters
 - Notification of foreclosures
 - Handling of any contested filings of mortgage complaints
 - Bankruptcy Discharge: Was correct status and amounts applied to the mortgage?
12. Notarization process within the foreclosure business unit.
- Review policies and procedures related to the notarization of foreclosure documentation including recent operating changes.
 - Determine level of compliance with these policies and the state notary law.

Financial Review

Review of audited financial statements and interim financial information to determine level of financial impact on the company as a result of this foreclosure issue.

- Has the company established any reserves or designation of funds to provide for legal and regulatory expenses associated with the foreclosure issue?
- Has the company conducted a review to determine if any additional allocations need to be made to the loan reserve levels?
- Determine the financial support available from the parent company.

Company Litigation

Obtain a complete listing of all pending litigation cases against the company.

- Review litigation logs to determine any recent trends as a result of this foreclosure issue.
- Review litigation logs to determine any other noted concerns.

Consumer Complaints

- Review of all consumer complaints received by the applicable state agencies during the examination period.
- Does the company maintain a complaint register? Obtain a copy of the complaint log.

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- Determine the detailed process utilized at the institution for handling consumer complaints in a timely manner.

Consumer Outreach

Determine when company first reached out to delinquent homeowners and loss mitigation efforts conducted in assisting the consumer on a consumer risk based approach.

- Review policies and procedures related to this function.
- Review of early and late loss mitigation cases in applicable states.
- Review history and current status of trial and permanent modifications conducted for state consumers.
- Review history of the company with the Home Affordable Modification Program (HAMP).

Consumer Interviews

Establish a consumer listing of applicable state foreclosure loans to conduct consumer interviews.

- Interviews to obtain consumers perspective on the company's handling of the foreclosure case.
- Consumer interviews to be conducted by the investigations group of the MMC.

Internal Review and Remediation

- Review scope of internal review conducted. Obtain copy of final report.
- Review copy of engagement letter to be conducted by an independent auditing firm.
- Review copies of internal reviews completed for Freddie Mac / Fannie Mae reviews.
- Determine specific level of change implemented as a result of these internal reviews.

Conclusion

- Completion of any outstanding review items
- Preparation of examination report
- Conduct advanced level meetings with company management.

Fair Lending

The purpose of the *Fair Lending* module is to provide some guidance for Fair Lending examinations, which occur infrequently among the states for mortgage institutions.

Introduction

The majority of states do not conduct Fair Lending exams for mortgage institutions. As such, the Fair Lending process is not incorporated in the normal exam process. Fair Lending Exams typically involve examining for compliance with Fair Housing Act (FH Act), Equal Credit Opportunity Act (ECOA), and the Federal Reserve Board's Regulation B.

Types of Lending Discrimination

The courts have recognized three methods of proof of lending discrimination under the ECOA and the FH Act:

- Overt evidence of disparate treatment,
- Comparative evidence of disparate treatment, and
- Evidence of disparate impact.

Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that an institution explicitly considered prohibited factors (overt evidence) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (comparative evidence).

Overt Evidence of Disparate Treatment. There is overt evidence of discrimination when an institution openly discriminates on a prohibited basis:

Example: An institution offered a credit card with a limit of up to \$750 for applicants aged 21 through 30 and \$1,500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when an institution expresses — but does not act on — a discriminatory preference:

Example: A lending officer told a customer, "We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law." This statement violated the FH Act's prohibition on statements expressing a discriminatory preference as well as Section 202.4(b) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

Comparative Evidence of Disparate Treatment. Disparate treatment occurs when an institution treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by

prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are “close cases,” there is more room and need for institution discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the institution provides the applicant in completing an application. The institution may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Banks are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

Example: A control group couple applied for an automobile loan. The institution found adverse information in the couple’s credit report. The institution discussed the credit report with them and determined that the adverse information, a judgment against the couple, was incorrect because the judgment had been vacated. The control group couple was granted their loan. A prohibited basis group couple applied for a similar loan with the same bank. Upon discovering adverse information in the prohibited basis group couple’s credit report, the institution denied the loan application on the basis of the adverse information without allowing the couple to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the institution provided.

