Examination Procedures
Mortgage Origination

These Mortgage Origination Examination Procedures ("Procedures") consist of modules covering the various elements of the mortgage origination process; each module identifies specific matters for review. Examiners will use the Procedures in examinations of mortgage brokers and mortgage lenders, generally called "mortgage originators" in these procedures. Before using the Procedures, examiners should complete a risk assessment and examination scope memorandum in accordance with general CFPB procedures. Depending on the scope, and in conjunction with the compliance management system review, including consumer complaint review, each examination will cover one or more of the following modules.

Module 1	Company Business Model
Module 2	Advertising and Marketing
Module 3	Loan Disclosures and Terms
Module 4	Underwriting, Appraisals, and Originator Compensation
Module 5	Closing
Module 6	Fair Lending
Module 7	Privacy

Examination Objectives

1. To assess the quality of a supervised entity's compliance management systems in its mortgage origination business.

2. To identify acts or practices that materially increase the risk of violations of federal consumer financial law, and associated harm to consumers, in connection with mortgage origination.

3. To gather facts that help determine whether a supervised entity engages in acts or practices that are likely to violate federal consumer financial law in connection with mortgage origination.

4. To determine, in accordance with CFPB internal consultation requirements, whether a violation of a federal consumer financial law has occurred and whether further supervisory or enforcement actions are appropriate.

Background

This section of the Procedures provides background on the mortgage business and the federal consumer financial law requirements that apply.

A. Mortgage Types

Residential mortgage loans offer a variety of features to meet differing consumer needs. The length of a mortgage can vary from one year to 50 years, with a number of lengths available in between. Interest rates can be fixed or adjustable. Some adjustable rate mortgage loans (ARMs)

are "hybrid," having a fixed interest rate for a certain period of time and then changing to an adjustable rate. Hybrid ARMs often are identified using two numbers, such as 5/1. The first number identifies the number of years the interest rate will be fixed, and the second number identifies the frequency with which the interest rate will adjust after the fixed interest rate period ends. A "5/1" loan would have a fixed interest rate for five years, and then the interest rate would adjust one time per year. Alternatively, the second number denotes the number of years the loan will have an adjustable rate: in a "2/28 loan," the loan would have a fixed interest rate for two years, and then the interest rate would adjust periodically over the subsequent 28 years.

Most, but not all, loans are "fully amortizing," meaning that the borrower pays down part of the principal and the full amount of interest that is due each month so that at the end of the loan term, the principal is paid off. Other loans might not amortize fully over their terms. An example is an "interest-only" (I-O) loan, which requires the payment of only interest for a certain time period at the beginning of the loan; after the initial period, the borrower either makes increased principal and interest payments to amortize the principal over the remaining term or pays a large "balloon" payment, usually at the end of the term. I-O loans can be fixed- or adjustable-rate. In addition, for a period of time, payment option adjustable rate mortgages (Pay Option ARMs or Option Payment ARMs) were offered to many consumers. These loans offer borrowers several payment choices each month during the loan's introductory period, including a minimum payment that is less than the interest accruing and due on the principal each month. If the borrower chooses the minimum payment option, the interest amount that remains unpaid each month is added to the loan balance, so the principal amount owed by the borrower increases. This is known as negative amortization. In addition, the loan is recast after the introductory period (typically five years), and the borrower's fully amortizing payments typically increase in order to repay the increased principal and interest due at the adjusted rate over the remaining loan term. Interest-only loans and Pay Option ARMs often are called "non-traditional loans."

Mortgage originators offer various mortgage products that may be classified in different ways, such as:

1. **Purpose**
   Mortgages often are categorized by whether they are used to purchase real property (called purchase money loans) or to refinance an existing loan (refinances). Refinance loans are sometimes "cash out" loans, made for more than the existing loan's outstanding principal balance. The borrower receives the cash borrowed in excess of the amount necessary to pay off the existing loan. Another category is a "home equity" loan, in which the borrower can receive funds to use for any purpose by borrowing against home equity. Equity is the amount the property is currently worth, minus the outstanding principal balance of any other mortgage the consumer has. Reverse mortgages are available to older homeowners to borrow against the equity they have in their homes. (See below for fuller discussion of reverse mortgages.)

2. **Lien position**
   Lien position determines which mortgage loan receives priority over other loans in the event of a foreclosure or bankruptcy. A mortgage that is in a first lien position, sometimes called a senior loan, has priority for payment over a mortgage in a junior lien position if there is a foreclosure or bankruptcy proceeding. The proceeds from the foreclosure sale are divided according to lien position. A “simultaneous second lien” is a second lien originated at the same time as a first lien mortgage, which may allow a consumer to borrow an amount that is 100% of the value of the home. Sometimes lenders have allowed consumers to borrow an amount greater than the value of the property, although this practice is not common in today’s mortgage marketplace.

3. **Closed-end or open-end**
   Most purchase money and refinance mortgages are considered “closed-end credit” under the Truth in Lending Act, generally consisting of installment financing where the amount borrowed and repayment schedule are set at the transaction’s outset. Closed-end mortgages can take first or junior lien positions.

   In contrast, home equity lines of credit (HELOCs) are “open-end credit,” extended to a consumer under a plan in which:
   - the creditor reasonably contemplates repeated transactions,
   - the credit line generally is made available to the consumer to the extent that any unpaid balance is repaid, and
   - the creditor may impose a finance charge from time to time on an outstanding unpaid balance.[1]

   During the time while borrowers are able to draw down funds, they usually must pay a monthly interest charge on the outstanding balance. If the borrower owes funds after a fixed period of years, called the “draw period,” the consumer enters the “repayment period” and must pay off the outstanding balance in regular periodic payments of principal and interest. The repayment period is also a fixed term of years. HELOCs are often, but not always, in a junior lien position.

