

Bank _____

Date of Exam _____

Charter _____

Prepared By _____

#24 – TEMPORARY MORTGAGE PURCHASE PROGRAMS (Non-Risk Focused)

ASSIGNMENT OVERVIEW:

Temporary purchase programs occur when banks take ownership of a mortgage loan for a limited period (usually under 60 days) pending the loan's resale to an investor. Typically, these programs are employed as an alternative to traditional warehouse lines of credit to individual mortgage companies when: (1) the mortgage company is unable to qualify for a line of credit; or (2) the volume of activity with any one company exceeds the bank's legal lending limit. Due to the higher volume and more direct loss exposure (from credit deterioration, deficiencies, etc.) on the purchased loans, temporary purchase programs contain greater risk than warehouse lines. A bank involved in a temporary purchase program should therefore have strong board oversight and internal controls, as well as adequate and capable personnel staffing the function. Policies, controls, contingency plans, quality control programs, and comprehensive management information systems are essential to protecting bank capital. For more information, refer to Policy Memorandum - 1011.

INSTRUCTIONS:

All examiners performing these procedures must be listed above in the "Prepared By" section. Completion of this procedure must be done electronically. All of the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner's thought process and all significant findings.

Based on any significant/critical findings in the CORE ANALYSIS PHASE or as directed by the EIC, the applicable SAP should also be performed. All findings in the SAP should be summarized in the corresponding CORE ANALYSIS comment section. Indicate if the SAP is performed in the comment section.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be indicated on the SCOPE AND WAIVER FORM.

Navigation through the work program is facilitated by hyperlinks throughout the document. In order to reach the linked sections, place the cursor over the underlined text, hold down the control key, and click to follow the link. Links are also provided to return to the CORE ANALYSIS. These links are found whenever a blue arrow (➤) appears.

EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION'S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.

CORE ANALYSIS PHASE

1. Prior Criticisms

1a. Determine whether deficiencies noted in the last examination and most recent internal/external audit have been addressed and/or corrected by management. Detail how deficiencies were corrected. *Include copy of exception and management response, if applicable.*

Comment:

2. Board Supervision

2a. Determine whether the bank has an adequate board approved policy governing the temporary purchase program. Refer to [Appendix](#) for guidance.

Comment:

2b. Determine whether the policy limits the purchase of loans which have not been pre-sold to an investor. Unless mitigating controls/hedging are in place, any material exposure in unsold loans may be considered unsafe and unsound.

Comment:

2c. Determine whether the board reviews and approves participants in the program, both mortgage originators and mortgage investors.

Comment:

2d. Determine whether the board has adequately considered the strategic impact of the temporary purchase program on the bank. Review board minutes or the bank's strategic plan. Refer to [Appendix](#) for specific guidance. *Provide a summary of the board's analysis in the comment section.*

Comment:

2e. Evaluate whether the board has employed adequate and qualified personnel to supervise and staff the activity. Review resumes of key officers (key officers should have technical knowledge and mortgage banking experience); the structure of compensation programs (bonuses tied to loan originations could compromise quality); and the adequacy of training provided. *Include copy of the organization chart for TPP personnel and copies of resumes in workpapers.*

Comment:

2f. Determine whether the board receives sufficient periodic reports to monitor the program. Review the most recent board report on mortgage purchase activity. See [Appendix](#) for guidance on information to be included in board reports.

Comment:

3. Credit Approval Standards – Loans Purchased

3a. Determine whether the bank requires a "preliminary package" on loans prior to funding, that contains:

- A copy of the loan application
- A copy of the appraisal
- A copy of the credit report
- A copy of any credit letters explaining deficiencies in the report or application (if applicable).
- A copy of the investor purchase commitment.

Comment:

3b. Determine whether the bank properly evaluates the quality of the prospective loan. See [Appendix](#) for a description of specific areas to be evaluated.

