CHAPTER 7
QUALITY CONTROL PLAN

7-1 General. All FHA approved mortgagees, including loan correspondents, must implement and continuously have in place a Quality Control Plan for the origination and/or servicing of insured mortgages as a condition of receiving and maintaining FHA approval. This applies to both the Single Family and the Multifamily Housing programs. A copy of the plan must be submitted when applying for mortgagee approval.

Quality Control must be a prescribed and routine function of each mortgagees operations whether performed by a mortgagees staff or an outside source. Mortgagees applying for approval to originate only or service only may submit a plan that pertains only to the function they will perform. A mortgagee that will perform both origination and servicing must submit a plan that covers both functions.

This Chapter sets forth basic requirements that all mortgagees must meet, along with a degree of flexibility, so that each mortgagee may develop a program that fits its circumstances while conforming to FHAs requirements. Mortgagees should consider that some of the requirements might not be applicable to their operation. It is necessary to perform Quality Control only on those activities in which a mortgagee is engaged.

Part A. Overall Requirements

7-2 Goals of Quality Control. The following are the overriding goals of Quality Control. Mortgagees must design programs that meet these basic goals:

* Assure compliance with FHAs and the mortgagees own origination or servicing requirements throughout its operations;
* Protect the mortgagee and FHA from unacceptable risk;
* Guard against errors, omissions and fraud; and
* Assure swift and appropriate corrective action.

Failure to comply with specific Quality Control requirements may result in sanctions and the imposition of Civil Money Penalties by the Mortgagee Review Board (MRB).

7-3 Basic Elements of Quality Control. There are several basic elements that are required in all Quality Control Programs that apply to both origination and servicing.

A.   Plan Form and Execution. All Quality Control Programs must be in writing. Mortgagees must have fully functioning Quality Control Programs from the date of their initial FHA approval until final surrender or termination of their approval.

B.   Independence. The Quality Control function must be independent of the origination and servicing functions. This independence may be accomplished in a variety of ways. Depending on a mortgagees operations, loan volume, staff size or other factors, a mortgagee may prefer one method over another. Quality Control functions may be performed using:

1. In-House Staff. Mortgagees may establish a unit that is dedicated solely to Quality Control. Staff performing Quality Control reviews must not be involved in the day-to-day processes that they are reviewing.

2. Outside Firms. Mortgagees may engage outside sources to perform the Quality Control function. The FHA approved sponsors of loan correspondents are acceptable as such outside sources. A mortgagee contracting out any part of its Quality Control function is responsible for ensuring that the outside source is meeting HUDs requirements. Any agreement with the outside source must be in writing, state the roles and responsibilities of each party, and be available for review by HUD staff.

C. Qualified Staff. Mortgagees must properly train staff involved in Quality Control and provide them access to current guidelines relating to the operations that they review. It is not necessary for mortgagees to maintain these guidelines in hard copy format if they are accessible in an electronic format. Many of the statutes, regulations, HUD Handbooks and Mortgagee Letters which establish the requirements for FHA programs are available on the web page for HUDCLIPS at:
http://www.hudclips.org/cgi/index.cgi.

D. Timeliness. Mortgagees must ensure that quality control reviews are performed on a regular and timely basis. Depending on a mortgagees production volume, origination reviews may be performed weekly, monthly, or quarterly. The review of a specific mortgage should be completed within 90 days of closing. Reviews of different aspects of servicing will vary in frequency; however, delinquent servicing and loss mitigation activities should be reviewed monthly. Timeliness is discussed further in the Origination and Servicing sections of this Chapter.

E. System of Loan File Review. The Quality Control Program must provide for the review of a representative sample of a mortgagees loans. This review must evaluate the accuracy and adequacy of the information and documentation used in reaching decisions in either the origination or servicing processes. Specific elements for items to review are discussed in the Origination and Servicing sections of this Chapter.

F. Adequate Scope and Sampling. The Quality Control reviews must thoroughly evaluate the mortgagees origination and/or servicing functions to determine the root cause of deficiencies. The mortgagee must expand the scope of the Quality Control review when fraud or patterns of deficiencies are uncovered; scope means both an increased number of files as well as more in-depth review. All aspects of the mortgagees operation, including but not limited to all branch offices or sites, FHA approved loan correspondents, authorized agents, loan officers or originators, processors, underwriters, appraisers, closing personnel, all FHA loan programs, servicing personnel, loss mitigation procedures, escrow analysis, and assumptions, must be subject to the mortgagees Quality Control reviews. Sample Size is discussed in the Origination and Servicing sections of this Chapter.

G. Site Review. A mortgagees offices, including traditional, nontraditional branch and direct lending offices engaged in origination or servicing of FHA-insured loans, must be reviewed to determine that they are in compliance with the Departments requirements.