   Depending upon the lender and the HELOC agreement, the consumer may have to pay back the entire outstanding balance as soon as the draw period ends. In these cases, there is no repayment period, just a balloon payment in the amount of the outstanding balance when the draw period ends. HELOCs usually have an adjustable interest rate that changes over time, so the consumer’s payments may not be the same from month to month.

4. **Reverse Mortgages**
   A reverse mortgage is a special type of loan that allows homeowners 62 and older to borrow against the equity in their homes. It is called “reverse” because the consumer receives payments ***from*** the lender, without making loan payments to the lender. In

[1] 12 CFR § 1026.2(a)(20).

exchange for borrowing the money and receiving these payments, the consumer gives the lender a share of the equity in the house equal in value to the amount borrowed plus interest. The lender charges interest each month and is paid off when the consumer leaves the home permanently. In taking out a reverse mortgage loan, a consumer can receive a lump-sum payment, regular monthly payments, or a line of credit. The consumer does not have to pay back the loan as long as he continues to live in the home, maintain it, and stay current on expenses like homeowner's insurance and property taxes. If the consumer moves, passes away, or goes into assisted living or a nursing home on a long-term basis, the loan has to be paid off, usually by selling the house.

The vast majority of reverse mortgages extended today are through the Home Equity Conversion Mortgage (HECM) program, which is the reverse mortgage product insured by the Federal Housing Administration.

5. **Conventional Lending**
   Conventional lending generally refers to prime standardized mortgage products that are not government-backed loans (discussed below). Conventional loans can be "conforming" or "non-conforming." Conventional conforming mortgages meet the underwriting and documentation standards set by the government sponsored enterprises (GSEs): Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac). On the other hand, non-conforming mortgages have, among other attributes, principal balances that exceed the loan limits set by the GSEs. Loans that are larger than the limits set by the GSEs also are called jumbo mortgages.

6. **Subprime and Alt-A Lending**
   Subprime mortgages carry interest rates higher than the rates of prime mortgages. A subprime mortgage is generally a higher cost loan that is meant to be offered to prospective borrowers with impaired credit records – those borrowers whose credit rating is "subprime." The higher interest rate is intended to compensate the lender for accepting the greater risk in lending to such borrowers. Traditionally, "subprime" has been the riskiest lending category, followed by "Alt-A," or Alternative-A, and then A-paper, or "prime," as the least risky. Alt-A borrowers may have prime credit, but some aspect of the loan makes it riskier.

7. **Governmental Support**
   Government-backed lending includes mortgage lending that is insured by the Federal Housing Administration (FHA) or guaranteed by the U.S. Department of Veteran Affairs (VA). Government-supported loans generally offer terms similar to conventional loans, but these loans allow additional benefits such as smaller down payments, higher loan-to-value ratios (amount of loan as a proportion of the appraised value of the home), or lower interest rates. FHA loans also are available to consumers with lower credit scores who otherwise meet FHA underwriting standards. Generally, consumers that qualify for these loans must pay additional insurance or guarantee fees.

B. Business of Mortgage Origination

Mortgage lending generally occurs through retail, wholesale, or correspondent lending channels. Sometimes there are no clear lines of demarcation among the channels, as a participant may operate in more than one of them. Each channel is described in more detail below.

1. **Retail Channel**
   In the retail channel, the lender conducts the origination process directly with the consumer, either in person or through an online application. An employee of the lender, generally called a loan officer, solicits the loan, takes the application, and tracks the application through to the closing process.

2. **Wholesale Channel − Mortgage Brokers**
   In the wholesale channel, a mortgage broker solicits the loan and takes the application from the consumer. Mortgage brokers are independent contractors and are not employees of the lender. The broker establishes relationships with multiple mortgage lenders and offers different mortgage loan products from these lenders. Mortgage brokers generally do not make underwriting decisions and do not actually fund the loans. In this channel, it is the mortgage lender that makes the underwriting decision, based on information provided by the broker. These mortgage lenders, called wholesale lenders, often are divisions of larger depository institutions. Generally, a wholesale lender requires a broker to enter into a wholesale lending agreement before the broker may originate loans on the lender's behalf.

   In a variant of standard wholesale mortgage originations, some brokers "table fund" loans. In a table-funded transaction, the mortgage broker closes the loan as the lender of record and then assigns the loan to a purchaser at or immediately after the closing. The loan purchaser provides the funding for the loan, but the documents name the mortgage broker as the creditor.

3. **Correspondent Channel – Small Mortgage Lenders**
   Correspondent lending, a hybrid of retail channel and wholesale channel lending, often features smaller institutions, acting as correspondent lenders. Correspondent lenders are the primary interface with consumers, conducting all steps in the mortgage origination process and funding their own loans. They generally originate and deliver loans pursuant to underwriting standards set by other lenders or investors, usually larger depository lenders, upon advance commitment on price. In addition to soliciting consumers directly, correspondent lenders may receive applications and mortgage documents from mortgage brokers and subsequently speak directly with the consumer. Generally, a wholesale lender requires a correspondent to enter into a written correspondent lending agreement before the correspondent may originate loans for sale to the wholesale lender.