Comment:

3c. Review the extent of verification performed on documents prior to funding, to avoid risk of fraud. Documents submitted by originators who may be financially weaker or out-of-area may warrant 100% sampling until a level of confidence regarding authenticity and accuracy can be established. Thereafter, some system testing a representative sample may be employed. Refer to [Appendix](#) for examples of verification steps which may be performed. *List bank's verification procedures and scope of sample in comment section.*

Comment:

4. Credit Approval Standards – Mortgage Originators

4a. Evaluate the adequacy of the bank's policy regarding selection of mortgage originators from whom loans are purchased. Refer to [Appendix](#) for guidance. *Include a list of approved originators in workpapers.*

Comment:

4b. Evaluate the adequacy of the bank's actual practice in analyzing and selecting mortgage originators. Review a sample of a representative group of files on the mortgage companies from which the bank has purchased loans. Refer to [Appendix](#) for recommended elements of a thorough analysis. *Include list of files sampled and deficiencies noted in workpapers.*

Comment:

5. Credit Approval Standards – Secondary Market Investors

5a. Evaluate the extent of analysis performed by the bank on secondary market investors to which loans are sold. Review a sample of files to determine whether the bank:

- Receives and reviews annual financial statements on the investors.
- Reviews historic performance under purchase commitments, including timely fundings and adequate information sharing.
- Determines that the investor will acknowledge and honor bailee letters under which loan documents are transmitted.
- Determines that the investor will comply with the bank's wire instructions regarding sale proceeds.

Comment:

6. Written Agreements with the Mortgage Company

6a. Determine if the bank has written agreements with each mortgage company from whom it purchases loans.

Comment:

6b. Review a sample of agreements (or a single agreement if they are all the same) for adequacy. Refer to [Appendix](#) for guidance on the recommended provisions in these agreements.

Comment:

6c. Determine whether the bank adequately assure itself against risk of misapplication of loan sale proceeds or fraud by the closing agent by: (1) obtaining evidence of fidelity bond and errors and omissions coverage from the company issuing the agent's policy (an "insured closing protection letter"); and (2) calling the insurance underwriter to confirm the existence of the coverage at the proposed closing location.

Comment:

6d. Determine if the bank has adequate systems in place to ensure that all required documentation is on hand or in process, through receipt and review prior to loan disbursement. In "wet funding" states, these documents should be received by facsimile prior to disbursement, with original/copies sent "overnight" after funding. See [Appendix](#) for list of documents. *Describe bank procedures prior to closing.*

Comment:

6f. Determine if the bank adequately controls funding by issuing funding instructions directly to the closing agent which: (1) reference the loan being closed, the funding amount, and the closing date; (2) identify missing documents which must be acquired prior to funding (if applicable); (3) require the agent to return the funds to the bank if the loan does not close by a certain date; and (4) require the agent to sign and return the instructions to confirm acceptance of the funding terms. *Comment on any deficiencies.*

Comment:

<p>6g. Determine if the bank prudently limits disbursements to less than 100% of the committed purchase price to protect its exposure on the sale, and avoid pre-funding the originators and closing agent's fees (97-98% of the purchase commitment is a good rule of thumb). <i>Comment on any deficiencies.</i></p>
<p>Comment:</p>
<p>7. Sale Closing</p>
<p>7a. Determine whether the bank obtains control over the original endorsed note and note assignment at the time of closing, either directly or through an independent party legally acting as the bank's agent. This should not be the originating mortgage company, since loan documents are in the company's name.</p>
<p>Comment:</p>
<p>7b. Determine whether the note and assignment are transmitted to the investor under adequate controls. See Appendix for guidance.</p>
<p>Comment:</p>
<p>7c. Determine whether the other documents underlying the loan are transmitted to the investor under a bailee letter in the bank's name and refer to the separately transmitted note (if applicable.)</p>
<p>Comment:</p>
<p>7d. Determine how the bank monitors the progress of the purchase of the note and follows up on any delayed sales. (When the bank is dealing with any of the government agencies as the investor, frequent calls should be made to ensure that the originator has not changed the wiring instructions, since many mortgage companies have on-line capacity in that regard.)</p>
<p>Comment:</p>
<p>7e. Determine whether the bank receives purchase proceeds and a purchase confirmation directly from the investor, specifying the loan being purchased and the application of the proceeds.</p>
<p>Comment:</p>
<p>7f. Determine whether the bank remits excess proceeds to the originator and title company only after the bank has been completely paid.</p>
<p>Comment:</p>
<p>8. Quality Control Program</p>
<p>8a. Determine whether the bank receives and reviews the external quality control audits performed on</p>

originating mortgage companies participating in government-sponsored mortgage programs.