1. Review Items. The review must include, but not necessarily be

limited to, confirmation of the following items:

* The office is properly registered with FHA and the address is current;
* Operations are conducted in a professional, business-like environment;
* If located in commercial space, the office is properly and clearly identified for any walk-in customers; has adequate office space and equipment; is in a location conducive to mortgage lending; and is separated from any other entity by walls or partitions (entrances and reception areas may be shared);
* If located in non-commercial space, the office has adequate office space and equipment; displays a fair housing poster if the public is received; if it is open to receive the public, it must be accessible to persons with disabilities, including those with mobility impairments; if it is not open to the public, but used occasionally to meet with members of the public, alternate means of accommodation may be used to serve persons with disabilities;
* The servicing office provides toll-free lines or accepts collect calls from mortgagors;
* The office is sufficiently staffed with trained personnel;
* Office personnel have access to relevant statutes, regulations, HUD issuances and Handbooks, either in hard copy or electronically;
* Procedures are revised to reflect changes in HUD requirements and personnel are informed of the changes;
* Personnel at the office are all employees of the mortgagee or contract employees performing functions that FHA allows to be outsourced; and
* The office does not employ or have a contract with anyone currently under debarment or suspension, or a Limited Denial of Participation.

2. Frequency. Technology enables mortgagees to conduct effective Quality Control remotely. Annual visits are mandatory for offices meeting certain higher risk criteria such as high early default rates, new branches or new key personnel, sudden increases in volume, and past problems. Other sites must be reviewed to assure compliance with FHAs requirements at a frequency and in a manner determined appropriate by the mortgagee. The criteria used by the mortgagee to determine the frequency of on-site reviews must be in writing and available for review by HUD at the corporate office and any branch office that is not being reviewed annually.

3. Staffing. When it is not feasible for Quality Control staff to visit each branch, qualified personnel from another office of the mortgagee, not involved in the day-to-day processes they are reviewing, or an outside firm may perform the review.

H. Affiliate Review. The Department requires mortgagees to ensure that their contractors, agents, and loan correspondents are acceptable to FHA and operate in compliance with FHA requirements.

1. Sponsors. A sponsors Quality Control Program must provide for a review of loans originated and sold to it by each of its loan correspondents. sponsors should determine the appropriate percentage to review based on volume, past experience and other factors. Sponsors must document the methodologies and results.

2. Loan Correspondents. Loan correspondents may arrange with their sponsor(s) to perform Quality Control provided:

* The arrangement with the sponsor(s) is detailed in writing;

* The aggregate number and scope of reviews meet FHA requirements;
* Loans are reviewed within 90 days of closing;
* Findings are clear as to source and cause; and
* Results are available in a timely manner to both mortgagees and HUD.

3. Whole Loan and Servicing Purchasers. Mortgagees acquiring loans must confirm that mortgage insurance premiums have been paid, insurance is in force, security instruments have been recorded, and that the files and records are complete and as expected.

I. Reporting and Corrective Action. Review findings must be reported to the mortgagees senior management within one month of completion of the initial report. Management must take prompt action to deal appropriately with any material findings. The final report or an addendum must identify actions being taken, the timetable for their completion, and any planned follow-up activities.

J. Notification to HUD. Findings of fraud or other serious violations must be immediately referred, in writing (along with any available supporting documentation) to the Director of the Quality Assurance Division in the HUD Homeownership Center (HOC) having jurisdiction (determined by the State where the property is located). In lieu of submitting a paper report, mortgagees must use the Lender Reporting feature in the Neighborhood Watch Early Warning System. If HUD staff is suspected of involvement, refer to the Office of Inspector General at 451 7th Street, SW, Room 8256, Washington, DC 20410.

A mortgagees Quality Control Program must ensure that findings discovered by employees during the normal course of business and by quality control staff during reviews/audits of FHA loans are reported to HUD within 60 days of the initial discovery.

K. File Retention. The Quality Control review report and follow-up, including review findings and actions taken, plus procedural information (such as the percentage of loans reviewed, basis for selecting loans, and who performed the review) must be retained by the mortgagee for a period of two years. These records must be made available to HUD on request.

L. Restricted Participation. Determine that no one is employed for HUD origination, processing, underwriting or servicing who is debarred, suspended, subject to a Limited Denial of Participation (LDP) or otherwise restricted from participation in HUD/FHA programs. Mortgagees must periodically check employee list, at least semi-annually.

7-4 Quality Control as a Risk Assessment Tool. The Department recommends that Quality Control reports to mortgagee management include an assessment of risks. Mortgagees may develop a system of evaluating each Quality Control sample on the basis of the severity of the violations found during the review. The system should enable a mortgagee to compare one months sample to previous samples so the mortgagee may conduct trend analysis.