C. Federal Consumer Financial Law Requirements

Mortgage originators must comply with the following federal consumer financial laws:

- The Real Estate Settlement Procedures Act (RESPA) and its implementing regulation, Regulation X, require lenders or brokers, with respect to mortgage origination, to provide borrowers with 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 requirements on the administration of, and limitations upon required deposits into, escrow accounts. The main disclosure requirements applicable at origination include:
  - Good Faith Estimate of settlement costs within three business days after application;
  - Disclosure of affiliated business arrangements;
  - An initial notice explaining whether the lender is likely to sell the servicing rights to the loan; and
  - A listing of the final settlement charges of borrowers and sellers on a prescribed settlement statement (HUD-1 or HUD-1A) that is provided at or before closing (and, at the borrower's request and whether it is complete or not, must be available for inspection one business day before closing).

- The Truth in Lending Act (TILA) and its implementing regulation, Regulation Z, provide a uniform system for creditors' disclosures of credit terms. In addition, they:
  - Impose certain advertising rules;
  - Require written disclosure and re-disclosure of certain loan terms;
  - Provide consumers with rescission rights in certain circumstances;
  - Delineate and prohibit certain unfair and deceptive mortgage lending practices;
  - Prohibit certain mortgage loan originator compensation structures;
  - Prohibit certain terms and practices in the origination of "higher-priced" loans and prohibit additional terms and practices on a subset of these loans known as "HOEPA loans;" and
  - Prohibit certain appraisal practices.

- The Equal Credit Opportunity Act (ECOA), and its implementing regulation, Regulation B, prohibit creditors from discriminating against any applicant with respect to any aspect of a credit transaction:
  - On the basis of race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract);
  - Because all or part of the applicant's income derives from any public assistance program; or

- o Because the applicant has in good faith exercised any right under the Consumer Credit Protection Act.[2]

Creditors also are prohibited from making 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.

In addition, ECOA and Reg B require lenders to provide adverse action notices and appraisal reports to consumers.

- The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) establishes requirements for registration and, when applicable, standards for licensing of individuals who are residential mortgage loan originators. The registration and licensing requirements are administered, in part, through the Nationwide Mortgage Licensing System and Registry (NMLSR). The SAFE Act and Regulation H require each mortgage loan originator who is not an employee of a federally regulated depository institution or certain subsidiaries of such an institution to obtain a state license, register with the NMLSR, obtain a unique identifier, and maintain the license and registration. In addition, the SAFE Act requires states to meet specific minimum standards for licensing and renewing licenses of state-licensed originators. State regulators are responsible for determining whether to grant licenses to loan originator applicants. Employees of depository institutions and certain subsidiaries of those institutions, as well as institutions regulated by the Farm Credit Administration, are subject to different requirements under the SAFE Act and Regulation G. Each such employee who acts as a residential mortgage loan originator must register through the NMLSR, obtain a unique identifier and provide it to consumers in certain circumstances, and maintain registration − but generally is not required to be licensed.
- The Home Mortgage Disclosure Act (HMDA) and its implementing regulation, Regulation C, require mortgage lenders that meet certain threshold conditions to collect, report to federal regulators, and disclose to the public certain data about applications for, and originations and purchases of, home purchase loans, home improvement loans, and refinancings for each calendar year. The data include information about the loan or application (e.g., loan amount, loan purpose, action taken), the applicant (e.g., sex, ethnicity and race), and the property (e.g., property type and geographic information such as state and metropolitan statistical area (MSA)).
- The Gramm-Leach-Bliley Act (GLB), through its implementing regulation, Regulation P, requires covered entities to provide privacy notices and limit information sharing in particular ways.

[2] The Consumer Credit Protection Act, 15 U.S.C. § 1601 et seq., is the collection of federal statutes that protects consumers when applying for or receiving credit. The Act includes statutes that have dispute rights for consumers, such as the Fair Credit Reporting Act. The ECOA prohibits discriminating against an applicant who has exercised a dispute right pursuant to one of the statutes outlined in the Act.

- The Fair Credit Reporting Act (FCRA) and its implementing regulation, Regulation V, impose disclosure and other requirements on mortgage lenders that obtain information from a consumer reporting agency to determine a consumer's credit worthiness. These include the disclosure of credit score information, disclosure of adverse action, and disclosure of risk-based pricing.
- Mortgage Acts and Practices – Advertising Rule (MAP Rule), Regulation N, issued pursuant to the 2009 Omnibus Appropriations Act as clarified by the Credit Card Accountability Responsibility and Disclosure Act of 2009, applies only to non-depository mortgage lenders and state-chartered credit unions, as well as entities that market and advertise mortgage products but are not mortgage lenders, such as mortgage brokers, real estate brokers, advertising agencies, lead generators, and rate aggregators. The MAP Rule sets forth specific deceptive acts and practices in the advertising of mortgage loan products and prohibits misrepresentation in any commercial communication concerning terms of mortgage loan products.[3]

These laws historically have been implemented by regulations published by one or more federal agencies, including the Federal Trade Commission, the Board of Governors of the Federal Reserve System, the Department of Housing and Urban Development, and other prudential regulators. The Dodd-Frank Act generally transferred these agencies' rulemaking authority under those laws to the Bureau, which has published new implementing regulations under its authority, effective December 30, 2011. Citations to implementing regulations in this manual are to the Bureau's regulations. In examining an institution, however, formal citations for any observed violations of regulatory requirements should be to the regulation that was in effect at the time the cited act occurred.

