MORTGAGE BANKING – ABBREVIATED

Core Analysis Decision Factors

Examiners should evaluate the Core Analysis in this section to determine whether an Expanded Analysis is necessary. Click on the hyperlinks found within each of the Core Analysis Decision Factors to reference the applicable Core Analysis Procedures.

Do Core Analysis and Decision Factors indicate that risks are appropriately identified, measured, monitored, and controlled?

C.1. **Are policies, procedures, and risk limits for the mortgage banking operations adequate?** ***Refer to Core Analysis Procedures #3-4 & Procedure #19.***

C.2. **Are internal controls adequate?** ***Refer to Core Analysis Procedures #5-6; Procedure #10; & Procedure #24.***

C.3. **Are the quality control (QC) and audit/independent review functions adequate?** ***Refer to Core Analysis Procedure #1 & Procedures #7-8.***

C.4. **Are information and communication systems adequate and accurate?** ***Refer to Core Analysis Procedure #4; Procedure #9; Procedures #12-14; Procedure #22; & Procedure #24.***

C.5. **Does management use appropriate strategies to manage liquidity and limit interest rate risk exposure?** ***Refer to Core Analysis Procedure #9; Procedure #20; Procedure #22; & Procedures #25-26.***

C.6. **Are warehouse loans sold in a timely manner?** ***Refer to Core Analysis Procedures #15-18 & Procedures #22-23.***

C.7. **Is the mortgage banking financial performance acceptable?** ***Refer to Core Analysis Procedure #25.***

C.8. **Do the board and senior management effectively supervise the mortgage banking area?** ***Refer to Core Analysis Procedures #4-6; Procedure #11; Procedure #19; & Procedures #27-28.***

MORTGAGE BANKING - ABBREVIATED

Core Analysis Procedures

Examiners are to consider these procedures but are not expected to perform every procedure at every bank. Examiners should complete only the procedures relevant for the bank's activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.

This abbreviated module is for use with non-complex mortgage banking operations that sell loans with servicing released. When useful, examiners can complete this Abbreviated module, or portions of it and portions of the Mortgage Banking - Core module. Examiner judgment should be used to determine whether to use abbreviated or core procedures. Generally, examiners should use the Mortgage Banking – Core module in more complex situations when the bank:

- ***Has a formal mortgage banking department or a mortgage banking subsidiary;***
- ***Has purchased and integrated a mortgage banking operation or company;***
- ***Engages in wholesale activities, including loans originated through third-parties;***
- ***Has warehouse line(s) of credit to fund the mortgage banking pipeline;***
- ***Is experiencing delinquencies, foreclosures, or extended agings within the warehouse;***
- ***Speculates on interest rate movements through unhedged positions;***
- ***Originates and sells nontraditional or subprime mortgage products; or***
- ***Retains mortgage servicing assets or services sold loans in excess of the Small Servicer exemption (12 CFR 1026.41(e)(4).***

References

- ***Interagency Advisory on Mortgage Banking, FIL-15-2003 (FDIC) or SR 03-4 (FRB)***
- ***Interagency Advisory on Accounting and Reporting for Commitments to Originate and Sell Mortgage Loans, FIL-39-2005 (FDIC), SR 05-10 (FRB)***
- ***Interagency Guidance on Nontraditional Mortgage Product Risks, FIL-89-2006 (FDIC) or SR 06-15 (FRB)***
- ***Statement on Subprime Mortgage Lending, FIL-62-2007 (FDIC) or SR 07-12 (FRB)***
- ***Statement on Working with Mortgage Borrowers,*** FIL-35-2007 ***(FDIC) or*** SR 07-6 ***(FRB)***

Preliminary Review

1. Review the following documents:

- **Previous examination reports and workpapers, including consumer compliance examinations;**
- **Recent internal and external audit reports, management letters, and management's response to criticisms or recommendations;**
- **Reports,[1] audits, or correspondence, if available, from government-sponsored enterprises[2] (GSE), Federal Housing Administration (FHA), and significant private investors;**
- **QC reports;**
- **Internal memoranda, board minutes, and management reports on the mortgage banking activities;**

[1] Scorecards or other reports that provide information on production levels and quality.
[2] References to GSEs include the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC).

- **Asset, liability, and profitability reports; and**
- **Organizational charts pertinent to mortgage banking activities.**

2. Review the types of products offered and sold, originator channels, sales volume, and target markets.

Policies and Procedures

3. Review policies and procedures regarding mortgage banking activities. Consider the following:

- **Permissible mortgage banking activities, including production channels and hedging;**
- **Loan production, origination, and underwriting guidelines;**
- **Individual officer and employee responsibilities;**
- **Lending limits and segregation of duties;**
- **Position and earnings-at-risk limits; and**
- **Accounting procedures for loan sales, loans held for sale, and derivatives.**

4. Evaluate the process for monitoring exceptions to policies and procedures. Satisfactory processes generally include monthly exception reporting to senior management and the board (including "no-exception" reports) and reports that detail compensating factors for each exception.

Internal Controls

5. Determine whether management established an effective QC program that is independent from the loan production process and ensures that loans, whether originated or purchased, are processed, underwritten, and closed according to lender and investor standards.

6. Determine whether QC findings (and management's response) are clearly documented and presented to the board and senior management at least quarterly.