Management can also use this tool to respond quickly to a sudden decline in the quality of its loans and help identify and correct the problem. Mortgagees may consider a ratings system such as the following for each loan reviewed, then aggregate these into an overall rating for the sample.

A. Low Risk. No, or a minor, problem was identified with the origination or servicing of the loan.

B. Acceptable Risk. A variety of issues were identified pertaining to processing, documentation or decisions made but none were material to creditworthiness, collateral security or insurability of the loan.

C. Moderate Risk. The records contained significant unresolved questions or missing documentation. Failure to resolve these issues has created a moderate risk to the mortgagee and FHA.

D. Material Risk. The issues identified during the review were material violations of FHA or mortgagee requirements and represent an unacceptable level of risk. For example, a significant miscalculation of the insurable mortgage amount or the applicants capacity to repay, failure to underwrite an assumption or protect abandoned property from damage, or fraud. Mortgagees must report these loans, in writing, to the Quality Assurance Division in the FHA Homeownership Center having jurisdiction.

Part B. Quality Control for Single Family Origination

7-5 Quality Control from Beginning to End. Quality Control for origination has historically been performed only at the end of the process, that is, after a loan has closed. In order to make it more useful, mortgagees are encouraged to implement Quality Control throughout the loan origination process. The following recommendations will help mortgagees accomplish these ends:

A. Monitor Application Process. Mortgagees should monitor the intake of mortgagor information to ensure sufficient questions are asked to elicit a complete picture of the mortgagors financial situation, the source of funds for the transaction, the intended use of the property, and that employees working with the mortgage applicant are knowledgeable of the origination process to fully describe the mortgagors responsibilities in obtaining a FHA-insured mortgage. This may involve periodically monitoring calls and following up with applicants regarding their treatment and understanding of the process and their obligations (e.g., to avoid misrepresentation and falsification). Mortgagees must also verify the identity of the loan applicant.

B. Conduct Pre-funding Reviews. Mortgagees may want to sample cases prior to closing to evaluate the quality of processing and underwriting. Using such reviews, mortgagees may detect problems prior to closing while problems can still be corrected. This would be especially beneficial in cases involving loans with higher risk characteristics. An important part of pre-funding reviews is reverification (by telephone or in writing) of the applicants employment, source of funds and residency history. If a written reverification received during a pre-funding Quality Control review is satisfactory, another written reverification is not required if the loan is selected for post-closing review.

C. Identify Patterns. Mortgagees must identify patterns of early defaults by location, program, loan characteristic, loan correspondent or sponsor. Mortgagees may use HUDs Neighborhood Watch - Early Warning System to identify patterns. Mortgagees must identify commonalities among participants in the mortgage origination process to learn the extent of their involvement in problem cases. Loans involving appraisers, loan officers, processors, underwriters, etc. who have been associated with problems must be included in the review sample.

7-6 Basic Requirements for Quality Control of Single Family Production. In order for a Quality Control Program to be useful and acceptable to FHA, there are several requirements that must be met. Mortgagees must adhere to each of the requirements below when conducting reviews.

A. Timeliness. Loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected prior to closing are identified as early after closing as possible.

B. Frequency. For mortgagees closing more than 15 loans monthly, quality control reviews must be conducted at least monthly and must address one months activity. Mortgagees closing 15 or fewer loans monthly may perform quality control reviews on a quarterly basis.

C. Sample Size and Loan Selection. Because it is not feasible to review all loans originated during a period, the Program must require that an appropriately sized sample is selected and evaluated during each review. A mortgagee who originates and/or underwrites 3,500 or fewer FHA loans per year must review 10 % of the FHA loans it originates. A mortgagee who originates and/or underwrites more than 3,500 FHA loans per year may review 10 % of its loans or a statistical random sampling that provides a 95 % confidence level with 2 % precision. Each review must document how the sample size and selections were determined.

Regardless of the percentage of loans being reviewed, the mortgagee must comply with the following:

1. Targeting Loans for Review. The Quality Control Program must contain provisions to select loans meeting the conditions stated below. It may not be feasible to select loans from each category every month, but an effort must be made to select loans from each category as often as possible. An emphasis should be placed on any participants that have large volumes of loans, show sudden increases in loan volumes or loan default rates, have recently begun a relationship with the mortgagee, or concentrate in soft market areas.

a. Loans must be reviewed from all branch offices and all sources including authorized agents and loan correspondents;

b. Mortgagees must review the work of each of the loan processors, loan officers, and underwriters based on the sample selected. In addition, mortgagees must review the work of roster appraisers, real estate companies, and builders with whom they do a significant amount of business; and

c. The sample must include all FHA programs in which the mortgagee participates including, but not limited to, 203(b), 203(k), 234(c), and Home Equity Conversion Mortgages.