To carry out the objectives set forth in the **Examination Objectives** section, the examination process also will include assessing other risks to consumers generally prohibited by the Dodd-Frank Act. These risks may include potentially unfair, deceptive, or abusive acts or practices (UDAAPs) with respect to mortgage originators' interactions with consumers.[4] The standards the CFPB will use in assessing UDAAPs are:

- A representation, omission, act, or practice is deceptive when:
  (1) the representation, omission, act, or practice misleads or is likely to mislead the consumer;
  (2) the consumer's interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and
  (3) the misleading representation, omission, act, or practice is material.

- An act or practice is unfair when:
  (1) it causes or is likely to cause substantial injury to consumers;
  (2) the injury is not reasonably avoidable by consumers; and

[3] The MAP Rule became effective on Aug. 19, 2011. Mortgage Acts and Practices – Advertising, 76 Fed. Reg. 43826 (July 22, 2011).
[4] Sec. 1036, PL 111-203 (July 21, 2010).

(3) the injury is not outweighed by countervailing benefits to consumers or to competition.

- An abusive act or practice:
  (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
  (2) takes unreasonable advantage of –
    - a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
    - the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
    - the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

Please refer to CFPB's examination procedures regarding UDAAPs for more information about the legal standards and the CFPB's approach to examining for UDAAPs.

The particular facts in a case are crucial to a determination of unfair, deceptive, or abusive practices. As set out in the Examination Objectives section, examiners should consult with Headquarters to determine whether the applicable legal standards have been met before a violation of any federal consumer financial law could be cited, including a UDAAP violation.

General Considerations

Completing the following examination modules will allow examiners to develop a thorough understanding of mortgage brokers' and lenders' practices and operations. To complete the modules, examiners should obtain and review, as applicable, each entity's: organizational charts and process flowcharts; board minutes, annual reports, or the equivalent to the extent available; relevant management reporting; policies and procedures; rate sheets; loan applications, loan account documentation, notes, disclosures, and all other contents of loan underwriting and closing files; operating checklists, worksheets, and review documents; relevant computer program and system details; wholesale and correspondent lending agreements, due diligence and monitoring procedures, and lending procedures; underwriting guidelines; compensation policies; historical examination information; audit and compliance reports; management's responses to findings; training programs and materials; third-party contracts; advertisements; and complaints.

Depending on the scope of the examination, examiners should perform transaction testing using approved sampling procedures, which may require use of a judgmental or statistical sample. Examiners also should conduct interviews with management and staff to determine whether they understand and consistently follow the policies, procedures, and regulatory requirements applicable to mortgage lending; manage change appropriately; and implement effective controls. Examiners also should consider observing customer interactions and, if consumer complaints or document review indicate potential concerns, interviewing customers.

Examination Procedures

Module 1 – Company Business Model

Conduct initial interviews for all relevant departments.

1. Determine the type of mortgage origination channel(s) used by the entity. Is the entity:
   - Acting as a broker,
   - Acting as a correspondent,
   - Lending through a retail system,
   - Lending through a wholesale or correspondent system, or
   - Using a combination of these strategies?
2. Determine the funding source(s) that the entity uses.
3. Ascertain the product volume, mix, trends, and concentrations, including in any of the branches.
4. Review the organizational chart and reporting structure for mortgage loan origination to determine the reporting structure and responsibilities of key managers.
5. Determine whether the quality control (or audit, as applicable), underwriting, and appraisal functions operate independently of the production function (sales unit).
6. Review and list the types of products the entity offers. Determine whether the entity offers hybrid ARMs, interest-only loans, Payment Option ARMs, simultaneous second liens, Alt-A loans, or subprime loans. If the entity offers reverse mortgages, determine whether it offers HECMs and, if so, what percentage of the reverse mortgages originated are HECMs.
7. Review the qualifications, experience levels, and training programs for originators, processors, underwriters, closers, and the quality control (or audit, as applicable) staff.
8. Determine whether the entity uses third parties in conducting its business, such as mortgage brokers (if it is a lender), lead generators or affinity groups, business process outsourcing, processors, underwriters, appraisers, or insurers.
9. Review compensation arrangements, including incentive programs for employees and third parties.
10. Review the entity's general compliance management system using the compliance management review section of the CFPB examination manual and its fair lending compliance management using Section A of the ECOA Examination Procedures if you have not already done so.

Module 2 – Advertising and Marketing

This module applies to both mortgage brokers and mortgage lenders. Examiners should develop a detailed understanding of the entity's marketing program to determine whether its marketing policies, procedures, and practices are consistent with the requirements of applicable laws and regulations. First, examiners should evaluate the originator's advertising materials and disclosures across all media, including: print, television, radio, telephone solicitation scripts, and electronic media including the Internet, email and text messages. If the entity engages in telemarketing, examiners also should listen to a selection of the sales calls. Finally, examiners should determine whether the entity employs or acts as a third-party lead generator, and should understand the extent of any relationships that the entity has with affiliated or other third parties (i.e., as a broker or agent) to advertise, offer, or provide loans or other products and services.

TILA, Reg. Z

1. Assess compliance with TILA, Advertising Provisions, for advertisements concerning open-end accounts. Please refer to the examination procedures regarding TILA, 12 CFR § 1026.16, for more information.

2. Assess compliance with TILA, Advertising Provisions, for advertisements concerning closed-end loans. Please refer to the examination procedures regarding TILA, 12 CFR § 1026.24, for more information.

RESPA, Reg. X

3. Determine whether the entity complies with RESPA Section 8 prohibitions against giving or accepting kickbacks for the referral of settlement service business and unearned fees. Please refer to the examination procedures regarding RESPA, 24 CFR § 1024.14, for more information.