If an institution apparently has treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the bank’s explanation is found to be not credible, the agency may find that the institution intentionally discriminated.

Illegal disparate treatment exists when applicants are “similarly situated,” but are treated differently on a prohibited basis. Typically, a disfavored applicant who is “similarly situated” is as well or better qualified than a favored one, though factors other than qualifications may be relevant. In fair lending examinations, examiners usually focus on whether the deficiency the institution cited to justify the unfavorable treatment of an applicant from a prohibited basis group also existed for any favorably treated control group applicant who was no better qualified. If not, such an inconsistency is termed “apparent disparate treatment,” indicating that the situation may be discrimination or it may have an innocent explanation. “Apparent” is not a synonym for “obvious” or “blatant.”

If the institution shows that, at the time of the credit decisions, it considered a legitimate difference between the applicants that justified treating one more favorably than the other, examiners conclude that the applicants were not actually “similarly situated,” so no illegal disparate treatment occurred.

There are numerous lawful reasons why an applicant from one race, gender, etc., might be treated less favorably than one from another group. The anti-discrimination laws do not require uniform treatment of all customers.

Redlining is a form of illegal disparate treatment in which an institution provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may violate both the FH Act and the ECOA.

Disparate Impact

When an institution applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a “disparate impact.”

Example: An institution’s policy is not to extend loans for single family residences for less than \$60,000.00. This policy has been in effect for 10 years. This minimum loan amount policy is shown to disproportionately exclude potential applicants based on race from consideration because of their income levels or the value of the houses in the areas in which they live.

The fact that a policy or practice creates a disparity on a prohibited basis is not by itself proof of a violation. When an examiner finds that an institution’s policy or practice has a disparate impact, the examiner seeks to determine whether the policy or practice is justified by “business necessity.” The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of discriminatory intent is not necessary to establish that an institution’s adoption or implementation of a policy or practice that has a disparate impact is in violation of the FH Act or ECOA.

These procedures do not call for examiners to plan examinations to identify or focus on potential disparate impact issues. The guidance in this introduction is intended to help examiners recognize fair lending issues that may have a potential disparate impact. Guidance in appendix G, “Other Types of Discrimination Analyses,” provides details on how to obtain relevant information regarding such situations, and methods to evaluate and follow up, as appropriate.

Referral to the DOJ or HUD

ECOA requires examiners to refer matters to the DOJ “whenever the (examiner) has reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit in violation of section

1691(a)” of ECOA, which states ECOA’s basic prohibitions against discrimination.

Additionally, ECOA requires the examiners to notify HUD whenever there is reason to believe that both ECOA and the FH Act have been violated and the suspected violations have not been referred to DOJ. Furthermore, Executive Order No. 12892 requires that HUD be notified “upon receipt of information . . . suggesting a violation” of the FH Act, and that such information also be forwarded to DOJ if it “indicate[s] a possible pattern or practice of discrimination in violation of the act.” The Concluding the Examination section of this booklet provides guidance to examiners and supervisory offices on how to respond to an institution’s apparent violation of a fair lending law.

Fair Lending Exam Procedures

For those states that conduct Fair Lending exams, the below details outline some important aspects of the exam:

- HMDA Data Verification
- Review of training policies and procedures to ensure all federal and state laws are addressed
- Monitoring of fair lending related issues
- Review of complaints, oral and written
- Review of internal/ external audit programs
- Review of third-party agreements to ensure compliance with the institution's policies and procedures
- Review of marketing policies and procedures
- Review of servicing policy and procedures
- Review of loan modification policy and procedures
- Review of collection policy and procedures
- Review of second-level review of declined and withdrawn applications
- Review of underwriting and pricing procedures, and
- Conduct a comparison test analysis of similarly situated applicants/ borrowers

FFIEC Fair Lending Procedures

Examiners should refer to the FFIEC Fair Lending Examination Procedures for more guidance on conducting a Fair Lending Exam: [FFIEC Fair Lending Procedures](#).

