

Essentials of a Compliant QC Plan

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Presented by:

Brady W. Meadows



Mortgage Compliance Advisors

Instructions

- Because of the large number of registrants, the lines will be muted.
- To ask a question, click the plus sign next to “Questions” on the GoToWebinar box and type your question.
- The panelists will address questions at the end of the presentation. If your question is not addressed, we will email the answer to you.
- You can find today’s slides on our News & Resources page:
 - <http://www.mortgagecomplianceadvisors.com/index.php/news-resources#resources>



Our Panelists

We are fortunate to have with us today a panel of experienced mortgage professionals. They will be taking the time to answer your questions and provide insight from hands-on application.

- Bob Warnock *MCA CEO*
- Craig Christensen *MCA COO*



Agenda

- Objective of a QC Plan
- Initial Disclosure Compliance
- Pre-Fund QC
- Post-Closing QC
- Adverse Action & EPDs
- Branch Reviews
- TPO Monitoring
- Trend Tracking
- Management Reporting
- Audit & Review of QC Process
- Record Retention
- Final Notes
- Q & A
- Resources



First Step: Establish Your Credit Culture

- A lender must establish its own set of standards for loan quality.
- Standards will define a company's credit culture and help develop appropriate controls necessary to ensure loans are of investment quality.
- A lender's overall commitment (or lack thereof) to Quality Control will ultimately determine how effective their Quality Control program is.



Objectives of a QC Plan:

- Ensure company is producing a quality product to sell to investors
- Protect against re-purchase demands
- Improve loan quality & production process
- Minimize costs by:
 - Reducing time file spends with UW
 - Reducing time in warehouse line
(By reducing investor conditions)



Objective of a QC Plan (cont.)

- Maintain compliance with contractual obligations and applicable federal, state, and local laws and regulations
- Guard against fraud, negligence, errors, and omissions
- Guard against unacceptable risk & potential law suits
- Assess compliance with internal policies



Objective of a QC Plan (cont.)

- And the last reason you should have a QC plan in place is...

Because it's required



Basic Elements of a QC Plan

- QC plan must be in writing
- It should cover:
 - Company overview and philosophy regarding QC
 - Goals of your QC plan
 - Who will perform the QC
 - What you are going to audit
 - When you will audit
 - How you will correct issues found
 - How and who you will issue reports to
 - Document retention



Drafting Your QC Plan

- Tailor your QC plan to meet the specific needs of your organization.
 - Size
 - Product mix
 - Business structure
 - Market
 - Day to day operational processes



QC Staff

- QC can be performed in-house or outsourced
- Report to Senior Management
- QC staff must be independent from production staff
- QC staff must be properly trained and experienced



Initial Disclosure Compliance

- RESPA and TILA define a mortgage application as:
 1. Borrower's Name
 2. Borrower's Monthly Income
 3. Borrower's Social Security Number
 4. Property Address
 5. Estimate of Value of Property
 6. Loan Amount
 7. Any other information deemed necessary by loan originator



Initial Disclosure Compliance

Initial disclosures are required to be sent to the borrower within 3 days of application.

RESPA	TILA	STATE
GFE	TIL	Lock-in agreement
Settlement cost booklet (purchase)	ARM disclosure	Mortgage broker agreements
Servicing disclosure statement	CHARM booklet	Upfront fee disclosures



Documenting Initial Disclosures

- Ensure you document when the disclosures were provided to the borrower.
- Examples:
 - Date stamp
 - Borrowers signed documentation of receipt
 - Initial disclosure letter with date and list of documents provided
- If you use an electronic delivery or outsource your initial disclosures, make sure you have documentation of what and when each document was sent.



Pre-Fund QC

- Pre-funding is now a requirement for Fannie Mae approved lenders.
- FHA and Freddie Mac recommend pre-funding.
- The pre-funding portion of the quality control plan can contain procedures to assess:
 - Overall underwriting process
 - Validation methods
 - Risk assessment
- Pre-funding does not need to be independent of production.



Pre-fund selection process

- Each lender is required to create their own pre-funding selection process to ensure it meets each company's needs.