ECOA, Reg. B

4. Assess compliance with ECOA's prohibition against discrimination or discouragement on a prohibited basis. Please refer to the examination procedures regarding ECOA / Regulation B, 12 CFR § 1002.4, for more information. See Module 6 for more information on fair lending examinations.

SAFE Act

5. For federally regulated depository institutions and certain of their subsidiaries, assess compliance with the SAFE Act's requirements to register in the NMLSR (and obtain a unique identifier) and to maintain that registration. For examinations of those institutions, please refer to the SAFE Act examination procedures for more information.

Other Risks to Consumers – General

6. Determine whether advertisements and promotional materials for mortgage loan products contain material misrepresentations, expressly or by implication, of the following:[5]

   a. the existence, nature, or amount of fees or other costs;
   b. number, amount, or timing of payments, including whether the payment includes amounts for monthly escrow payments for taxes and insurance;
   c. credit qualifications for a particular product or program;
   d. potential for default;
   e. product type;
   f. product effectiveness with respect to debt elimination;
   g. nature of counseling services; or
   h. the existence, nature, or amount of prepayment penalties.

7. Determine whether advertisements and promotional materials for mortgage loan products contain misleading representations that a lender or broker is acting in a fiduciary capacity or in the consumer's best interest.

8. Determine whether advertisements and promotional materials for mortgage loan products clearly disclose all material limitations or conditions on the terms or availability of products or services, such as:

   a. special interest rates for a limited time period (teaser rates);
   b. the expiration date for terms that apply only during an introductory period;
   c. interest rate resets that could cause significant increases in payments;
   d. material prerequisites for obtaining particular products, services, or benefits (e.g., discounts, refunds or rebates);
   e. non-amortizing or less-than-fully amortizing loan terms;
   f. balloon payments; or
   g. prepayment penalties.

9. Determine whether advertisements and promotional materials avoid using fine print, separate statements, or inconspicuous disclosures to correct potentially misleading headlines.

10. If additional products or services are sold or offered in connection with the loan, such as credit insurance products, home warranties, or annuities, determine whether advertisements and promotional materials provide timely, clear, and understandable information about the existence of costs, payment terms, penalties, or other terms and charges, the reasons for their imposition, and the salesperson's compensation from cross-sales.

[5] The MAP Rule, 16 CFR § 1014.3, which applies to nonbanks and certain state-chartered credit unions, lists 19 examples of specific prohibited claims, including the claims described in this item.

11. Determine the target audience for each type of advertisement and product and whether the entity designs advertisements, promotional materials, disclosures and scripts to be comprehensible by the target audience.

12. Determine whether the entity maintains appropriate procedures for resolving complaints about marketing practices.

Other Risks to Consumers - Non-traditional Mortgage Loans

13. Determine whether advertisements and promotional materials:

    a. Provide information about the costs, terms, and features associated with non-traditional mortgage loans, including information about payment shock, balloon clauses, negative or less than full amortization, prepayment penalties, and the cost of reduced documentation;

    b. Provide timely, clear, and understandable information about the relative risks of non-traditional mortgage products;

    c. Clearly disclose key terms, including limitations and conditions that are important in enabling the consumer to make an informed decision regarding whether the product or service meets the consumer's needs.

Other Risks to Consumers - Reverse Mortgages

14. Determine whether the entity offers other financial products, like an annuity or long-term care insurance, with the proceeds of the reverse mortgage. If so, determine whether the entity provides timely, clear, and understandable information about these products.

15. Determine whether the entity provides timely, clear, and understandable information about the costs and relative risks of reverse mortgages.

16. Determine whether the entity provides timely, clear, and understandable information about the requirements to pay property taxes, insurance, utilities, maintenance, and other expenses after obtaining a reverse mortgage.

17. Determine whether the entity provides timely, clear, and understandable information about the circumstances under which the borrower may be required to pay the loan in full.

18. Determine whether the entity has adequate safeguards against improper marketing of reverse mortgages to seniors who have medical or cognitive problems or in situations raising concerns about undue influence by third parties.

Conduct of Employees and Third Parties

19. Determine whether the entity has developed appropriate training and monitoring policies and procedures for employees and third parties, including:

    a. monitoring outbound calls to consumers to ensure compliance with applicable law and internal policies;
    b. ensuring third-party service provider compliance with legal obligations; and
    c. regular evaluations of employee and third-party performance.

    Refer to the Compliance Management Review - Compliance Program examination procedures for more information.

Module 3 – Loan Disclosures and Terms

When lenders take applications, evaluate applicants, and originate mortgage loans, they are subject to disclosure and legal requirements. Examiners should identify acts, practices, or materials that indicate potential violations of federal consumer financial laws.

1. Examiners should review financial institution policies, procedures, and systems to determine whether the applicable disclosures listed below are scheduled to be furnished when required.

2. Examiners should obtain a list of consumer accounts and select a sample for further review.

    a. Consider weighting the sample so that more loans from branches with a larger volume of complaints are reviewed.

    b. Obtain complete loan files, which contain the disclosures required by federal consumer financial laws and other legal documents, as well as underwriting documents, rate sheets, and all documents provided to the consumer.

3. Review the sample of loan origination files to assess the adequacy and completeness of required disclosures, as described below.

4. Determine whether the disclosures were made as required and ensure the presence and accuracy of the items below, as applicable.

5. If consumer complaints or document review indicate potential violations in the areas discussed below, examiners also may conduct review of recorded telephone calls and/or complaints, if available, and interviews of consumers from the sample and ask questions relevant to each topic area below.

