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Quality Control Plans

April 19, 2022

About this Material

This material is based on the current information in the MPF® Program Guide as of the date of training. It should not be used in place of the MPF Program Guide. The MPF Guides are the governing documents and control in the event of discrepancies between the information in this presentation and the MPF Guides. The official version of the MPF Guides are available at www.fhlbmpf.com and through AllRegs®.

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General Quality Control Plan Requirements

Quality Control Programs

A QC program must be maintained for mortgages originated and serviced under the MPF® Program

- Each QC program must be designed to fit the specific needs of the individual organization's operating environment.
- While plans may differ, it's important that they meet the minimum requirements of the MPF Program.

Quality Control Programs

- Plans should be in writing.
- Provide standard QC procedures for all personnel involved or impacted by the QC process.
- Must include the performance of pre- and post-closing QC reviews.
- Provides for the independence of the post-closing QC process from mortgage origination, processing and underwriting staff.
- Contain a process for sampling loans using both **targeted** and **random** selections that must include:
  - ✓ Loans originated through each applicable production channel (retail, correspondent, third party originations).
  - ✓ Loans originated under all MPF product lines (if applicable)
  - ✓ Loans underwritten manually and with an AUS.

Quality Control Programs (continued)

- Ensure the loans are originated according the MPF Guides and any applicable laws.
- Include a process for reviewing QC work performed by vendors.
- Include a process for maintaining QC records and reports for _three_ years.
    - ✓ Loan files reviewed
    - ✓ All related documentation
    - ✓ Document the location of the records
- Have written procedures for reporting the results/findings of reviews.
    - ✓ Outline the components included in the reports
    - ✓ Distribution of the findings (to whom and how often)
    - ✓ Timing requirements to resolve issues

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Quality Control Programs (continued)

- At a minimum, any loan with a defect must be identified and categorized by the severity of the defect.
- The QC report must define the severity levels that are appropriate for the organization and reporting needs.
  - ✓ The highest level of severity must be assigned to loans that are not eligible under the MPF Program guidelines.
- QC plans must establish a post-closing defect rate for its organization
  - ✓ Based upon post-closing random QC samples
  - ✓ At a minimum the target rate must be established for the highest level of severity and recommended for lower severity levels.

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Quality Control Program Requirements

Quality Control plans must include procedures for reviews of Early Payment Default (EPD) loans

An EPD is defined as:

a. A conventional loan that becomes delinquent within the first 12 months of the borrower's first payment and subsequently becomes 90 days past due within the first 14 months.

b. A conventional loan that becomes delinquent within the first 6 months of the borrower's first payment and subsequently becomes 90 days past due within the first 9 months.

c. A conventional loan that becomes delinquent within the first 9 months of the borrower's first payment and subsequently becomes 90 days past due within the first 12 months.

The answer is a.

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EPD Requirements

A QC review of each loan that reaches EPD status is required, even if the loan has subsequently been brought current

- The QC review must be initiated within <u>60</u> calendar days after the date the loan reaches EPD status.
- EPD QC reviews must include reverification of income and employment, sources of funds and credit reports.
- Either a new appraisal or field inspection/review or a review of the property value used to obtain an appraisal waiver (if applicable) must be conducted.

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Pre-Closing Sample Selection

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Pre-Closing Sample File Selection

The sample selection process must target areas that have a higher potential for errors, misrepresentation or fraud

What are some of those targeted areas?

- The selection must include a sampling of loans with the characteristics of loans that were found to have defects in previous pre-and post-closing QC reviews.

- For each 12-month period, samples must represent the full scope of production and products:
  - ✓ All product lines
  - ✓ All states of operation
  - ✓ Each branch office
  - ✓ Each third party involved with the origination process
  - ✓ Loans with high-risk attributes

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Pre-Closing Sample File Selection

Sampling must be timed to allow for:

- Every loan within the selected population to have a chance of being selected for review.

- Adequate time for the completion of the pre-closing reviews so origination personnel has time to make corrections before closing.