Comment:

8b. Determine whether the bank employs an adequate program of independent audit. Refer to [Appendix](#) for guidance. *Include copy of audit control program, if not already included elsewhere in workpapers.*

Comment:

8c. Determine if the internal audit program results in (1) the documentation of all exceptions noted; and (2) the timely report of findings to the board of directors.

Comment:

9. Management Information Systems

9a. Determine the adequacy of the MIS. Does management have adequate access to information in a timely and accurate basis? See [Appendix](#) for specific information requirements.

Comment:

10. Contingency Planning

10a. Determine if loans are sold to the investor with recourse.

- If recourse is to the mortgage originator, then determine whether the bank has evaluated the originators ability to perform and/or determined its own liability to perform if the originator is unable.
- If the recourse is back to the bank, determine whether the bank has identified funding mechanisms and liquidity sources to buy ineligible loans back from the secondary market if necessary.

Comment:

10b. If necessary (consult with EIC), evaluate the bank's ability to respond to and manage a volume of failed sales, considering a scenario of retaining some portion of the loans awaiting resale at any one time. Analysis should be based on a reasonable "worst case" scenario (i.e. maximum exposure to any one investor). Determine if the bank has analyzed the impact on its balance sheet due to:

- Increased funding needs;
- The impact to capital of mark-to-market accounting on loans held for sale;
- Interest rate risk management;
- The ability to resell the loan either directly or through an agent; and
- The costs of administering or foreclosing on the underlying real estate.

Comment:

11. Reserve Standards

11a. Review the bank's methodology in determining the adequacy of the ALLL to ensure that it considers credit risk on loans in the temporary purchase program. Determine whether trends in early loan default and rejection rates are considered and whether the increased credit risk of any rejected or unsold loans on the bank's books is considered.

Comment:

12. Accounting Standards

12a. If necessary (discuss with EIC), evaluate the adequacy of accounting systems to:

- Ensure that loans held for sale are recorded as "held for sale," and reported at the lower of cost or market (LOCOM) in accordance with FAS 65: Accounting for Certain Mortgage Banking Activities.
- Properly segregate loans held awaiting sale from those held in the bank's regular portfolio and report these in call report schedule RC-C.
- Defer loan fees in excess of cost in accordance with FAS 91: Accounting for Non-refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Cost of Leases.
- Ensure that liability under any repurchase agreements is appropriately reflected in call reports per applicable instructions.

Comment:

13. Legal Lending Limit

13a. Determine whether loans purchased by the bank comply with the legal lending limit exception for temporary mortgage purchase programs in 7 TAC 12.6(h) (4). Failure to meet the criteria for exception could indicate an apparent violation of Section 34.201(a) of the Texas Finance Code.

Comment:

14. Final Analysis

14a. Complete the [Summary of Findings](#) Page.

SUMMARY OF FINDINGS

#24 TEMPORARY MORTGAGE PURCHASE PROGRAMS

Describe all strengths evident from the evaluation.

Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/ noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.

Report Worthy:

Not Report Worthy:

Determine why weaknesses exist and comment on management's response and plan of action. Identify bank personnel making the response.

SUMMARY RISK RATING ASSIGNED:

Definitions:

1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient; NR-Not Rated

[➤ \(Return to Core Analysis\)](#)

Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE AND WAIVER FORM (Planning and Control Worksheet #1).

APPENDIX

2a Policy Governing Temporary Purchase Program

The Board of Directors should approve the policy governing temporary mortgage purchase program.

The following should be included in the policy:

1. Requirement for periodic review of reports by the board.
2. Internal control policies and procedures on loan closings.
3. Criteria for mortgage originators participating in the program.
4. Internal audit and quality control program.
5. Minimum management information system requirements.
6. Authorized loan products for each production source.
7. Reasonable investment limitations for:
 - ◆ Loans awaiting funding
 - ◆ Loans awaiting sale
 - ◆ Purchases from any individual mortgage company
 - ◆ Sale to any secondary market investor
 - ◆ Loans by geographic region
 - ◆ Loans by specific mortgage type.

[▶\(Return to Core Analysis\)](#)

2d Strategic Impact of Temporary Purchase Program

The Board of Directors should adequately consider the strategic impact of the temporary mortgage purchase program on the bank. A review of the board minutes or the bank's strategic plan will assist the examiner in determining if the board has considered several important issues.

The following should be considered by the Board:

1. The program's relation to other aspects of the bank's business.
2. The projected volume of business in relation to physical facilities, including the bank's data processing and human resource capacities.
3. Its impact on the bank's liquidity, asset/liability management, and funding availability.
4. Desired rates of return and yield.

