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Introduction and Purpose of Model Examination Guidelines

On November 14, 2006, the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators released the CSBS/AARMR GUIDANCE ON NONTRADITIONAL MORTGAGE PRODUCT RISKS FOR STATE-LICENSED ENTITIES (hereinafter referred to as Guidance). The CSBS/AARMR Guidance applies to non-depository mortgage brokers and lenders and followed the substantially similar federal agency guidance for insured financial institutions and affiliates released on October 4, 2006.

On July 17, 2007, the Conference of State Bank Supervisors, the American Association of Residential Mortgage Regulators, and the National Association of Consumer Credit Administrators released the CSBS/AARMR/NACCA STATEMENT ON SUBPRIME MORTGAGE LENDING (hereinafter referred to as Statement). The CSBS/AARMR/NACCA Statement applies to non-depository mortgage brokers and lenders and followed the substantially similar federal agency Statement for insured financial institutions and affiliates released on June 29, 2007.

The purpose of this AARMR/CSBS NONTRADITIONAL MORTGAGE PRODUCT RISKS AND SUBPRIME LENDING MODEL EXAMINATION GUIDELINES (hereinafter referred to as MEGs) is to provide state regulators with a uniform set of examination standards for conducting examination reviews under both the Guidance and Statement.

While MEGs is not a required standard, it will provide the following:

- A set of examination guidelines that states can use to determine compliance with the Guidance and Statement.
- Uniform standards applicable for multi-state examinations and enforcement actions, or for review by one state of another state’s report of examination.
- Consistent and uniform guidelines for use by lender and broker in-house compliance and audit departments.

State regulators may wish to use all or portions of MEGs depending on the size and complexity of the institution examined and the available resources of the agency. Examiners should identify within the scope of the examination report if and to what extent MEGs were used so that other state regulators will know that a standard examination model has been employed.

MEGs is divided into major sections or modules. The modules may be used as an entire examination package or individual modules may be chosen for specific applications. Module 1 – MEGs Examiner Instructions provides further guidance on the use of each module.
Covered Transactions

Throughout this document, Covered Transactions refers to any product considered or contemplated in the Guidance and Statement, including:

**Interest-Only Mortgage Loan**—A nontraditional mortgage on which, for a specified number of years (e.g., three or five years), the borrower\(^1\) is required to pay only the interest due on the loan during which time the rate may fluctuate or may be fixed. After the interest-only period, the rate may be fixed or fluctuate based on the prescribed index and payments include both principal and interest.

**Payment Option ARM**—A nontraditional mortgage that allows the borrower to choose from a number of different payment options. For example, each month, the borrower may choose a minimum payment option based on a “start” or introductory interest rate, an interest-only payment option based on the fully indexed interest rate, or a fully amortizing principal and interest payment option based on a 15-year or 30-year loan term, plus any required escrow payments. The minimum payment option can be less than the interest accruing on the loan, resulting in negative amortization. The interest-only option avoids negative amortization but does not provide for principal amortization. After a specified number of years, or if the loan reaches a certain negative amortization cap, the required monthly payment amount is recast to require payments that will fully amortize the outstanding balance over the remaining loan term.

**Subprime ARM products**: ARM products typically marketed to subprime borrowers with the following characteristics:

- Offering low initial payments based on a fixed introductory or “teaser” rate that expires after a short initial period then adjusts to a variable index rate plus a margin for the remaining term of the loan.\(^2\)
- Loans for which borrowers are approved without considering appropriate documentation of their income.
- Loans with very high or no limits on how much the payment amount or the interest rate may increase (“payment or rate caps”) at reset periods, potentially causing a substantial increase in the monthly payment amount “payment shock.”
- Loans containing product features likely to result in frequent refinancing to maintain an affordable monthly payment.
- Loans that include substantial prepayment penalties and/or prepayment penalties that extend beyond the initial interest rate adjustment period.
- Soliciting and transacting loans where borrowers are provided inadequate information relative to product features, material loan terms and product risks, prepayment penalties, and the borrower’s obligations for property taxes and insurance.

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\(^1\) The terms “borrower” and “consumer” are used interchangeably throughout this document. Where possible, the term originally used in the Guidance or Statement has been retained.