High LTV	Low FICO	1% to 100%
Loan Originator/TPO	Closer	Branch



Pre-Fund Reviews

- Fannie Mae says an effective pre-funding process includes reviews of the following:
 - Data entered into AUS
 - Social Security numbers used to verify borrowers
 - Income calculations consistent with supporting documentation
 - Verification of employment
 - Assets are adequate to meet cash to close and reserve requirements
 - Appraisal valuation data is acceptable
 - Mortgage insurance is acceptable



Pre-Fund QC (cont.)

- Review your loan file against investor and agency guidelines.
- Address and satisfy conditions *before* shipping file to investor, to allow for minimal investor conditions.
- Minimize strain on warehouse lines by allowing loans to be quickly acquired by investors.

This will dramatically reduce time in warehouse line
= Less interest paid



Pre-Fund QC (cont.)

- Additional automated compliance tools can be part of your pre-funding QC Plan:
 - ComplianceEase
 - Interthinx
 - Direct Check
 - AVM applications
- Address all red flags uncovered by the compliance tools, and retain documentation used to resolve them.



Pre-Fund QC (cont.)

- Pre-funding QC is your last chance to correct any errors.
- Reviewing initial and final documents is critical.
- Steps should allow for the review of RESPA, MDIA, and state timing rules.
- Review GFE and HUD-1 to ensure fees are within tolerance.



Pre-Fund QC (cont.)

- Create monthly reports to analyze any findings trends discovered in your pre-funding process.
- Re-evaluate your pre-fund QC on a regular basis to make sure it is up to date with current trends.
- Investor and lender requirements are constantly changing.
- Perform periodic re-evaluation to gain the most benefit.



Post-Closing File Audits

- Post-closing file audits are the most encompassing portion of your QC Plan.
- Post-closing file audits are required by many investors and most agencies, including:
 - FHA
 - Fannie Mae
 - Freddie Mac



Selection of Files to Audit

- You must do a random or statistical selection of the files to be audited. All files must be available for selection.
- Most companies chose to do a random 10% minimum selection.
- Over a specified time period, all company segments should have 10% audited.



Timing of Selections and Reviews

- **FHA**
 - Selections within 30 days of funding
 - Reviews within 90 days of selection
- **Fannie Mae**
 - Selections within 30 days of funding
 - Reviews within 60 days of selection
 - If you are more than 30 days behind, you must report this to Fannie Mae
- **Freddie Mac**
 - Selections within 30 days of funding
 - Reviews within 90 days of selection



Loan Reviews

- Post-close file audit selection details should be outlined in your QC plan and should contain at least the following:
 - Detailed review of the credit package
 - Detailed review of the funding package
 - Desk or field review of the appraisal
 - Review of all state and federal regulations
 - Re-calculations, re-verifications, & re-validations



Discretionary Reviews

- Fannie Mae recommends discretionary reviews on the following:

LTV ratios over 90%	Investment properties
High risk credit scores	Cash-out refinances

- FHA and Freddie Mac only recommend discretionary reviews when necessary.
- Example of discretionary reviews:

10% of new Loan Originators	All high LTV loans
Low FICO scores	Manufactured homes



Appraisal Reviews

- Fannie Mae, Freddie Mac, and FHA all require appraisal desk reviews and appraisal field reviews.
- Field reviews must be done on 10% of the files selected for audit.
 - Field reviews must be done by a licensed appraiser.
- For the remaining 90% of the files selected for audit, a desk review is required.



Re-verifications

- Fannie Mae, Freddie Mac, and FHA require verifications on the following:
 - Employment
 - Income
 - Assets
- FHA requires all verifications be written. If reverification not returned, then a follow up phone call must be made.
- Fannie Mae and Freddie Mac both recommend written but allow verbal re-verifications.
- If re-verification is not returned, lender must document all attempts made to verify documentation.



Adverse Action Reviews

- Adverse action file reviews are audits of all your denied and cancelled files.
- Only FHA requires you to review **10%** of all adverse action files.
- Must be reviewed within 90 days from the day in which the decision was made.
 - Review to ensure file was correct in its denial
 - Denial was approved by Officer or Senior Level Underwriter
 - Ensure ECOA guidelines were met
 - Review no Civil Rights were violated



Early Payment Default (EPD) Reviews

- FHA , Fannie Mae, and Freddie Mac all require you to review **100%** of your EPD files.
- Fannie Mae and Freddie Mac define an EPD as 60 days late in 24 months.
- FHA defines EPD as 90 days late in first 6 months
 - Must be reviewed 45 days from the end of the month the loan is reported 60 days past due.
- The purpose of reviewing EPD files is to **uncover any patterns** and if those patterns can be corrected with new company policy.
- EPD review are also done to identify any information that could have been used to predict default.



