

MORTGAGE BANKING

Expanded Analysis Decision Factors

This section evaluates the significance of deficiencies or other specific concerns identified in the Core and Expanded Analyses. Click on the hyperlinks found within each of the Expanded Analysis Decision Factors to reference the applicable Expanded Analysis Procedures. If needed, proceed to the accompanying [Impact Analysis](#).

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

E.1. Are deficiencies immaterial to the supervision of mortgage banking operations? Refer to Expanded Analysis [Procedures #1-34](#).

E.2. Are deficiencies immaterial to the bank's overall condition? Refer to Expanded Analysis [Procedures #1-34](#).

MORTGAGE BANKING

Expanded Analysis Procedures

Generally, procedures used in the Expanded Analysis should target concerns identified in the Core Analysis and Decision Factors. The flexible procedures specified for the Core Analysis also apply to the Expanded Analysis.

Policies and Procedures

1. Investigate why the policy and procedure deficiencies identified in the Core Analysis exist. Discuss recommendations with management. Possible reasons for policy deficiencies may indicate management:

- Overlooked issues,
- Is unfamiliar with prudent mortgage banking guidelines and procedures, and
- Has not been responsive to previous recommendations to create or enhance policies and procedures.

2. If poor compliance with policies and procedures exist, determine the reasons. Possible reasons include:

- Lack of awareness of the policies,
- Disregard for established policies,
- Misunderstanding of the intent of policy guidelines,
- Poor internal communication of revisions to policy and procedures, and
- Poor management oversight.

3. Determine whether management commits to and supports proper controls and monitoring to ensure policy guidelines are followed in the future.

Internal Controls

ACCOUNTING

The following accounting pronouncements apply to mortgage banking activities:

- *FASB ASC Subtopic 310-20 – Nonrefundable Fees and Other Costs*
- *FASB ASC Topic 320 – Investments - Debt and Equity Securities*
- *FASB ASC Topic 325 – Investments - Other*
- *FASB ASC Topic 815 – Derivatives and Hedging*
- *FASB ASC Topic 820 – Fair Value Measurements and Disclosures*
- *FASB ASC Topic 825 – Financial Instruments*
- *FASB ASC Topic 860 – Transfers and Servicing*
- *FASB ASC Topic 948 – Financial Services - Mortgage Banking*
- *SEC Codification Topic 5.DD – Written Loan Commitments Recorded at Fair Value*

<p>4. Determine whether held-for-sale assets are segregated from portfolio loans and recorded at the lower of cost or fair value as required by FASB ASC Topic 948. (Note: Per FASB ASC Topic 815, the carrying value of assets held-for-sale may be adjusted to reflect the use of derivatives as hedges.)</p>
<p>5. Determine whether mortgage loans transferred from held-for-sale to held-for-investment are properly recorded (at the lower of cost or fair value) at the transfer date. Determine whether, after the transfer, any difference between the carrying amount of the loan and its outstanding principal balance is be recognized as an adjustment to yield by the interest method (as described in FASB ASC Subtopic 310-20). (Note: If a bank elects to account for a loan under the fair value option for a loan held for sale, the assets remain to be accounted for at fair value when transferred to held for investment, since the election is irrevocable).</p>
<p>6. Determine whether loan sales are properly reported in regulatory reports.</p>
<p>7. Determine whether management continues to defer origination fees and costs in accordance with FASB ASC Subtopic 310-20 if the bank swaps loans for pass-through certificates issued by the investor.</p>
<p>Audit or Independent Review</p>
<p>8. Investigate why audit or independent review deficiencies identified in the Core Analysis exist.</p>
<p>Information and Communication Systems</p>
<p>9. Determine why management and board reports contain deficiencies. Determine management's response and consider corrective actions to address the deficiencies. The cause of deficient reports may stem from:</p> <ul style="list-style-type: none"> • Inaccurate information contained in reports or input/output has not been tested, • Necessary information cannot or is not generated, • Management's unfamiliarity with the information system's capabilities, or • Management's unfamiliarity with necessary monitoring reports.
<p>10. Review the quality of investor reporting. Investor reporting varies based on the servicing contract, but typically the servicing bank is responsible for reporting:</p> <ul style="list-style-type: none"> • Detailed account reconciliations;

- Information such as the mortgagor's name, principal balance, and escrow balance; and
- Payment status, foreclosures, and transfers to their other real estate owned (OREO) account.

Internal Loan Production (Origination, Underwriting, and Closing)

11. Review mortgage pricing strategies, and consider:

- How prices are determined;
- If the pricing strategy is typically at, above, or below market; and
- The affect pricing strategies may have on current and future profitability.

12. Determine the frequency of price changes for retail and wholesale channels by reviewing historic price levels. Evaluate the timing of changes relative to market rate movements.

13. Determine whether managers understand the marketability of new products and the bank's ability to price, deliver, and service the products. Ascertain that senior management approval is obtained prior to new product roll-out.

Pipeline, Warehouse, and Hedging

14. If the bank was unable to meet mandatory commitments, assess the reasons, and determine whether:

- The situation was reported promptly to the directorate or other board committee.
- Management purchased loans from other sources or paid investors a pair-off fee.

15. If hedging strategies are ineffective, determine the cause(s), such as:

- Poor correlation of data,
- Unreliable data, or
- Speculation.

16. Determine whether the following controls over forward sales activities exist:

- Traders are prohibited from entering forward sales data into the system. (Trade tickets should be submitted to an independent person or unit for processing.)
- Third-party trade confirmations are received and reviewed by a separate unit.
- Management researches all unconfirmed trades and discrepancies.