Glossary

Appraisal Management
Company (AMC)

A business entity that administers a network of certified and licensed appraisers to fulfill real estate appraisal assignments on behalf of mortgage lending institutions and other entities. The company recruits, qualifies, verifies licensing, and negotiates fees and service-level expectations with a network of third-party appraisers. It also provides administrative duties like order entry and assignment, tracking and status updates, pre-delivery quality control, and preliminary and hard copy report delivery. Furthermore, the AMC oversees ongoing quality control, accounts payable and receivable, market value dispute resolution, warranty administration, and record retention.

Appraiser

One who is expected to perform valuation services competently and in a manner that is independent, impartial, and objective.

Borrower

One who receives funds in the form of a loan with the obligation of repaying the loan in full with interest. The borrower may be purchasing property, refinancing an existing mortgage loan, or borrowing against the equity of the property for other purposes.

Buyer

A buyer is a person who is acquiring property.

Closing

The culmination of any RE transaction in which the interested parties or their representatives meet to execute documents, exchange funds, and transfer title to a property.

Closing Costs

Moneys expended by a party in completing a RE transaction, over and above the purchase price, including: legal fees, taxes, origination fees, discount points, mortgage insurance premium, interest adjustments, registration fees, appraisal fees, title, insurance premiums, etc.

Closing/Settlement/
Escrow Agent

An individual or company that oversees the consummation of a mortgage transaction at which the note and other legal documents are signed and the loan proceeds are disbursed. Title companies, attorneys, settlement agents, and escrow agents can perform this service. Local RE law may dictate the party conducting the closing.

Concessions

Benefits or discounts given by the seller or landlord of a property to help close a sale or lease. Common concessions include absorption of moving expenses, space remodeling, upgrades (also called "build-outs"), and reduced rent for the initial term of the lease.

Collusion

An agreement, usually secretive, which occurs between two or more persons to deceive, mislead, or defraud others of their legal rights, or to obtain an objective forbidden by law, typically involving fraud or gaining an unfair advantage.

Correspondent

A mortgage originator who underwrites and/or sells mortgage loans to other mortgage bankers or financial institutions.

Credit Report Fraud Alert

A notation at the bottom of a credit report indicating that some items of identification, i.e., Social Security number, address, etc., are associated with past fraudulent activities. For example, an address may be flagged because the previous occupant allegedly used the property for financial misbehavior. Each credit reporting agency has different names for these alerts: TransUnion – HAWK Alerts, Experian – Fraud Shield, and Equifax – Safescan.

Deed

The document by which title to real property is transferred or conveyed from one party to another. (See Quitclaim Deed and Warranty Deed.)

Deed of Trust

A type of security instrument in which the borrower conveys title to real property to a third party (trustee) to be held in trust as security for the lender, with the provision that the trustee shall re convey the title upon the payment of the debt. Conversely, the third party will sell the land and pay the debt in the event of default by the borrower. (See Mortgage.)

Developer

A person or entity, who prepares raw land for building sites, constructs buildings, creates residential subdivisions or commercial centers, rehabilitates existing buildings, or performs similar activities.

eNotary

An electronic notary that may include the use of a digital seal to notarize digital documents. (See also Notary.)

Escrow Instructions

Instructions prepared by a lender and/or underwriter to direct the progression of a mortgage closing transaction from start to finish.

Evaluation

A valuation required by the Agencies' appraisal regulations for certain transactions that are exempt from the regulations.

Federal Home Loan
Mortgage Corporation
(Freddie Mac)

Commonly used name for the Federal Home Loan Mortgage Corporation (FHLMC), a government sponsored entity that provides a secondary market for conforming conventional residential mortgage loans by purchasing them from primary lenders.

Federal Housing
Administration (FHA)

A federal agency established to advance homeownership opportunities. The FHA provides mortgage insurance to approved lending institutions.