2. Recommendations for Selecting Individual Loans. The Departments experience in reviewing loans that went into early default has shown that many have one or more of the characteristics listed below. It is

recommended that mortgagees consider these characteristics, or any additional ones they find useful, in identifying loans to be reviewed.

* 2-4 unit properties;
* New construction or rehab loans;
* Properties transferred within the past year;
* Substantial seller concessions;
* Non-occupying co-mortgagors or multiple mortgagors;
* Housing expenses increasing by 1.5 times or more;
* Large or multiple earnest money deposits (money orders);
* Large increase in bank account balance;
* Sale of personal property for funds to close;
* Gifts or loans of funds to close;
* Self-employed; and
* Loans risk assessed as refers by automated underwriting systems.

D. Early Payment Defaults. In addition to the loans selected for routine quality control reviews, mortgagees must review all loans going into default within the first six payments. As defined here, early payment defaults are loans that become 60 days past due.

E. Documentation Review and Verification. The Quality Control Program must provide for the review and confirmation of information on all loans selected for review.

1. Credit Report. A new credit report must be obtained for each borrower whose loan is included in a Quality Control review, unless the loan was a streamline refinance or was processed using a FHA approved automated underwriting system exempted from this requirement. A credit report obtained for a Quality Control review may be a Residential Mortgage Credit Report, a three repository merged in-file report or, when appropriate, a business credit report. The report must comply with the credit report standards described in HUD Handbook 4155.1 (as revised). A full Residential Mortgage Credit Report must be obtained from a different credit source on cases in which the in-file report reveals discrepancies with the original credit report.

2. Credit Document Reverification. Documents contained in the loan file should be checked for sufficiency and subjected to written reverification. Examples of items that must be reverified include, but are not limited to, the mortgagors employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds. Sources of funds must be acceptable as well as verified. Other items that may be reverified include mortgage or rent payments. If the written reverification is not returned to the mortgagee, a documented attempt must be made to conduct a telephone reverification. If the original information was obtained electronically or involved alternative documents, a written reverification must still be attempted. Any discrepancies must be explored to ensure that the original documents (except blanket verification releases) were completed before being signed, were as represented, were not handled by interested third parties and that all corrections were proper and initialed. All conflicting information in the original documentation should have been resolved before the complete file was submitted to the underwriter.

3. Appraisals. A desk review of the property appraisal must be performed on all loans chosen for a Quality Control review except streamline refinances and HUD Real Estate Owned (REO) sales. The desk

review must include a review of the appraisal data, the validity of the comparables, the value conclusion (as repaired to meet safety and soundness requirements in HUD Handbook 4905.1 (as revised)), any changes made by the underwriter and the overall quality of the appraisal.

Mortgagees are expected to perform field reviews on 10 % of the loans selected during the sampling process outlined previously in paragraph 7-6 C and D. Field reviews must be performed by licensed appraisers listed on FHAs Roster of Appraisers. Mortgagees should select loans for field reviews based on factors such as those listed previously in paragraph 7 6(C)(2) and the following:

* Property complaints received from mortgagors;
* Discrepancies found during desk reviews;
* Large adjustments to value;
* Comparable sales more than six months old;
* Excessive distances from comparables to the subject property;
* Repetitive sales activity for the subject property;
* Investor-sold properties;
* Identity of interest between buyer and seller;
* Seller identity differs from owner of record; and
* Vacant properties.

In addition, a field review should be completed on loans selected in accordance with paragraphs 7-6(C) and (D) where the desk review revealed significant problems/deficiencies with the appraisal report. If serious deficiencies or patterns are uncovered, mortgagees must report these items, in writing, to the Quality Assurance Division in the HUD Homeownership Center having jurisdiction.

4. Occupancy Reverification. In cases where the occupancy of the subject property is suspect, mortgagees must attempt to determine whether the mortgagor is occupying the property. The failure of the mortgagor to occupy the property may be an indication that the loan contains other problems. If it is found that the mortgagor is not occupying a property mortgaged as owner-occupied, mortgagees must report this, in writing, to the Quality Assurance Division in the HUD Homeownership Center having jurisdiction. It also would be advisable to review other similar loans for occupancy.

F. Underwriting Decisions. Each Direct Endorsement loan selected for a quality control review must be reviewed for compliance with HUD underwriting requirements, sufficiency of documentation and the soundness of underwriting judgements.

G. Condition Clearance and Closing. Each loan selected for a quality control review must be reviewed to determine whether:

* Conditions which were required to be satisfied prior to closing were in fact met prior to closing;
* The seller was the owner of record, or was exempt from the owner of record requirement in accordance with HUD regulations;
* The loan was closed and funds disbursed in accordance with the mortgagees underwriting and subsequent closing instructions; and
* The closing and legal documents are accurate and complete.