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Pre-Closing Sample File Selection

The sample selection process should include random sampling and the targeted sampling of loans

Pre-closing sampling should include:

- Loans with characteristics similar to previously reviewed loans that contained errors
- LTVs greater than 90%
- Self employed borrowers
- Cash-out refinances
- High debt-to-income (DTI) ratios
- Multi-unit properties, condominiums, manufactured homes
- Loans originated by new employees or new third parties involved with the origination process
- Loans underwritten by all underwriters
- Loans with complex income calculations like rental income and assets used as income

Pre- Closing Verifications

Pre-Closing Verifications

Pre-closing QC reviews should be conducted after final loan approval or at the very least be completed when there is sufficient documentation in the file to perform a full review of data and documentation

- **Information needed to be reviewed should include (and is not limited to) the following**:
  - ✓ Make certain that data entered into DU or LPA is accurate
  - ✓ Confirm all documentation required in the AUS feedback is present
  - ✓ Is the borrower's identity verified?
  - ✓ Verify the borrower's SSN or ITIN
  - ✓ Is all required employment documentation present*?
  - ✓ Is the qualifying income calculated correctly?
  - ✓ Are the assets verified and do they satisfy funds to close and reserve requirements?

**The verbal verification of employment (VOE) may be performed during the pre-closing review when the review occurs just before the closing date.*

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Pre-Closing Verifications (continued)

- Review the appraisal.
- Watch for any closing conditions set by the underwriter.
- If there's mortgage insurance on the loan, document that it is adequate and coverage is in place.
- If the property is a condominium, ensure it meets the project eligibility and has been reviewed according to the applicable review type. Confirm that the documentation is present to support the review type and decision.

As a reminder, pre-closing reviews must be performed by personnel other than those with a vested interest in the closing and at a minimum, be conducted by individuals who have no involvement in the processing and underwriting decision of the loan being reviewed.

Post-Closing Sample Selection

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Post-Closing Random Sampling

- Post-closing random sampling may be **statistical** or a **percentage of loans closed**.
- Typically when using a percentage, at least __10__% of closed loans should be randomly selected.
- The 10% can consist of any of these categories:
  - ✓ Total mortgage production
  - ✓ Total secondary market production
  - ✓ Total MPF Program production/deliveries

Post-Closing Random Sampling

Number of Loans Closed During the Month	Requirements
10 or more	Randomly sample 10% of the closed loan files by the last day of the following month. Example: 16 loans were delivered to the MPF Program in March, randomly select 2 loans and complete the reviews by April 29.
Less than 10	Reviews may be deferred* for up to 3 months until 10 loans are closed but after 3 consecutive months, at least one file must be reviewed by the last day of the following month. Example: There were 5 loans delivered to the MPF Program in February, 3 loans in March and 1 loan in April. Select 1 file for review by May 31. Example: There were 5 loans delivered to the MPF Program in February, 3 loans in March and 9 in April. Select 10% (2 loans) and complete the reviews by May 31.

*If sampling is done over the extended 90-day period, notify your MPF Bank if the sampling cycle will be in arrears for any reason.

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True or False?

Post-closing samples may exclude loans that underwent a pre-closing QC review.

False, they may not be excluded.

If a loan is chosen that was subject to a pre-closing review:

- Examine the pre-closing QC review report and verify that all deficiencies from that review were cured prior to closing and;
- Reverify only the items that were not satisfactorily validated, verified or cured as a result of the pre-closing QC review.

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Targeted Sampling

- There should be a process in place for selecting loans for targeted post-closing QC samples.
- The process should take into account the risks that may be present during the origination process.
- The process must be reviewed regularly and when necessary, adjusted to ensure that the sample selected, including sample size, is appropriate.
- Loans selected for post-closing targeted QC reviews must concentrate on areas that have a higher potential for errors, misrepresentations and fraud.

Let's take a look…

Targeted Loan Characteristics

- Loans with similar characteristics that resulted in errors or defects identified in previous reviews.
- Loans with complex income calculations like self-employed borrowers and rental income.
- Loans with non-standard guidelines such as delayed financing, multiple financed properties or manual reserve calculations.
- Loans in areas with high delinquency rates or areas experiencing rapid increases or decreases in property value.
- Loans with multiple layers of credit risk.
- Loans originated, processed or underwritten by a newly hired individuals.
- Loans utilizing a new appraisal provider.

Post-Closing Verifications

Post-Closing Verifications

Post-closing verifications should ensure that the final terms of the loan align with that of the underwriting decision

- If DU or LPA were used, all data submitted to the AUS must be true, correct and complete.
  - ✓ Make sure the file contains the documentation to support the submitted data.
  - ✓ Confirm that all of the borrower’s liabilities were included in the AUS analysis.

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Post-Closing Verifications

When discrepancies are discovered, these steps must be followed:

1. **Determine if the discrepancies are within the permitted tolerances.**

2. **If underwritten with DU or LPA** and they are outside of the tolerances, re-submit using corrected data. If unable to resubmit, the loan must be manually underwritten according to the manual underwriting guidelines.

   Manually underwritten loans: If discrepancies cause the total debt ratio to increase by 3% or more, the loan must be re-underwritten to determine if it meets MPF Program guidelines.