HUD's Neighborhood Watch



- Neighborhood Watch:
 - <https://entp.hud.gov/sfnw/public/>

- Neighborhood Watch FAQs:
 - <http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/02-15a1.doc>

Branch Reviews

- It is a good business practice to make random on-site visits to your branches to make sure they are compliant with all company policies
 - Signage and licenses posted
 - Compliance with Gramm-Leach-Bliley
 - Operation structure meets company requirements
 - Meets all company policy and procedures
- FHA requires branch reviews, and Fannie and Freddie recommend them.



Branch Reviews (cont.)

- A few of FHA's branch review requirements:
 - Office is properly registered with FHA and address is current
 - Regulatory Lending signage posted and evident in each branch location including Fair Housing and Equal housing signage
 - Operations are conducted in professional, business-like environment
 - If located in non-commercial space, office has adequate office space and equipment
 - Office does not employ or have a contract with anyone currently under debarment or suspension, or a Limited Denial of Participation



TPO Monitoring

- Third Party Originators are generally mortgage brokers. However, TPOs can also be correspondent lenders.
- FHA eliminated correspondent (mortgage broker) approvals on December 31, 2010. Lenders are now responsible for the approval of Sponsored TPO.
 - All FHA-approved mortgagees, including those in sponsored relationships must have a QC plan that requires review of loans that are originated or underwritten.



TPO Monitoring (cont.)

- Fannie Mae has updated their TPO Monitoring with their new Loan Quality Initiative. Fannie Mae now requires:
 - Written approval process
 - Ongoing monitoring and evaluations
 - Quarterly review of loan performance
 - Re-certifications
 - Sample selection of each TPO's post-close file audits reviewed annually



Trend Tracking

- Trend tracking is not required, but it is the best way to track and monitor your QC. Trend tracking gives you added value to your completed post close audits.
- Simply place a numerical value to each file audit and track that numerical value over time.
- Trend tracking is an effective way to ensure your employees and business segments are producing quality loans.



Trend Tracking (cont.)

- Our audits include a loan score and risk rating on each file
 - Track ratings over time to see if score is decreasing or increasing
- In addition, run tracking reports to determine most common findings and how often they reoccur.
- Track the performance of many categories, including the following:
 - Loan originators
 - Underwriters
 - Branches
 - Processor
 - TPO (correspondents or brokers)



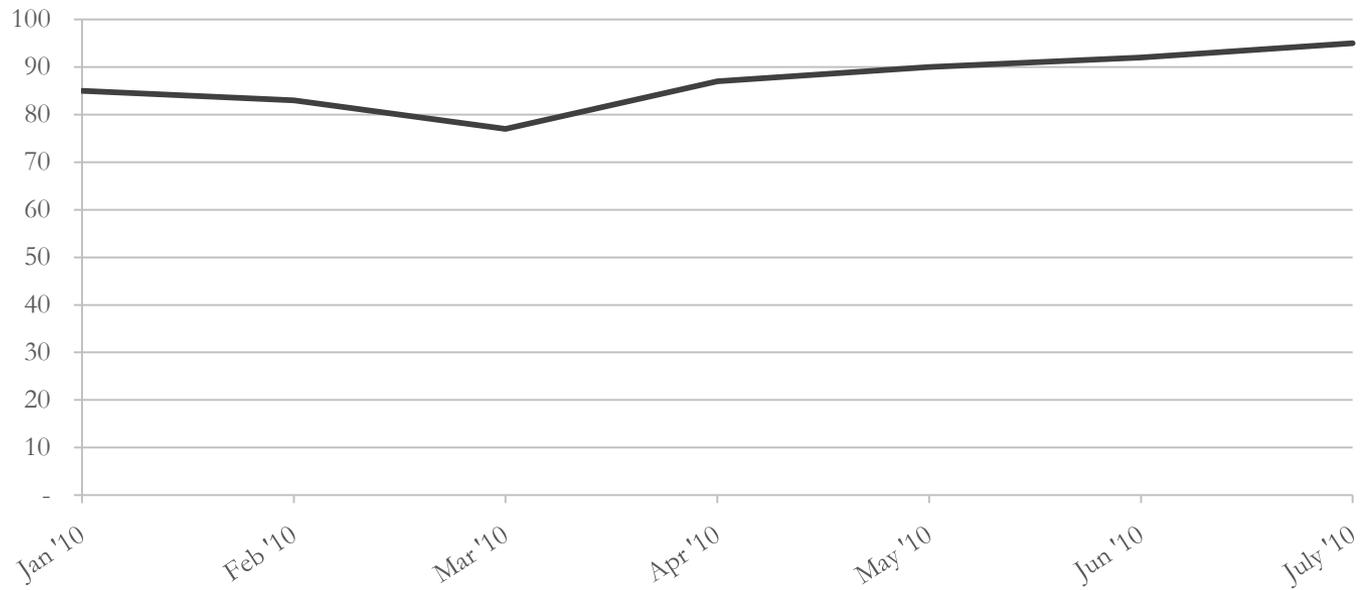
Trend Tracking (cont.)

