

MORTGAGE BANKING – ABBREVIATED

Core Analysis Decision Factors

Examiners should evaluate the Core Analysis in this section to determine if 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 #24](#).

C.3. Are the audit or 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](#), [Procedure #12](#), [Procedure #14](#), & [Procedure #24](#).

C.5. Does management use appropriate strategies to manage liquidity and limit interest rate risk exposure? Refer to Core Analysis [Procedures #9](#), [Procedures #22](#), & [Procedures #25-26](#).

C.6. Are warehouse loans sold in a timely manner? Refer to Core Analysis [Procedures #15-18](#) & [Procedure #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](#), & [Procedure #27-28](#).

MORTGAGE BANKING - ABBREVIATED

Core Analysis Procedures

Examiners are to consider the following 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 in banks with non-complex mortgage banking operations that sell loans with servicing released. Mortgage banking activities vary greatly among banks and it may not be necessary to perform all of these procedures. 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 such as 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*
- *Engages in the servicing of sold loans and/or retains mortgage servicing assets.*

References

- *Interagency Advisory on Mortgage Banking (FDIC FIL-15-2003, FRB SR 03-4)*
- *Interagency Advisory on Accounting and Reporting for Commitments to Originate and Sell Mortgage Loans (FDIC FIL-39-2005, FRB SR 05-10)*
- *Interagency Guidance on Nontraditional Mortgage Product Risks (FDIC FIL-89-2006, FRB SR 06-15)*
- *Statement on Subprime Mortgage Lending (FDIC FIL-62-2007, FRB SR 07-12)*
- *Statement on Working with Mortgage Borrowers (FDIC FIL-35-2007, FRB SR 07-6)*
- *Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages (FDIC FIL-76-2007, FRB SR 07-16)*
- *Servicing for Mortgage Loans: Supplemental Information for Loss Mitigation Strategies (FDIC FIL-77-2007)*

Preliminary Review

1. **Review the following documents.**
 - **Previous examination reports and workpapers, including consumer compliance examinations;**
 - **Internal audit reports;**
 - **The most recent external audit report, management letter, and management's response to criticisms and recommendations;**
 - **Government-sponsored enterprise (GSE), Federal Housing Administration (FHA), and significant private investor reports, if available; (Note: References to GSEs include the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC).)**
 - **Internal memoranda, board minutes, and management reports on the mortgage banking activities;**

<ul style="list-style-type: none"> • Asset, liability, and profitability reports; and • Organizational charts pertinent to the mortgage banking activities.
<p>2. Review the types of products offered and sold, originator channels, and target markets.</p>
<p>Policies and Procedures</p>
<p>3. Review bank policies and procedures regarding mortgage banking activities. Consider the following:</p> <ul style="list-style-type: none"> • Permissible mortgage banking activities, including 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.
<p>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.</p>
<p>Internal Controls</p>
<p>5. Determine whether management established an effective quality control program that is independent from the loan production process and ensures that loans, whether originated or purchased, are processed, underwritten, closed, and serviced according to lender and investor standards.</p>
<p>6. Determine whether quality control findings are clearly documented and presented periodically to the board and senior management and include documentation of management’s response.</p>
<p>Audit or Independent Review</p>
<p>7. Determine whether the scope of recent audits or independent reviews is sufficient to identify policy, reporting, and internal control deficiencies. Ensure detailed results are promptly reported to the board.</p>

<p>8. If internal audits or independent reviews disclosed any deficiencies, determine whether management responses are appropriate and timely.</p>
<p>Information and Communication Systems</p>
<p>9. Determine whether the management information systems (MIS) generate all necessary reports, such as:</p> <ul style="list-style-type: none"> • 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.
<p>Loan Production (Origination, Underwriting, and Closing)</p>
<p>10. Assess the qualifications, experience, and compensation levels of originators and underwriters.</p>
<p>11. Evaluate procedures for underwriting and closing loans. Determine whether management ensures all necessary documents are obtained before funds are released.</p>
<p>Pipeline Management</p>
<p><i>Pipelines include loan applications that are approved, but unfunded.</i></p>
<p>12. Review the timeliness, accuracy, and composition of pipeline reporting.</p> <ul style="list-style-type: none"> • Determine whether unfunded commitments are identified by product type, and adequately stratified, such as between fixed-, floating-, and adjustable-rate commitments and rate-locked or non-rate-locked commitments. • Review management’s process for monitoring and reporting expired rate-locked commitments.
<p>13. Ensure that management reports all rate-locked commitments (on loans designated as held for sale) as derivatives (written options) in financial and regulatory reports, as described in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 815.</p>

14. Review management’s procedures and assumptions for monitoring and projecting fallout rates, and consider how these rates correspond to hedging practices.
Warehouse Management
<i>Warehouse loans are funded and closed loans waiting to be delivered to the secondary market.</i>
15. Review the appropriateness and timeliness of internal warehouse-reconciliation reports.
16. Review warehouse turnover and aging reports, and determine whether there are any 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 Measurements.
Hedging Practices
<i>Many mortgage banking programs use derivative instruments, such as forward commitments, to hedge the rate-locked pipeline and warehouse loans against changing market interest rates.</i>
19. Determine whether management established hedging policies that, at a minimum, address objectives, 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.

<p>21. Determine whether hedging instruments are accurately reported in financial and regulatory reports.</p>
<p>22. If the bank was unable to fulfill any forward commitments, assess the potential implications, such as pair-off fees, interest rate risk, and reputation risk.</p>
<p>Secondary Marketing</p>
<p><i>Secondary marketing encompasses the process of selling and delivering mortgage loans to investors, which includes repurchase risk.</i></p>
<p>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.</p>
<p>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 the bank is selling loans with recourse, determine whether appropriate controls exist over recourse provisions, which may include the following:</p> <ul style="list-style-type: none"> • MIS reports adequately 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, including accurate risk weighting of recourse associated with credit default and premium recapture.
<p>Financial Analysis</p>
<p>25. Assess the earnings of the mortgage banking activities in terms of the level, trend, volatility, composition, and earnings at risk. Consider historic and projected gains on sales, growth plans, interest rates, economic environment, and industry comparisons when evaluating earnings.</p>
<p>26. Determine whether liquidity and capital levels support the demands and risks of the operation.</p>
<p>Board and Senior Management Oversight</p>
<p>27. Evaluate the effectiveness of management’s oversight of the mortgage banking operations. Determine whether the experience, technical knowledge, and administrative capabilities of management are</p>

sufficient.
28. Review the strategic planning process and determine whether mortgage banking goals are reasonable, attainable, and complement the bank's overall business plan and reflect the bank's associated risks.
End of Abbreviated Module. If needed, continue to Core Analysis Module.