Audit or Independent Review

7. Determine whether the scope of internal audits or other independent reviews is sufficient to identify bank policy, reporting, and internal control deficiencies and whether results are fully and promptly reported to the board.

8. If external audits, internal audits, or other independent reviews disclosed deficiencies, determine whether management responses are appropriate and timely.
Information and Communication Systems
9. Determine whether management information systems (MIS) reports generate sufficient information, such as: • **Held-for-sale loans and inventory agings;** • **Loans segregated by product type and investor;** • **Application volumes (through origination) and any processing backlogs;** • **The status of delivery commitments to investors;** • **Daily positions, including pipeline, warehouse, and hedged loans;** • **Operating results, including profitability, efficiency, and cost information; and** • **Liquidity and capital needs.**
Internal Loan Production (Origination, Underwriting, and Closing)
10. Assess the qualifications, experience, and compensation levels of originators,[3] processors, and underwriters.
11. Evaluate procedures for underwriting, closing, and funding loans. Determine whether management ensures all necessary documents are obtained before funds are released.
Pipeline Management
Pipelines include loan applications approved but unfunded.
12. Review the timeliness, accuracy, and composition of pipeline reporting. • **Determine whether unfunded commitments are identified by product type and stratified between fixed-rate, adjustable-rate, and floating-rate derivative loan commitments.**

[3] **Examiners should remain aware of the loan originator compensation requirement (Regulation Z) and contact compliance examiners with questions or potential concerns, as appropriate. The *Interagency Guidelines Establishing Safety and Soundness Standards* address excessive compensation in *section III. Prohibition on Compensation That Constitutes an Unsafe and Unsound Practice* (FDIC: 12 CFR Part 364, Appendix A; FRB: 12 CFR Part 208, Appendix D-1). Refer also to the Management and Internal Control Evaluation Module for procedures on assessing compensation arrangements.**

- **Review management's process for monitoring, reporting, and managing expired rate-lock commitments.**

13. Verify that management reports all rate-lock commitments on loans designated held-for-sale as derivatives (written options) in financial and regulatory reports, as described in ASC Topic 815, Derivatives and Hedging.

14. Review management's procedures and assumptions for monitoring and projecting fallout rates, and consider how these rates correspond to hedging practices.

Warehouse Management

Warehouse loans are funded and closed loans waiting to be delivered to the secondary market.

15. Review the appropriateness and timeliness of internal warehouse-reconciliation reports.

16. Review warehouse turnover and aging reports, and determine whether there are unusual characteristics that suggest impaired marketability, such as delinquencies, underwriting defects, or loans in the warehouse for extended periods. Determine the level of, and reasons for, any unsaleable loans.

17. Review the number and volume of loan-repurchase demands from investors since the prior examination. Consider the status (outstanding, repurchased, indemnified, or withdrawn by investor) and any associated losses.

18. Determine whether warehouse loans are accurately reported at the lower of cost or fair value. Determine whether estimates of fair value for held-for-sale loans use reasonable approaches, assumptions, and are valued in accordance with ASC Topic 820, Fair Value Measurement.

Hedging Practices

Many mortgage banking programs use derivative instruments, such as forward loan sales commitments, to hedge the rate-lock pipeline and warehouse loans against changing market interest rates.

19. Determine whether management established hedging policies that address objectives, such as derivative types, authorizations, exposures, and exceptions.

20. Review the effectiveness of hedging strategies, such as forward sales or options, used to hedge risks associated with the pipeline and the warehouse.

21. Determine whether hedging instruments are accurately reported in financial and regulatory reports.

22. If management was unable to fulfill any forward commitments, assess the potential implications, such as pair-off fees, interest rate risk, and reputation risk.

Secondary Marketing

Secondary marketing encompasses the process of selling and delivering mortgage loans to investors, which includes repurchase risk.

23. Review a sample of loan purchase and sale agreements with investors (correspondent agreements). Identify volume commitments, expirations, representations, warranties, recourse provisions, repurchase guidelines, and other provisions.

24. Review a sample of correspondent agreements to determine whether the bank has any continuing recourse obligations to the purchaser beyond standard representations and warranties. If management is selling loans with recourse, determine whether appropriate controls exist over recourse provisions, which may include the following:

- **MIS reports track all recourse obligations;**
- **Recourse liability reserves are at an appropriate level for loans sold with recourse; and**
- **Management properly accounts for all loans sold with recourse in the regulatory reports.**

Financial Analysis

25. Assess the profitability of mortgage banking activities in terms of the level, trend, volatility, and composition of earnings. Consider historic and projected gains on sales, growth plans, interest rates, economic environment, and industry comparisons when evaluating earnings.

26. Determine whether liquidity and capital levels support the demands and risks of the operation.
Board and Senior Management Oversight
27. Evaluate management's oversight of the mortgage banking operation. Determine whether the experience, technical knowledge, and administrative capabilities of management are sufficient.
28. Review the strategic planning process and determine whether mortgage banking goals are reasonable, attainable, complement the bank's overall business plan, and reflect the board's risk appetite. Determine whether planning addresses contingencies such as departmental scaling (i.e., flexibility to quickly increase or decrease department resources due to changes in production volumes to maintain profitability) or exiting the mortgage banking program, if and when conditions warrant.
End of Abbreviated Module. If needed, continue to Core Analysis Module or to the Expanded and Impact Analyses.