- Trend tracking can help decrease the number of defaults.
 - If you find a trend of low FICOs defaulting more than higher FICOs, you can implement a minimum FICO requirement.
 - You can trend track underwriter performance to increase the quality of underwriting.



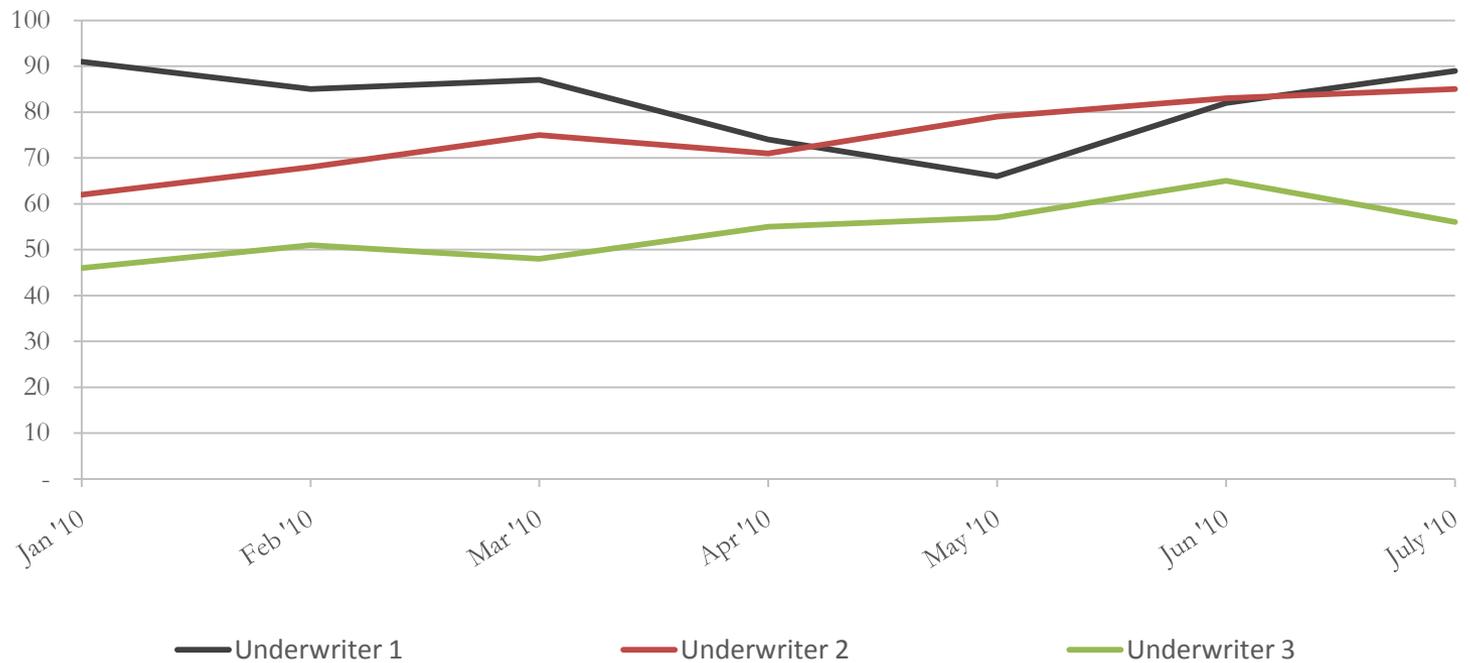
Trend Tracking Charts

ABC MORTGAGE LOAN SCORE TRENDING



Trend Tracking Charts

UNDERWRITER LOAN SCORE TRENDING



Trend Tracking Charts

SCORECARD

# of Loans	Average Loan Score	Processing / Underwriting			Credit Report			Appraisal			Closing			Regulatory Compliance			Total		
		IS	M	S	IS	M	S	IS	M	S	IS	M	S	IS	M	S	IS	M	S

Investor

Investor 1	11	86	10	-	-	1	-	-	5	-	-	1	-	-	7	12	3	24	12	3
Investor 2	2	90	2	-	-	1	-	-	-	1	-	-	-	-	-	2	-	3	3	-

Loan Officer

Loan Officer 3	2	93	1	-	-	-	-	-	2	-	-	-	-	-	2	-	3	2	-	
Loan Officer 7	2	79	1	-	-	-	-	-	1	-	-	1	-	-	1	3	1	4	3	1
Loan Officer 6	1	87	1	-	-	-	-	-	1	-	-	-	-	-	1	-	1	2	-	
Loan Officer 1	2	84	2	-	-	-	-	-	1	-	-	-	-	-	3	1	1	6	1	1
Loan Officer 10	1	86	1	-	-	1	-	-	-	-	-	-	-	-	2	-	2	2	-	
Loan Officer 4	1	98	1	-	-	-	-	-	-	-	-	-	-	-	1	-	-	2	-	
Loan Officer 2	1	92	1	-	-	1	-	-	-	-	-	-	-	-	1	-	2	1	-	
Loan Officer 8	1	91	1	-	-	-	-	-	1	-	-	-	-	-	1	1	-	3	1	
Loan Officer 9	1	66	1	-	-	-	-	-	-	-	-	-	-	-	2	1	1	2	1	
Loan Officer 5	1	91	2	-	-	-	-	-	-	-	-	-	-	-	1	1	-	3	1	

Underwriter

Underwriter 1	2	81	1	-	-	-	-	-	3	-	-	1	-	-	-	2	1	5	2	1
Underwriter 4	8	85	8	-	-	2	-	-	-	1	-	-	-	-	4	10	2	14	11	2
Underwriter 3	2	95	2	-	-	-	-	-	1	-	-	-	-	-	2	1	-	5	1	-
Underwriter 2	1	91	1	-	-	-	-	-	1	-	-	-	-	-	1	1	-	3	1	-



Management Reporting