   Some MPF Xtra loans require DU and an Approve/Eligible finding.
   Those loans cannot be manually underwritten during the post-closing review process. If re-submitted through DU and an Approve/Eligible finding is not returned, the loan is ineligible.

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Post-Closing Verifications

3. Determine if the loan with the corrected data remains eligible as delivered.
4. If the loan is eligible as delivered, document the underwriting file to reflect this decision.
5. If the loan is not eligible as delivered, the MPF Provider must be notified of these findings.

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Reverifications

Reverifications

If certain red flags are identified in the origination and underwriting documentation it may warrant re-verification

- When information from the reverification process differs from the information utilized in the underwriting of the loan, the loan must be re-underwritten to determine that it remains eligible as delivered.

- For **targeted** samples, reverifications should be limited to those that apply to the reason the loans were selected under the targeted sample's criteria.

- **Example:** If the purpose of the targeted selection is to focus on income calculations, the re-verification of assets and/or credit would not be necessary. Only reverification of income and employment would be needed.

Reverifications: Employment and Income

All employment and income documentation used in the original underwriting process must be re-verified

- If tax returns were not obtained prior to closing, tax transcripts must be obtained for the post-closing review using Form 4506-C (signed at closing).

- Reverification of employment should be in writing but a verbal reverification may be permitted if the following information is documented in writing:
  - ✓ Name of your organization
  - ✓ Name of the borrower's employer
  - ✓ The name and title of the person contacted at the employer
  - ✓ The date of the conversation
  - ✓ Whether or not the information in the original verification was accurate and if not, disclose the nature of the inaccuracy.

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Reverifications: Sources of Funds

The sources of funds used in the original underwriting process should be reverified

- Confirmations should be obtained as to the validity of the documents by sending the issuers copies of the original verification documentation with a request for validation.

- The reverification should be in writing but a verbal reverification may be accepted provided it is documented in writing.
  - ✓ The same information as previously stated for employment/income verbal reverifications should be applied.

- In the rare instance that an asset cannot be obtained from the financial institution, the attempt must be documented with a copy of the documentation request and notation that states the date the information was requested and that it was not returned by the financial institution.

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Reverifications: Credit Reports

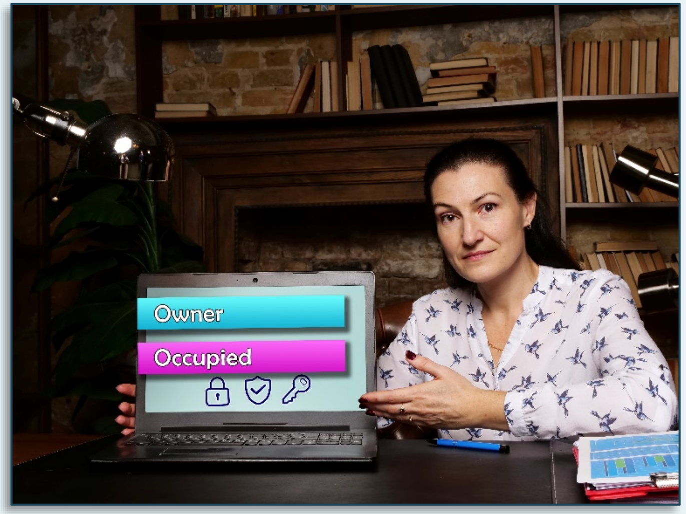
The borrower's credit history must be reverified for all loans chosen via random selection*

- A new tri-merged report is required.
- If non-traditional credit was utilized, each of the credit references on the report must be re-verified.
- The new and original reports must be compared for discrepancies or the existence of any debt that may not been taken into consideration when the loan was underwritten.

Reverifications: Owner Occupancy

The post-closing QC review must include a verification of owner-occupancy for all loans secured by a primary residence

- Review the property insurance policy and any other documentation to confirm there is no indication that the property is not the borrower's primary residence.
- Watch for a change of address after closing (servicers).



Summary

It's important to ensure that your Quality Control Plan meets the requirements of the MPF Program

- Information about plan requirements can be found in **Chapter 8** of the **MPF Program Guide.**
- A robust QC plan may help uncover staff deficiencies and prevent future errors.
- **A successful QC program results in fewer findings and repurchases!**

MPF Contacts and Resources

MPF Service Center

- Email - MPF-Help@FHLBC.com
- Hours - 8:30 am to 4:30 pm CST
- Phone: (877) 345-2673

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MPF National Education

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https://www.fhlbmpf.com/education/upcoming-webinars

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