7-7 Specific Elements for the Production Portion of the Quality Control

Program. A mortgagees Quality Control Program must provide for a review of mortgage loan files to evaluate the loan origination and underwriting functions. The Department has found that the items listed below are typically found in a good Quality Control Program. Minimally, the Quality Control Program must address these elements as well as any others that might be useful in the evaluation.

A. Determine whether the information in the preliminary loan application, final application and all credit documents is consistent or reconciled.

B. Determine whether the appraised value was established using reasonable comparables, reasonable adjustments, and in expectation of repairs required to meet minimum safety and soundness requirements.

C. Determine whether loan documents requiring signature (other than blanket verification releases) were signed by the mortgagor or employee(s) of the mortgagee only after completion; and that all corrections were initialed by the mortgagor or employee(s) of the mortgagee.

D. Determine whether verifications of employment, verifications of deposit or credit reports are suspect due to handling by any interested third party or the mortgagor.

E. Determine whether the loan file contains a financial statement, tax returns and the appropriate type of credit report if the mortgagor is self-employed.

F. Determine whether more than one credit report was ordered and whether all credit reports were submitted with the loan package to HUD/FHA or the Direct Endorsement Underwriter.

G. Determine whether outstanding judgements shown on the credit report were shown on the HUD form 92900, Mortgage Credit Analysis Worksheet (MCAW) and acceptably explained in accompanying documentation.

H. Determine whether the loan file contains pertinent documentation of the mortgagors source of funds for the required investment, the acceptability of that source, and that any obligation to repay the funds is included on HUD form 92900. This is especially important in cases where the source was other than the applicants accounts at a financial institution.

I. Determine whether all conflicting information or discrepancies in the application file were resolved and properly documented in writing prior to submission of the loan for underwriting.

J. Determine whether there are sufficient and documented compensating factors if the debt ratios exceed FHA limits.

K. Determine the accuracy and completeness of underwriting conclusions and mortgagee documentation.

L. Determine whether all conditions were cleared prior to closing.

M. Determine whether the HUD-1 Settlement Statement was accurately prepared and properly certified. Assure that only FHA allowable fees and charges were paid by the mortgagor. The HUD 1 should be compared with other relevant loan documents to determine whether the mortgagor made the required minimum investment and whether any credits resulted in an over-insured mortgage.

N. Determine whether the loan file contains all required loan processing, underwriting and legal documents.

O. Determine whether the loan was submitted for insurance within 60 days of closing or included a payment history showing the loan was current when it was submitted for mortgage insurance.

P. Determine whether the seller acquired the property at the time of or soon before closing, indicating a possible property flip.

Q. If possible, determine whether the mortgagor transferred the property at the time of closing or soon after closing, indicating the possible use of a straw buyer in the transaction.

R. Determine whether all items requiring documentation have been properly evidenced and retained in the file.

7-8 Review of Procedural Compliance in Production. In addition to a review of a mortgagees case files, there are certain other areas of a mortgagees operation that must be reviewed and corrected if deficient.

A. Fair Lending. The Quality Control Program must verify that the mortgagees operations are in compliance with the various fair lending laws including the following:

* Fair Housing Act;
* Equal Credit Opportunity Act (15 U.S.C. º1691 et seq.); and
* Federal Truth in Lending Act (15 U.S.C. º1601 et seq.).

Additional fair lending matters are discussed below. Possible violations or incidences of discrimination must be reported to the Office of Fair Housing and Equal Opportunity in HUDs Headquarters in a timely manner.

1. Rejected Applications. Of the total loans rejected, a minimum of 10 % or a statistical random sampling that provides a 95 % confidence level with 2 % precision must be reviewed, concentrating on the following areas:

* Ensuring that the reasons given for rejection were valid;
* Ensuring that each rejection has the concurrence of an officer or senior staff person of the company, or a committee chaired by a senior staff person or officer;
* Ensuring that the requirements of the Equal Credit Opportunity Act are met and documented in each file;
* Ensuring that no Civil Rights violations are committed in rejection of applications; and

Where possible discrimination is noted, the mortgagee is expected to take immediate corrective action.

2. Mortgagee Practices. Ensure that the mortgagee is in compliance with the Departments requirements concerning Tiered Pricing, Overages and Premium Pricing.

3. Minimum Loan Amounts. Mortgagees are prohibited from setting minimum loan amounts.

4. Fair Housing Logo. Verify that fair housing and equal opportunity signs and logos are displayed in offices and on stationery and documents.

B. Home Mortgage Disclosure Act. The Quality Control Program must verify that the mortgagee is in compliance with the Home Mortgage Disclosure Act reporting requirements and the Departments requirements for reporting FHA-insured mortgages. The check should include confirmation that the report is made timely, information being reported is accurate, and information is being reported correctly. Refer to current HUD requirements.