Federal National
Mortgage Association
(Fannie Mae)

A government sponsored entity that, as a secondary mortgage loan institution, is the largest single holder of residential mortgage loans in the United States. Fannie Mae

	primarily buys conforming conventional residential loans from primary lenders.
Federally related transaction	Means any real estate-related financial transactions entered into after the effective date hereof that: (1) The FDIC or any regulated institution engages in or contracts for; and (2) Requires the services of an appraiser.
Foreclosure	A legal proceeding following a default by a borrower in which real estate secured by a mortgage or deed of trust is sold to satisfy the underlying debt. Foreclosure statutes are enacted by state government.
Form 1003	The standardized loan application form used in residential mortgage loan transactions.
Form 4506T	An IRS form that taxpayers execute to authorize the IRS to release past tax returns to a third party. Many lenders require mortgage loan applicants to execute this form in order to verify income.
Fraud	A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to their detriment.
Government National Mortgage Association (Ginnie Mae)	A government-owned corporation that provides sources of funds for residential mortgage loans, insured or guaranteed by the FHA or VA.
HUD-I Form	A standardized form prescribed by the Department of Housing and Urban Development that provides an itemization listing of funds paid at closing. Items that appear on the statement include RE commissions, loan fees, points, taxes, initial escrow amounts, and other parties receiving distributions. The HUD-I statement is also known as the "closing statement" or "settlement sheet."
Lapping	A fraud that involves stealing one customer's payment and then crediting that customer's

	account with a subsequent customer's payment.
Loan Servicer	A loan servicer is a public or private entity or individual engaged to collect and process payments on mortgage loans.
Loan-to-Value Ratio (LTV)	Relationship of loan amount to collateral value, expressed as a percentage.
Market Value	<p>The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:</p> <ul style="list-style-type: none">(1) Buyer and seller are typically motivated;(2) Both parties are well informed or well advised, and acting in what they consider their own best interests;(3) A reasonable time is allowed for exposure in the open market;(4) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and(5) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.
Modification Agreement	A document that evidences a change in the terms of a mortgage loan, without refinancing the loan. Commonly, changes are made to the interest rate, repayment terms, guarantors, or property securing the loan.
Mortgage	A lien on the property that secures a loan. The borrower is the mortgagor; the lender is the mortgagee.
Mortgage Banker	An individual or firm that originates, purchases, sells, and/or services loans secured by mortgages on real property.
Mortgage Broker	An individual or firm that receives a

	commission for matching borrowers with lenders. Mortgage brokers typically do not fund the loans they help originate.
Mortgage Fraud	A knowing misrepresentation of the truth or concealment of a material fact in a mortgage loan application to induce another to approve the granting of a mortgage loan. For the purpose of this paper, mortgage fraud refers solely to fraudulent schemes pertaining to residential mortgage loans.
Nominee Loan	A loan made to one individual in which the proceeds of the loan benefit another individual without the knowledge of the lender.
Notary	A person who certifies the authenticity of required signatures on a document, by signing and stamping the document. (See also eNotary.)
Originator	The individual or entity that gathers application data from the borrower. Alternatively, a person or entity, such as a loan officer, broker, or correspondent, who assists a borrower with the loan application.
Power-of-Attorney	A legal document that authorizes a person to act on another's behalf. A power-of-attorney can grant complete authority or can be limited to certain acts (closing on a property) or timeframes (from date granted until a termination date). A durable power-of-attorney continues until the grantor's death.
Pretext Calling	A scheme associated with identity theft in which a fraudster, pretending to represent a legitimate entity, calls an unsuspecting party seeking personal identification data, such as social security numbers, passwords, or other forms of account information. The fraudster then uses this information to assume the identity of the unsuspecting victim. Among other things, the fraudster can obtain a mortgage loan in the name of the unsuspecting victim.
Processor	The processor is an individual who assembles all the necessary documents to be included in the loan package.