RESPA, Reg. X

Under RESPA and its implementing regulation, Regulation X, the lender/creditor is responsible for providing the Good Faith Estimate (GFE) and the Settlement Cost Booklet. The regulations permit the mortgage broker to provide the disclosures, but the lender must ascertain whether the GFE has been provided. During an examination of a mortgage broker, examiners should determine whether it has agreed to provide the GFE and Booklet and if so, whether it is doing so.

6. For mortgage lenders, determine whether the lender complies with RESPA Special Information Booklet Provisions. Please refer to the examination procedures regarding RESPA, 24 CFR § 1024.6, for more information.

7. For mortgage lenders, determine whether the lender complies with RESPA GFE requirements. Please refer to the examination procedures regarding RESPA, 24 CFR § 1024.7, for more information.

8. For any person making a referral to an entity that is part of an affiliated business arrangement, determine whether the entity complies with RESPA requirements for affiliated business arrangements. Please refer to the examination procedures regarding RESPA, 24 CFR § 1024.15, for more information.

9. Review the final settlement statement (HUD-1 or HUD-1A), and assess compliance with RESPA disclosure requirements and tolerance limits on settlement charges. Please refer to the examination procedures regarding RESPA, 24 CFR § 1024.7, for more information.

TILA, Reg. Z

10. Assess compliance with TILA's disclosure provisions, including appropriate disclosure of amount financed, annual percentage rate, and payment schedule or rate and payment summary table (as applicable). Please refer to the examination procedures regarding TILA, 12 CFR § 1026.4, § 1026.5, § 1026.40, and § 1026.6 (open-end accounts) and § 1026.4, §§ 1026.17 – 1026.20 (closed-end accounts), for more information.

11. Assess compliance with TILA disclosure provisions for appropriate calculation of finance charge and annual percentage rate. Please refer to the examination procedures regarding TILA, 12 CFR § 1026.4 and § 1026.14 (open-end accounts) and § 1026.4 and § 1026.22 (closed-end accounts), for more information.

12. If the creditor originates high-cost mortgage loans, assess compliance with TILA provisions concerning those mortgage loans.[6] Please refer to the examination procedures regarding TILA, 12 CFR § 1026.32 and § 1026.34, for more information.

13. If the creditor originates reverse mortgage loans, assess compliance with TILA provisions concerning those loans. Please refer to the examination procedures regarding TILA, 12 CFR § 1026.33, for more information.

14. If the creditor originates higher-priced mortgage loans, assess compliance with TILA provisions concerning those loans.[7] Please refer to the examination procedures regarding TILA, 12 CFR § 1026.35, for more information.

15. Ensure that the creditor does not structure a high-cost or higher-priced mortgage loan as an open-end plan to evade the requirements of Reg. Z.

16. If the creditor originates high-cost mortgage loans, assess compliance with TILA and Reg. Z provisions concerning restrictions on prepayment penalties and required escrow account for property taxes and homeowners insurance, for high-cost, closed-end mortgages. Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.32, for more information.

ECOA, Reg. B, Adverse Action Notices

17. Review loan files to determine whether ECOA adverse action notices were provided when required. Please refer to the examination procedures regarding Reg. B, 12 CFR § 1002.9, for more information.

18. Assess compliance with ECOA's prohibition against discrimination or discouragement on a prohibited basis. Please refer to the examination procedures regarding ECOA / Regulation B, 12 CFR § 1002.4, for more information. See Module 6 for more information on fair lending examinations.

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[6] A "high-cost" loan is a consumer credit transaction secured by the consumer's principal dwelling, in which either:
• The APR at consummation will exceed by more than 8 percentage points for first-lien mortgage loans, or by more than 10 percentage points for subordinate-lien mortgage loans, the yield on Treasury securities having comparable periods of maturity to the loan's maturity (as of the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor); or
• The total points and fees (as defined in the regulation) payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount or $579 for the calendar year 2010. (This dollar amount is adjusted annually based on changes in the Consumer Price Index. See staff commentary to 12 CFR § 1026.32(a)(1)(ii) for a historical list of dollar amount adjustments.)

[7] A "higher-priced" mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an APR 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 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

FCRA, Reg. V

19. Review the loan file to determine whether FCRA adverse action and risk-based pricing notices were provided when required. Please refer to the examination procedures regarding FCRA, 15 U.S.C. § 1681m(a) and 12 CFR § 1022.72, for more information.

Home Owners Protection Act

20. Determine whether the entity provided a notice to the borrower of the borrower's ability to terminate private mortgage insurance. Please refer to the examination procedures regarding the Home Owners Protection Act for more information.

Other Risks to Consumers

21. Review the loan file to determine whether loan documentation, including income documentation, has been altered or forged. Any indications of fraud should be handled in accordance with CFPB internal consultation procedures, and examiners should refer them to other authorities, as appropriate.

22. Review policies and procedures regarding rate locks, and review the loan file to determine whether there are instances where consumers lose their rate locks prior to its expiration, resulting in their being placed in more expensive mortgage products, despite obtaining a rate lock and submitting all required documentation within required time frames.

Module 4 – Underwriting, Appraisals, and Originator Compensation

Underwriting, appraisals, and originator compensation are important parts of the origination process and important areas for review.

Underwriting

This section of the Procedures applies only to mortgage lenders, not mortgage brokers.