C. Ineligible Participants. The Quality Control Program must verify that the mortgagee is ensuring that none of the participants in a mortgage transaction (excluding the seller of a principal residence) is debarred or suspended, or is under an LDP for the program and jurisdiction. Periodically check employee list, at least semi-annually. There also must be procedures to determine if the mortgage applicant is ineligible due to a delinquent federal debt (eligibility is influenced by repayment arrangements, extenuating circumstances and the age of the debt).

D. Real Estate Settlement Procedures Act. The Quality Control Program must verify that the mortgagee is in compliance with the provisions of RESPA, including, but not limited to:

* Distributing the Special Information Booklet to mortgage applicants;
* Providing applicants with Good Faith Estimates of the settlement costs relating to obtaining a mortgage not later than 3 business days after the application is received or prepared;
* Providing applicants with their HUD 1;
* Disclosing transfer of servicing; and
* Disclosing business relationships with affiliated entities.

E. Escrow Funds. The Quality Control Program must verify that escrow funds received from mortgagors are not used for any purpose other than that for which they were received. Mortgagees must also ensure that the funds are maintained in an account separate from the mortgagees general operating account.

F. Mortgage Insurance Premiums. The Quality Control Program must verify that HUD/FHA Mortgage Insurance Premiums (MIPs) that are due upfront (prior to insurance) are remitted within the time period established by FHA, or if not, that the remittance includes late charges and interest penalties. Mortgagees must address any pattern of late submissions and promptly take corrective measures.

G. Timely and Accurate Insurance. The Quality Control Program must determine whether mortgages are being submitted to HUD for insurance within 60 calendar days of closing. If mortgages have been submitted beyond the 60 days, the Quality Control Program should verify that the mortgage was current when submitted and met the payment requirements of HUD Handbook 4165.1 (as revised). Mortgagees must address any pattern of late submissions and promptly take corrective measures. The Quality Control Program also should include a review of the Mortgage Insurance

Certificate for accuracy.

H. Underwriting Reports. The Quality Control Program should include a review of reports available to mortgagees, including underwriting reports and notices of return (regarding cases rejected for insurance due to errors or omissions).

I. Advertising. Ensure that branch offices or employees are not engaging in false or misleading advertising practices. Refer to paragraph 2-17.

7-9 Other Quality Control Issues Regarding Single Family Production.

A. Automated Underwriting. Mortgagees using an automated underwriting system should consider how best to design their Quality Control Programs to evaluate loans underwritten by these systems. The following are only basic requirements:

1. Sample. The Quality Control sample must include loans that fairly represent the percentage of loans underwritten in this manner.

2. Requirements. The Quality Control Program must verify that correct information has been entered into the automated underwriting system, including data identifying the borrower(s), property, mortgage, income, assets, and source of funds. Copies of the assessment by the automated underwriting system must be included in the loan file in addition to the normal documentation required for an FHA mortgage transaction. Whenever the automated underwriting system cannot accept the application, the basis of the automated underwriter systems decision on the loan must be documented and retained.

3. Referred Applications. The Quality Control Program must verify that applications receiving a refer are manually underwritten by an underwriter before a final decision is made on the application.

4. Exemptions to Individual Quality Control Program Requirements. A new credit report is not required.

5. Overrides. The Quality Control Program must verify that if manual downgrades or overrides are applied, that no patterns of illegal discrimination against loan applicants are revealed and that the downgrade or override was proper.

B. Streamline Refinances. Mortgages made under FHAs streamline refinancing requirements typically will contain very few documents. Streamline refinances should be included in the Quality Control sample; however, they should comprise a very small proportion of the sample unless streamline refinances are a significant proportion of the mortgagees production. The reviews may be limited to the functions performed when originating such loans and confirmation that the loan was eligible for streamline processing.

C. Specific Programs. Mortgages originated under specific FHA programs warrant special attention.

1. Section 203(k) Loans. The Quality Control Program of mortgagees originating or purchasing 203(k) loans must provide for reviews of the

handling of rehabilitation escrows and disbursements, the rehabilitation loan agreements, the scope of the repairs, the timeliness of their completion, and borrower complaints about quality. Also, mortgagees should conduct physical inspections on a sampling of 203(k) loans.

In addition, the Quality Control Program of mortgagees originating 203(k) loans must clearly define standards for the 203(k) consultants performance in its Quality Control Program. These standards must be provided to each consultant that the mortgagee relies on in the 203(k) program. Mortgagees must evaluate and document the performance of these consultants on at least an annual basis, to include a review of the consultants actual work product. Mortgagees must not use the services of consultants who have demonstrated previous poor performance. Fraud or malfeasance should be documented and reported to the Department for possible administrative action.

2. Home Equity Conversion Mortgages (HECMs). The Quality Control Program of mortgagees originating HECMs should provide for reviews to ensure that the homeowners received the appropriate counseling and that any referral fees paid are reasonable for the service provided and disclosed in the loan file.