[▶\(Return to Core Analysis\)](#)

2f	Monitoring Activity of Board
The board should receive sufficient periodic reports to monitor the program.	
<p>The following information should be provided to the board:</p> <ol style="list-style-type: none"> 1. Volume of loan purchase commitments outstanding. 2. Volume of loans on the bank's books awaiting sale. 3. An aging of loans awaiting sale. 4. Loans held beyond projected sale date. 5. Rejected sales. 6. Mark to market analysis of rejected unsold loans. 7. Documentation or underwriting deficiencies on loans awaiting sale and timeframe for correction. 8. Policy exceptions. 9. Financial performance of the program as compared to performance goals. 	
<p>➤(Return to Core Analysis)</p>	

3b	Credit Approval Standards – Loans Purchased
The bank should properly evaluate the quality of each prospective loan.	
<p>The following steps should be followed when evaluating the quality of a prospective loan:</p> <ol style="list-style-type: none"> 1. Checking the accuracy of all qualifying calculations performed by the originator, and determining that debt service and collateral coverage are sufficient for bank and investor requirements. 2. Confirming the value of the property through review of pertinent appraisal pages for completeness, accuracy and quality. 3. Evaluating the marketability of the loan by comparing it to the standards of the applicable government program and the terms of the investor purchase commitment. 4. Determining that all required documentation is on hand or in process. 	
<p>➤(Return to Core Analysis)</p>	

3c	Credit Approval Standards – Loans Purchased
The bank should establish verification procedures on documents prior to funding.	
The following are examples of verification steps which may be performed:	
<ol style="list-style-type: none"> 1. Call to verify the employment as indicated in the application. 2. Run of an independent credit report. 3. Verify the authenticity of the appraisal through a call to the appraiser. 4. Verification of the purchase commitment directly with the investor (by phone). 	
Return to Core Analysis	

4a	Credit Approval Standards – Mortgage Originators
The bank should have a policy regarding the selection of mortgage originators from whom loans are purchased.	
Consider the following:	
<p>A. Are there documented minimum standards for participation in the program such as:</p> <ul style="list-style-type: none"> • Minimum net worth. • Minimum number of years in business. • Management expertise. • Underwriter certification by HUD/ GNMA/ FNMA/ FHLMC. • Fidelity bond and errors and omissions insurance coverage. • Acceptable quality controls as demonstrated by Quality Control Audits performed by an independent party. • Clear standing as determined by a reference/background check on the company and its principals. <p>B. Is a thorough financial analysis of each company required at least annually?</p> <p>C. Are interim financial statements required to provide a means of monitoring the company's condition?</p> <p>D. Does the bank require the originator to maintain a deposit account at the bank, which may also be a means to monitor the originators condition?</p>	

E. Does the board approve companies in the program at least annually?

[▶\(Return to Core Analysis\)](#)

4b **Credit Approval Standards – Mortgage Originators**

Evaluating the adequacy of the bank’s actual practice in analyzing and selecting mortgage originators.

The following are recommended elements of a thorough analysis:

- A.** An initial and annual site visit by bank officers.
- B.** Credit analysis of annual audited and interim financial statements
- C.** At least annual credit reports on the company and its principal owners.
- D.** At least annual verification of HUD/FNMA/FHLMC investor status (by phone) with the appropriate agency.
- E.** Receipt and review of current Quality Control Audits performed on companies participating in government-sponsored programs.
- F.** At least annual verification of fidelity bond and errors and omissions insurance coverage.
- G.** Receipt and review of current "master sales commitment" agreements between the mortgage company and the secondary market investors for whom the company originates loans. This document should detail:
 - The dollar amount and maturity of the commitment.
 - Any net worth and purchase limitation criteria.
 - Any investor-mandated underwriting standards.
 - Any loan delivery and servicing requirements.
- H.** A review of the company’s historical performance under commitments with the bank, including:
 - Historic volume of rejections by investors of loans originated by the company.
 - Historic losses taken on loans purchased from the company.
 - Historic delivery performance.
 - Historic instances of delay under sales commitments on loans originated by the company.