TILA, Reg. Z – High-cost or higher-priced mortgage loans

If the entity originates high-cost mortgage loans (12 CFR § 1026.32) or higher-priced mortgage loans (12 CFR § 1026.35), assess compliance with provisions concerning the borrower's repayment ability for closed-end, high-cost mortgages, including required documentation of income and assets. Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.32 and § 1026.35, for more information.

Other Risks to Consumers

1. Review the mortgage lender's underwriting policies and guidelines to determine whether they contain:

   a) Verifiable standards for qualifying borrowers, including ranges/limits for applicable debt-to-income (DTI) ratios, credit scores, and loan-to-value (LTV) ratios for the different loan products offered by the institution.

   b) Authenticated processes and bases for approving exceptions to underwriting standards.

   c) Standards and methods for determining, verifying, and documenting that the borrower has the ability to repay the loan.

2. Review communication logs or notes in the mortgage loan files, and interview sales and production staff of the mortgage lender or broker to determine the independence of underwriters from the sales or production unit, with an emphasis on any influence mortgage loan originators may have over underwriters.

3. Determine whether the compensation systems for underwriters (whether in-house or contracted) affects their incentives concerning the speed and quality of their underwriting.

4. If the lender offers non-traditional or subprime loan products:

   a) Determine if underwriting standards take adjusted payments into account in considering borrower ability to repay at expected payment change dates.

   b) If the lender offers loans that have two or more risky characteristics (called "risk layering"), determine whether risk layering is taken into account as part of the underwriting policies, whether any mitigating factors are required for approval, and whether actual underwriting practices conform with policies. Risky characteristics are any of the following:

      - Limited or no documentation of income, assets, and/or employment;
      - Simultaneous second lien;
      - Negative amortization, option payment, or interest-only features;
      - Introductory rate 200 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; or
      - Balloon clauses.

   c) Determine whether a customer is referred up to prime if he qualifies for prime and whether the referral is structured or framed to discourage the customer from applying for a prime loan.

5. Review the documentation used to make underwriting decisions, including applications, tax returns, verifications of income, assets, and employment, credit reports, and all other required documentation to determine that the entity complied with applicable underwriting policies and procedures and with regulatory requirements. If not, determine the reasons for and frequency of exceptions.

6. For loans made using automated underwriting systems, determine whether the originator entered the correct inputs and that all of the conditions on the feedback certificate were satisfied and documented before the loan was funded.

7. Confirm that the lender has an adequate quality assurance program both pre-funding and post-closing to detect and correct any violations of its underwriting policies.

8. Determine whether the lender has appropriate policies and procedures related to underwriting of loans to be sure that the borrower is able to repay without selling or refinancing and whether the lender is adhering to its policies.

9. Determine whether the lender frequently uses exceptions to override underwriting decisions in order to allow a greater volume of loans into the pipeline.

10. Review underwriting guidelines and use of exceptions for changes and deterioration in lending standards.

ECOA

11. Assess compliance with ECOA's prohibition against discrimination or discouragement on a prohibited basis. Please refer to the examination procedures regarding ECOA / Regulation B, 12 CFR § 1002.4, for more information. See Module 6 for more information on fair lending examinations.

Appraisals

Review appraisal policies and procedures. Interview employees about their relationships with independent third-party appraisers to determine whether there are conflicts of interest. Determine whether the entity has an affiliated appraisal company or appraisal management company.

TILA, Reg. Z – Valuation Independence

12. Determine whether the lender complies with the Reg. Z requirements for valuation independence. Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.42 for more information.

ECOA, Reg. B – Providing Appraisal Reports

13. Determine whether the regulated entity provides appraisals to applicants in accordance with Regulation B, 12 CFR § 1002.14.

Other Risks to Consumers

14. Determine whether practices of the mortgage lender or its employees undermine appraisal independence.

15. Confirm that the entity maintains adequate oversight of the appraisers it uses (including termination where necessary) and safeguards against appraisal fraud.

Originator Compensation

Review compensation policies and procedures. Interview employees to assess the entity's actual compensation practices. Review loan files and originator compensation records to confirm that the entity is complying with its applicable policies and procedures.

TILA, Reg. Z - Prohibited Payments to Loan Originators

16. Determine that, in connection with a consumer credit transaction secured by a dwelling, no loan originator receives and no person pays to a loan originator, directly or indirectly, compensation that is based on any of the transaction's terms or conditions (12 CFR § 1026.36(d)(1)(i)).[8] Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.36(d)(1)(i) for more information.

17. If any loan originator receives compensation directly from a consumer in a consumer credit transaction secured by a dwelling, determine that (12 CFR § 1026.36(d)(2)):

    a) No loan originator receives compensation, directly or indirectly, from any person other than the consumer in connection with the transaction (12 CFR § 1026.36(d)(2)(i)); and
    b) No person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) pays any compensation to a loan originator, directly or indirectly, in connection with the transaction (12 CFR § 1026.36(d)(2)(ii)). Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.36(d)(2), for more information.

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[8] This prohibition does not apply if the loan originator receives compensation directly from a consumer in a consumer credit transaction secured by a dwelling. Additionally, the amount of credit extended is not deemed to be a transaction term or condition, provided compensation received by or paid to a loan originator, directly or indirectly, is based on a fixed percentage of the amount of credit extended. Such compensation may be subject to a minimum or maximum dollar amount.