Part C. Quality Control for Single Family Servicing

7-10 Basic Requirements for Quality Control over Single Family Servicing. In general, servicing activities vary on individual loans and over the course of the year. As a result, sampling for servicing reviews will be focused on specific aspects of servicing rather than against the entire portfolio.

A. Areas to be reviewed. Servicers must review all aspects of their servicing operations as they relate to FHA-insured mortgages. The areas listed below must be reviewed to ensure that all FHA, RESPA, and other pertinent requirements are being met.

* Servicing delinquent accounts;
* Loss Mitigation efforts;
* Reporting under the Single Family Default Monitoring System (SFDMS);
* Foreclosure processing;
* MIP billings;
* Deficiency judgements;
* Claims, and claims without conveyance of title;
* New loans, servicing transfers, acquisitions;
* Customer service;
* Fees and charges;
* Escrow administration;
* ARM adjustments and disclosures;
* HECM disbursement reporting;
* Section 235 recertifications;
* Assumption processing;
* Handling of prepayments;
* Paid-in-full mortgages; and
* Maintenance of records.

B. Timeliness and Frequency. Quality Control of servicing must be an ongoing function. Due to the importance of these aspects of servicing, mortgagees must perform monthly reviews of delinquent loan servicing, claims, and foreclosures. The other items listed in the previous paragraph must be reviewed at least quarterly and should address activity that occurred within the prior three months.

C. Sample Size. Mortgagees servicing fewer than 3,500 loans, in their total FHA portfolio, must review 10% of the FHA loans for each area of servicing outlined in Paragraph 7-10(A), in accordance with the review period described in 7-10(B). Mortgagees servicing more than 3,500 loans may use an appropriately sized statistical sampling that provides a 95 % confidence level with 2 % precision for the review of each area of servicing --- provided the total population of the area of servicing outlined in Paragraph 7-10(A), for the review period described in 7 10(B), is sufficient to apply a statistical random sampling methodology. All mortgagees, regardless of their portfolio size, must document the total population and how the sample size and selections were determined for each area of servicing outlined in Paragraph 7-10(A).

7-11 Review of Procedural Compliance in Servicing.

A. Real Estate Settlement Procedures Act. The Quality Control Program must determine whether the mortgagee is in compliance with the provisions of RESPA in its escrow account administration.

B. Ineligible Participants. The Quality Control Program must determine whether the mortgagee is ensuring that none of the participants in an assumption (excluding the seller of a principal residence) has been debarred or suspended, or is under an LDP for the program and jurisdiction. There also must be procedures to determine if the mortgage assumptor is ineligible due to a delinquent federal debt (eligibility is influenced by repayment arrangements, extenuating circumstances and the age of the debt).

C. Fair Lending. The Quality Control Program must include a review of the mortgagees operations, including assumption processing, to assure compliance with the various fair lending laws including the Fair Housing Act and the Equal Credit Opportunity Act. Possible violations or incidences of discrimination must be reported, in writing with supporting documentation, to the Office of Fair Housing and Equal Opportunity in HUD Headquarters. Patterns of disproportionate aggressiveness or forbearance in foreclosures on the basis of race, color, religion, sex, handicap, familial status or national origin under the Fair Housing Act or the same prohibited areas in addition to age or martial status under the Equal Credit Opportunity Act.

D. Transfer of Servicing. The Quality Control Program must include a review of the transfer of servicing provisions as provided under Section 6 of RESPA.

7-12 Required Elements for the Servicing Portion of the Quality Control Program. Mortgagees must service mortgages in compliance with HUD regulations, Handbook 4330.1 (as revised), Mortgagee Letters and instructions for the submission of claims. A mortgagees Quality Control Program for servicing must provide for a review of all aspects of loan servicing. Mortgagees must include the following elements in the evaluation.

A. Determine whether loan-servicing records are promptly established after loan closing and if the servicing records contain all necessary documentation.

B. Determine whether mortgagors are promptly notified when the mortgagee acquires servicing from another mortgagee and whether loan servicing records are established immediately upon transfer of a loan to the mortgagees loan servicing portfolio.

C. Determine whether loans purchased contain all necessary documents.

D. Determine whether all Mortgage Insurance Premiums (MIP) are paid timely and in the correct amounts. The Quality Control review must include an analysis to determine whether a monthly or risk-based premium is due. This review must include a sampling of recently purchased loans.

E. Determine whether the Mortgage Record Change was reported to HUD on loans sold to another servicer. Also, determine whether the selling servicer reported the transfer of recently purchased loans. This may be done by examining the portfolio using the FHA Connection.

F. Determine whether requests from mortgagors concerning their individual mortgage accounts are responded to promptly. Determine whether complaints are promptly and effectively handled.