Mortgage Servicing
PORTFOLIO SUPERVISION
<p>17. Review the procedures for receiving payments from borrowers, depositing funds into segregated custodial accounts, and remitting funds to investors.</p> <ul style="list-style-type: none"> • Assess the bank's system for ensuring borrowers' payments are applied accurately and investors receive payments on schedule. • Determine whether adequate controls exist over custodial accounts, such as daily balancing, monthly reconcilements, proper authority for disbursements, and segregation of administrative duties.
<p>18. Review written servicing agreements to determine investor servicing requirements, fund remittance schedules, contractual servicing fees, guarantee fees, and servicer representations and warranties.</p> <ul style="list-style-type: none"> • Determine whether loan delinquencies prompted the use of bank funds to meet remittance requirements. • Track the flow of funds from the investor cutoff date, the remittance of funds to investors and security holders, and the recognition of servicing revenue.
<p>19. If there is poor administration of servicer advances, assess these receivables for potential adverse classification and contingency reserves.</p>
<p>20. Review system reports to ensure the timely payment of taxes, insurance, and other obligations of the borrower.</p>
<p>21. Review the method for correcting shortages and surpluses in escrow accounts.</p>
<p>22. Review the procedures for ensuring tax and insurance payments are made on delinquent loans.</p>
MORTGAGE SERVICING ASSETS (MSAs)
<p>23. Determine whether the bank recognizes and initially measures at fair value a servicing asset or a</p>

servicing liability that qualifies for separate recognition when it undertakes an obligation to service a financial asset. (For additional information, refer to ASC Subtopic 860-50, Transfers and Servicing – Servicing Assets and Liabilities; ASC 820, Fair Value Measurements; and Call Report-Glossary definitions for Servicing Assets and Liabilities, and Fair Value.)

24. Complete an in-depth review of the valuation process (policies, procedures, and controls) for MSAs.

- **Determine whether management appropriately identifies servicing portfolio characteristics, such as:**
 - **Investors;**
 - **Product types;**
 - **Transactions made with or without recourse;**
 - **Geographic distribution of borrowers;**
 - **Average loan size;**
 - **Range of interest rates;**
 - **Projected life and average age of loans;**
 - **Delinquency, foreclosure, OREO, and bankruptcy levels; and**
 - **Loss experience.**
- **Review prepayment speed assumptions to determine if they are realistic and conform to acceptable industry standards.**
- **Determine whether discount rate assumptions are realistic and in-line with industry practices.**
- **If servicing costs exceed contractual servicing fees and other projected servicing income, determine whether the bank records a loss on the sale or a mortgage servicing liability.**
- **Determine whether changes in the servicing fee are caused by changes in the weighted-average coupon for each mortgage pool.**

25. For MSAs accounted for using the amortization method, determine whether the bank amortizes capitalized servicing assets (servicing liabilities) over the period of estimated net servicing income (net servicing loss).

- **Determine how the bank establishes amortization periods for its classes of servicing assets and servicing liabilities.**
- **Determine whether the bank adjusts the amortization when the actual prepayment speed is faster or slower than originally projected.**

26. If assumptions used in the MSA valuation appear unrealistic, or the reported MSA value appears materially overstated, consider recalculating the value of MSR. If the bank's internal model is considered reliable, it may be used to recalculate the MSR value, after substituting more realistic assumptions.

COLLECTIONS
<p>27. Review loan delinquency reports. Select and review a sample of files for severely delinquent borrowers.</p> <ul style="list-style-type: none"> • Determine whether the bank initiates foreclosure proceedings in a timely manner and properly notifies borrowers, investors, and mortgage insurers. (Note: Reference GSE Servicer Guides for state-specific foreclosure timelines.) • Review a sample of loans in which the foreclosure action is delayed due to forbearance agreements. Determine whether the agreements are within investors' guidelines.
<p>28. Review procedures for filing mortgage insurance (MI) claims and the application of such funds. Select a sample for detail testing if procedures are inadequate or if there are indications that MI claims are not properly handled and posted.</p>
<p>29. Review a sample of investor-owned OREO properties to determine if administrative and marketing practices comply with investor guidelines.</p>
<p>30. Determine whether there are any contingencies resulting from improper administration of foreclosed properties.</p>
Financial Analysis
<p>31. Investigate the causes for operating losses in mortgage banking operations, and evaluate prospects for future profitability.</p> <ul style="list-style-type: none"> • Determine whether elevated operating costs or other inefficiencies are impairing profitability. • Determine whether repurchase demands have impaired profitability, the near and long-term effects on liquidity and capital, and the impact on earnings due to reserve implications. • Establish whether excessive borrowing activities have led to adverse changes in the cost of funds. Evaluate the impact that a change in the cost of funds would have on the net interest margin. • Determine the holding company's ability to provide capital support, if necessary. • Determine why hedging strategies have not appropriately controlled interest rate risk (improper hedging is often a major cause of poor profitability).
End of Expanded Analysis. If needed, Continue to Impact Analysis.

MORTGAGE BANKING
Impact Analysis Procedures

Impact Analysis reviews the impact that deficiencies identified in the Core and Expanded Analysis and Decision Factors have on the bank's overall condition, and directs the examiner to consider possible supervisory options.

Impact Analysis Procedures
1. Determine which risks associated with mortgage banking pose material threats to earnings, capital, and liquidity. Consider credit, interest-rate, price, transaction, liquidity, reputation, legal, compliance, and strategic risks.
2. Consider the need for administrative and enforcement actions, formulate specific recommendations, and discuss the nature of the concerns with appropriate regulatory supervisors.
3. When appropriate, discuss the possibility of administrative and enforcement actions with executive management and the board of directors.
End of Impact Analysis.