TILA, Reg. Z - Prohibition on Steering

18. Confirm that, in connection with a consumer credit transaction secured by a dwelling, a loan originator does not direct or "steer" a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer's interest (12 CFR § 1026.36(e)(1)). The rule provides a safe harbor to facilitate compliance with the prohibition on steering in 12 CFR § 1026.36(e)(1). The loan originator is deemed to comply with the anti-steering prohibition if the consumer is presented with loan options that meet specific conditions for each type of transaction in which the consumer expressed an interest. Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.36(e)(1), for more information.

ECOA

19. Assess compliance with ECOA's prohibition against discrimination or discouragement on a prohibited basis. Please refer to the examination procedures regarding ECOA / Regulation B, 12 CFR § 1002.4, for more information. See Module 6 for more information on fair lending examinations.

Module 5 – Closing

In addition to making sure they comply with the disclosure requirements covered in Module 3 – Mortgage Disclosures and Terms, lenders are responsible for the way their closings are conducted. If consumer complaints or document review indicate potential violations in these areas, examiners also may conduct interviews of consumers from the sample and ask questions relevant to each topic area below.

1. Determine whether the entity has adopted written policies and procedures to ensure that all disclosures required to be provided to the borrower at or before closing, including the final TILA disclosure, HUD-1 (or HUD-1A), servicing transfer disclosure, PMI cancellation notice, and privacy and opt-out notices, were provided.

2. Determine whether the entity allows borrowers to choose their settlement agents or requires the borrowers to use any other settlement service provider (other than an attorney, credit reporting agency, or appraiser chosen by the entity to represent its interests in the transaction, all of which are permitted).

3. Review the sample of loan files to assess the entity's closing procedures.

4. Determine whether the settlement agent established escrow accounts for taxes and insurance as required for higher-priced mortgages under Reg. Z, 12 CFR § 1026.35(b)(3). Please refer to the examination procedures regarding Reg. Z, 12 CFR § 1026.35(b)(3), for more information.

5. If escrow accounts were established, determine whether the borrower received an initial escrow account statement. Please refer to the examination procedures regarding RESPA, 24 CFR § 1024.17, for more information.

6. Determine whether each borrower received copies of the notice of the right to rescind required by Reg. Z for a loan secured by a principal dwelling. Please refer to the examination procedures regarding TILA, 12 CFR § 1026.15 (open-end accounts) and §1026.23(b) (closed-end accounts), for more information.

7. Review policies or scripts that explain loan terms to consumers, in connection with loan closings, in a deceptive manner.

8. Determine whether the entity's practices obscure or obfuscate key loan terms, fees, or provisions. Compare initial GFEs and TIL disclosures with final HUD-1 settlement statements and final TIL disclosures for any evidence of bait-and-switch tactics with respect to the interest rate, points, closing costs, or the loan product or loan features.

9. Review complaints and closing files for evidence of coercion of or fraud against the borrower at settlement.

Module 6 – Fair Lending

The purpose of a fair lending examination is to determine whether the creditor discriminated on a prohibited basis in any aspect of its credit operations. This includes examining whether any of the creditor's policies and procedures has an adverse impact on a prohibited basis, and is not supported by a legitimate business need that cannot be met by a less discriminatory alternative. Most fair lending examinations will involve requesting loan-level data and detailed information concerning lending practices. Headquarters staff will perform statistical modeling and analysis based on entity-specific information and data. Examiners are responsible for collecting and reviewing policies and procedures, interviewing bank employees, and conducting comparative file reviews. Examiners and Headquarters staff will work together to scope the fair lending examination.

For fair lending scoping and examination procedures, the CFPB is using the FFIEC Interagency Fair Lending Examination Procedures which are referenced in Section B of the CFPB's ECOA Examination Program. When conducting a fair lending examination, consult and work with Headquarters.

HMDA, Reg. C

HMDA data are used for fair lending examinations. See HMDA Examination Procedures.

Financial institutions routinely provide HMDA data on an annual basis as required by the statute. The CFPB usually has this information, so it is not necessary to ask the regulated entity to produce HMDA data. However, we will ask the entity to produce additional non-HMDA data fields when conducting a fair lending examination.

ECOA, Reg. B

See Section B (Fair Lending Examination Procedures) of the ECOA Examination Procedures for details.

Module 7 – Privacy

Financial institutions often sell and share consumer information. The main objectives for evaluating privacy and information sharing are to ensure consumers' non-public information is protected as required by federal consumer financial law. Mortgage lenders and brokers must adhere to disclosure requirements and information sharing restrictions under the Gramm-Leach Bliley Act (GLBA) and its implementing regulation, Regulation P, as well as the FCRA and its implementing regulation, Regulation V. These requirements generally are triggered at the start of the customer relationship, depending on the information that entity is sharing or selling.

GLBA, Reg. P

GLBA and Regulation P govern the treatment of nonpublic personal information about consumers by financial institutions and restrict the sharing of nonpublic personal information with unaffiliated third parties. GLBA requires financial institutions to disclose their privacy policies accurately to consumers. GLBA also permits consumers to opt out of certain sharing practices.

1. Determine whether the entity's information sharing practices are consistent with the requirements of the GLBA and implementing rule. Please refer to the examination procedures regarding Reg. P, 12 CFR § 1016.4, for more information.

FCRA, Reg. V

FCRA's privacy provisions cover information sharing among affiliates. In general, entities may share customer transaction and experience information with affiliated entities. However, an entity may not use information received from an affiliate to market its products or services to a consumer, unless the consumer is given notice and a reasonable and simple method to opt out of the making of such solicitations.

2. Assess compliance with FCRA's affiliate marketing rule. Please refer to the examination procedures regarding Reg. V, 12 CFR §§ 1022.20 – 1022.27, for more information.