Quitclaim Deed	A deed that transfers without warranty whatever interest or title, if any, a grantor may have at the time the conveyance is made. A grantor need not have an interest in the property to execute a quitclaim deed.
Real Estate Agent	An individual or firm that receives a commission for representing the buyer or seller, in a RE purchase transaction.
Reverse Mortgage	A reverse mortgage loan converts the equity in the home into cash. Unlike a traditional loan, no repayment is required until the borrower no longer uses the house as a principal residence. To be eligible under FHA's program, Home Equity Conversion Mortgage (HECM), the homeowner must be at least 62 years old, and live in the house. The program was expanded in 2009 so that HECMs can be used to purchase a primary residence.
Secure and Fair Enforcement Mortgage Licensing Act of 2008 (S.A.F.E. Act)	Legislation designed to enhance consumer protection and reduce fraud by encouraging states to establish minimum standards for the licensing and registration of state-licensed mortgage loan originators and for the Conference of State Institution Supervisors and the American Association of Residential Mortgage Regulators to establish and maintain a nationwide mortgage licensing system and registry for the residential mortgage industry. The S.A.F.E. Act further requires the federal agencies to establish similar requirements for the registration of depository institution loan originators.
Secondary Market	The buying and selling of existing mortgage loans, usually as part of a "pool" of loans.
Seller	Person offering to sell a piece of real estate.
Short Sale	Sale of the mortgaged property at a price that nets less than the total amount due on the mortgage loan. Servicers and borrowers negotiate repayment programs, forbearance, and/or forgiveness for any remaining deficiency on the debt to lessen the adverse impact on borrowers' credit records.

Straw Buyer/Borrower

A person used to buy property or borrow against property in order to conceal the actual owner. The straw buyer does not intend to occupy the property or make payments and often deeds the property to the other individual immediately after closing. The straw buyer is usually compensated for use of his identity.

Third Party

The parties necessary to execute a residential mortgage transaction other than a financial institution and a legitimate borrower. Third parties include, but are not limited to, mortgage brokers, correspondents, RE appraisers, and settlement agents.

Title Agent

The title agent is a person or firm that is authorized on behalf of a title insurer to conduct a title search and issue a title insurance report or title insurance policy.

Title Company/Abstract Company

Entity that researches recorded ownership of and liens filed against real property and then issues a title insurance policy guaranteeing the lien position of the lender or provides a title opinion. Some states also require an attorney opinion supported by an abstract.

Title Insurance

An insurance policy that indemnifies the lien position of a lender against losses associated with property interests not disclosed in the title opinion. The borrower can also obtain this coverage by purchasing a separate policy.

Title Opinion/Commitment/
Binder

An examination of public records, laws, and court decisions to ensure that no one except the seller has a valid claim to the property, and to disclose past and current facts regarding ownership of the subject property.

Underwriting

The credit decision-making process which can be automated, manual or a combination of both. In an automated process, application information is entered into a decision-making model that makes a credit determination based on pre-determined criteria. In a manual process an individual underwriter, usually an employee of the financial institution, makes the credit decision after evaluating all of the

	information in the loan package, including the credit report, appraisal, and verifications of deposit, income, and employment. Financial institutions often use a combination of both, with the automated decision representing one element of the overall credit decision. In each case, the decision may include stipulations or conditions that must be met before the loan can close.
Verification of Deposit (VOD)	Written document sent to the borrower's depository institution to confirm the existence of a down payment or cash reserves.
Verification of Employment (VOE)	Written document sent to the borrower's employer to confirm employment/income. Employment is often reconfirmed by calling the employer prior to funding.
Verification of Income (VOI)	Written documentation supporting the borrower's income level and income stream.
Warehouse Lender	A short-term lender for mortgage bankers. Using mortgage loans as collateral, the warehouse lender provides interim financing until the loans are sold to a permanent investor.
Warehouse (Loan)	In mortgage lending, warehouse loans are loans that are funded and awaiting sale or delivery to an investor.
Warehouse Financing	Short-term borrowing of funds by a mortgage banker based on the collateral of warehoused loans. This form of interim financing is used until the warehoused loans are sold to a permanent investor.
Warranty Deed	A deed warranting that the grantor has a title free and clear of all encumbrances and will defend the grantee against all claims against the property.