We have our Post-Closing audits completed...Now what?

- **Report to Management**
 - Deliver to senior management within 30 days of the audits being completed.
- **Management's Response & Action Plan**
 - Management must respond to the report and make an action plan as to who should do what to correct the findings.
- **Corrective Action Plan and Monitoring**
 - Action report should identify actions taken, timetable for completion, and planned follow-up.
- **Reporting to Investors and Agencies**
 - Report any misrepresentation, breach of your contract agreement, or detection of fraud within 30 days of uncovering the findings.



Audit and Review of the QC Process

- Review of QC process is a requirement of most agencies.
- Complete an annual review of your entire QC process to ensure it is working as intended.
 - No gaps in the process
 - All elements of QC plan are addressed
 - Unnecessary items are removed
 - Changes are updated in your **written** QC plan
- Continuously evaluate your QC process and update to correct recurring errors.



Audit and Review of the QC Process (cont.)

- Remember, no QC plan will fit every company.
 - Each QC plan needs to be customized to your company and product mix.
 - Each company will have unique portions of their QC process that need more attention than others.



Record Retention

- Each agency requires you to keep all documentation pertaining to QC review

FHA **2 years**

FNMA **3 years**

FHLMC **3 years**

- Also check with each state your are licensed in to ensure you are retaining the correct documentation and for the required amount of time.