G. Determine whether escrow account functions are being performed properly. This includes ensuring that:

* Funds are maintained in an account separate from the mortgagees general operating account;
* Mortgagors are billed the proper amounts;
* Disbursements are made promptly as the items for which the escrow was established become due and payable;
* Bills are requested and obtained when not automatically received;
* Excessive balances are promptly refunded to the mortgagor or applied to the unpaid principal balance if the mortgagor so requests; and
* Escrow shortages are promptly reported to the mortgagor and the mortgagor is informed of all options to remedy the shortage.

H. Determine whether fees and charges imposed on the mortgagor are permitted and do not exceed the amount allowed by HUD/FHA and the provisions of the mortgage and mortgage note. For example:

* Allowed fees: such as late charges, inspection fees, assumption fees, and attorneys fee (only for the initiation of foreclosure proceedings); and
* Prohibited fees: such as prepayment fees or reinstatement fees.

I. Determine whether ARM adjustments are calculated correctly and implemented timely, after mortgagors are properly notified.

J. Determine whether Section 235 recertifications are performed annually, that assistance payments are accurately computed and billed using the proper formula, that the income used for computing the assistance payments is compared to the income included in the mortgagors income verification, and that mortgagors are properly notified of any changes to their payment. Determine if the prior years income increased and/or a job change occurred necessitating computation and collection of any overpaid assistance.

K. Determine whether qualifying assumptions were properly underwritten. Determine whether a Mortgage Record Change (identifying assumptors name and Social Security Number) is promptly reported to HUD when the mortgage is assumed.

L. Determine whether effective collection activities are pursued in a timely fashion. Determine whether contact is attempted with all co-mortgagors, co-signors and former mortgagors, as appropriate.

M. Determine whether accurate documentation of collection efforts is maintained, including:

* referral of the mortgagor to a HUD-approved counseling agency; and
* mailing of HUD pamphlet HUD 426 to mortgagors no later than the second month of delinquency.

N. Determine whether a personalized interview (face-to-face or telephone) with the mortgagor is attempted before three full mortgage installments become delinquent. If the interview was not conducted, documentation must be provided of an exception allowed by HUD.

O. Determine whether accurate and timely submission of required reports is being made to the Single Family Default Monitoring System.

P. Determine whether mortgagor information is reported to credit reporting bureaus when appropriate.

Q. Determine whether property inspections to protect and preserve the property are performed in accordance with HUD requirements.

R. Determine whether all appropriate Loss Mitigation tools (i.e. special forbearance, loan modification, partial claim, pre-foreclosure sale, and deed-in-lieu) have been considered and documented, and that mortgagors are provided every reasonable opportunity to remedy a delinquency or default prior to the decision to foreclose.

S. Determine whether additional assistance to remedy the delinquency (e.g. oral and written forbearance agreements and refinances) is reasonable given the financial data submitted by the mortgagor. Determine whether reasonable partial payments are accepted in accordance with requirements.

T. Determine whether foreclosure proceedings are initiated and completed in a timely manner, and in compliance with HUD requirements (e.g., decision to foreclose had concurrence of management).

U. Determine whether disaster moratorium requirements are met.

V. Determine whether deficiency judgements are taken where required.

W. Determine whether there are sufficient controls to ensure that claims for insurance benefits are accurately prepared, properly calculated, fully supported, and submitted in a timely manner to HUD. The review must include, but should not be limited to, the following items:

* Preservation and protection;

* Appraisal costs;
* Foreclosure costs of acquiring the property;
* Costs associated with pursuing a deficiency judgment;
* Taxes;
* Special assessments;
* Association fees;
* Hazard insurance premiums;
* Periodic MIP;
* Uncollected mortgage interest; and
* Debenture interest.

All fees included must comply with the reasonable and customary fees specified by the FHA Single Family Homeownership Center having jurisdiction over REO in the location or with Fannie Mae guidelines.

X. Determine whether interest charges in prepayments are accurate. Determine whether the note and security instrument are promptly satisfied, the termination of FHA mortgage insurance is properly reported to FHA on paid-in-full mortgages, and escrow balances are promptly refunded. Determine whether security instruments are promptly released.

Y. Determine whether the documents required to be retained as originals and the remaining paper documents or acceptable imaged or microfilmed versions are retained for a minimum of the life of the loan plus three years, and any additional time required due to payment of a claim or Section 235 subsidies.

Z. Determine whether the servicing of 203(k) loans has been completed in accordance with FHA guidelines (i.e., reviews of the handling of rehabilitation escrows and disbursements, the rehabilitation loan agreements, the scope of the repairs, the timeliness of their completion, and borrower complaints about quality). In addition, mortgagees should conduct physical inspections on a sampling of 203(k) loans.