[▶\(Return to Core Analysis\)](#)

6b	Written Agreements with the Mortgage Company
Evaluate the adequacy of the bank's agreements.	
<p>The following are recommended elements of a written agreement with a mortgage company:</p> <ol style="list-style-type: none"> 1. Clear statements about circumstances under which a mortgage company has indemnification or repurchase liability. 2. Responsibilities of each party in regard to mortgage loan default. 3. Actions that may be taken against the mortgage company for submission of false information. 4. Requirements for handling mortgage loan deficiencies such as inadequate documentation, etc. 5. Requirements for fidelity and errors and omissions insurance coverage. 6. Responsibilities when investor commitments to purchase the loans are not honored. 7. Requirements for timely submission of financial information on the mortgage company. 8. Provisions for acquiring copies of important agreements between the mortgage company and other third parties. 9. Requirements for submission of Quality Control Audit Reports for audits performed on the mortgage company. 	
<p>➤(Return to Core Analysis)</p>	

6d	Written Agreements with the Mortgage Company
The bank must review certain documents prior to funding.	
<p>The following documents must be received and reviewed prior to loan disbursement:</p> <ol style="list-style-type: none"> 1. Original executed note, endorsed in blank by the mortgage company. 2. An assignment of the loan from the mortgage company to the bank. 3. An assignment of the purchase commitment from the mortgage company to the bank. 4. A certified copy of the executed deed of trust. 5. A certified copy of a title policy binder 6. A certified copy of evidence of hazard insurance coverage. 7. Certification from the seller that the borrower's loan file contains all prescribed 	

documents necessary to meet the criteria of the secondary market.

8. For any out-of-state loans, a local opinion of counsel directed to the bank to ensure that the loan documents meet the requirements of state law.

[▶\(Return to Core Analysis\)](#)

7b	Sale Closing
Determine whether the note and assignment are transmitted to the investor under adequate controls.	
Consider the following:	
<ol style="list-style-type: none">1. Send each note in a separate "overnight" package to facilitate tracing if necessary.2. Each note is accompanied by a separate bailee letter which:<ul style="list-style-type: none">• Identifies the bank as the owner of the note being transmitted.• Refers to the investor's commitment with the originator to purchase the note.• Requires the investor to remit purchase proceeds directly to the bank.• Requires the investor to sign and fax the bailee letter as acknowledgment of the receipt and agreement to its terms. (Note: the bank should employ follow-up procedures if these have not been faxed back).	
▶(Return to Core Analysis)	

8b	Quality Control Program
Elements of an adequate independent audit program.	
Determine if the following is performed:	
<ol style="list-style-type: none">1. Audit procedures performed by personnel outside of the temporary purchase program.2. Verification that loan underwriting complied with bank's internal policies and procedures.3. Statistical sampling of a reasonable representation of loans purchased during the last	

twelve months. Ten percent is an industry standard; however, a larger sample may be advisable for loans coming from a weaker or out-of-area originator. A smaller sampling may also be supported for originators undergoing independent Quality Audits under government programs.

4. Re-verification of employment, income, deposits, and sources of funds on the loan application.
5. Re-verification of credit history information provided in the application.
6. Verification of quality of the original appraisal.
7. Verification that sound controls and internal policies were followed in loan purchase/closing.
8. Verification that sound controls and internal policies were followed in the loan sale/closing.
9. Confirmation that mortgage originators have been selected, approved, and monitored in compliance with internal policies and procedures.
10. Follow-up on reverification requests not responded to within a reasonable period of time.

[▶\(Return to Core Analysis\)](#)

9a Management Information Systems

Management should have access to information on a timely and accurate basis.

The following information should be readily available:

A. Commitments outstanding but not yet funded:

- In aggregate.
- By originating mortgage company
- By mortgage type

B. Loans awaiting sale:

- In aggregate.
- By investor
- By mortgage type
- By take-out date. NOTE: When a firm take-out date is not available to track performance on a purchase commitment, the bank should arbitrarily set a date at a maximum of 45 days after the purchase to act as a "tickler."
- With payment delinquency.
- With pending documents/exception.

C. Documentation and underwriting exceptions by loan production source.

D. The number and dollar volume of loans rejected by investors by production source.

E. Foreclosures.

F. Loss experience by geographic location, origination source, product type.

[▶\(Return to Core Analysis\)](#)

f:\dob\proced\cmrcl\nonriskfocused\24-mort purch-rev0804.doc (Release Date: 6/00 Reformat Date:02/07)