FNMA QC Specialist

- Fannie Mae has created a new position called the QC Specialist
- The QC Specialist's job is to contact approved Fannie Mae Seller/Servicers and assure they are meeting all of Fannie Mae's QC requirements. They will ask for the following:
 - Copies of Pre-Funding and Post Closing QC plans and procedures
 - Training materials for QC or Vendor staff
 - Statistical sampling methodology (if applicable)
 - QC reports for the last 3 months
 - Documented action plans in place to correct loan defect issues
 - Corrective tracking reports
 - Management Response to QC Reports
 - Internal Audit QC reports for the past 3 years
 - Most recent independent audit of your QC function
 - TPO Approval Process and Monitoring documents

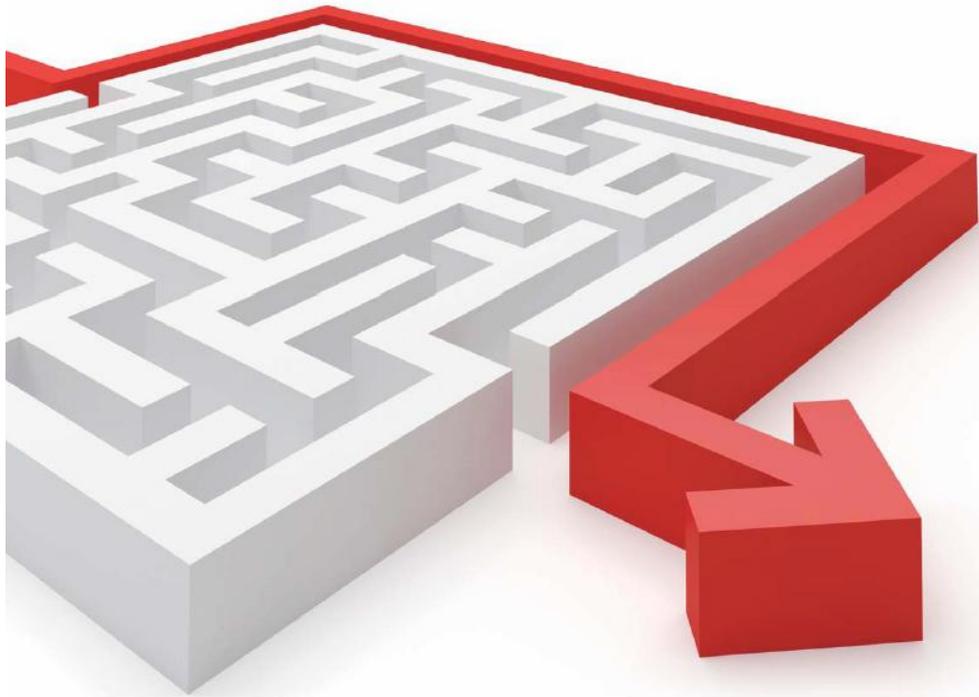


Additional Fannie Requirements

- Validate Social Security number with Social Security Administration
- Check GSA and LDP on all loans
- Do an occupancy certification on all primary and secondary residences selected for audit
- Pull 4506T transcripts on all loans selected for audit
- Establish an acceptable defect rate and monitor rate to make sure it meets your requirements
- Validate borrowers identity via OFAC and Patriot Act methods



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a better way



MORTGAGE COMPLIANCE ADVISORS, LLC

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- Post-Closing QC Audits
- Pre-Funding Reviews
- QC Plan Implementation
- Red Flag Policies
- Training and Consulting
- Agency Approval
- Etc.

Contact Information

- We will be answering a few of your questions in just a moment. Questions not addressed at this time will be emailed directly to you, as well as answered in our next newsletter. You are also welcome to contact us at any time:

Mortgage Compliance Advisors, LLC

5505 South 900 East # 110 • Salt Lake City, Utah 84117

- **Support (Current Clients):** (801) 649-6038
- **Support (General):** (877) 250-5243
- **Email:** Info@MortgageComplianceAdvisors.com



Resources

- Fannie Mae
 - <https://www.efanniemae.com>
- Fannie Mae's LQI Resources
 - <https://www.efanniemae.com/sf/lqi/index.jsp>
- Freddie Mac
 - <http://www.freddiemac.com>
- HUD/FHA
 - <http://www.hud.gov>
- HUD's Neighborhood Watch
 - <https://entp.hud.gov/sfnw/public/>



Questions & Answers

You can find today's slides on our News & Resources page:

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