\(^2\) For example, ARMs known as “2/28” loans feature a fixed rate for two years and then adjust to a variable rate for the remaining 28 years. The spread between the initial fixed rate of interest and the fully indexed interest rate in effect at loan origination may range from 300 (3%) to 600 (6%) basis points.
Subprime “extended amortization” products: Adjustable rate and fixed rate products marketed to subprime borrowers with amortization period longer than the term of the loan, such as to require the payment of a balloon amount at the end of the loan term.\(^3\)

**Other Definitions**

Reduced Documentation—A loan feature that is commonly referred to as “low doc/no doc,” “no income/no asset,” “stated income” or “stated assets.” For mortgage loans with this feature, a provider sets reduced or minimal documentation standards to substantiate the borrower’s income and assets.

Simultaneous Second-Lien Loan—A lending arrangement where either a closed-end second-lien mortgage loan or a home equity line of credit (HELOC) is originated simultaneously with the first-lien mortgage loan, typically in lieu of a higher down payment.

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\(^3\) For example, products known as “50/30” loans feature an amortization period of 50 years with a loan term of 30 years. As a result, at the end of the 30 year term, the borrower is required to make a final balloon payment to repay the remaining principal of the loan.
Module 1 – MEGs Examiner Instructions

The Guidance and Statement establish compliance and safety and soundness practices for Covered Transactions greater than compliance requirements for non-Covered Transactions (“Baseline Requirements”). Therefore, MEGs augment, but do not replace standard examination procedures for the Baseline Requirements. The examiner should consider all Baseline Requirements in conjunction with MEGs. A violation of the Baseline Requirements may indicate a likely violation of the Guidance and Statement, but a violation of the Guidance and Statement will not necessarily be indicative of a violation of the Baseline Requirements.

MEGs consists of the following modules:

1. MEGs Examiner Instructions
2. MEGs Examiner Checklist
3. MEGs Information and Data Request (includes Covered Transaction Summary Sheet)
4. MEGs Institution Questionnaire

Module 2 – MEGs Examiner Checklist is divided into eight sections that may be employed separately or combined for a more comprehensive or complex examination. The sections are as follows:

A. **Pre-Examination:** This section covers pre-examination elements that should be reviewed and considered regardless of the size, type or scope of the examination.

B. **Consumer Contact/Origination:** Covers marketing as well as direct and indirect origination or retail activity. This section may be used alone for the examination of mortgage brokers or for a limited scope examination of a lender. This section may be combined with other sections for a comprehensive lender evaluation.

C. **Underwriting:** Covers the activity of “making” or “funding” loans, by focusing on the underwriting activity of lenders. For lenders with retail or origination business units, this section should be combined with Consumer Contact/Origination.

D. **Operational Management:** Covers personnel, training, systems, monitoring and reporting for Covered Transactions.

E. **Servicing:** Covers monthly payment statements and accounting controls.

F. **Secondary Market:** Covers exposure risk in secondary market transactions.

G. **Investment Lending:** Covers non-owner occupied investment properties. This section is provided for agencies with jurisdiction over non-owner occupied lending, or in situations where the examiner believes investment lending may have an adverse impact on the safety and soundness of the institution.

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1 The term Baseline Requirements is used in MEGs to denote common or previously established regulatory requirements. For example, all owner-occupied residential mortgage loans originated by a financial institution must comply with the requirements of Regulation X, Regulation Z, Regulation B and any additional state regulations. However, lenders should also comply with the Guidance and Statement for Covered Transactions, thereby triggering MEGs in addition to the examination for Baseline Requirements.

2 It should be noted that failure to adhere to recommended practices under the Guidance and Statement may create violations of state laws or regulations.

3 The terms “borrower” and “consumer” are used interchangeably throughout this document. Where possible, the term originally used in the Guidance or Statement has been retained.
H. **Practices for Institutions to Avoid:** Covers practices that should raise red-flags for agencies and institutions.

Module 4 – MEGs Institution Questionnaire is divided into eight sections that may be employed separately or combined for a more comprehensive or complex examination. The sections are as follows:

A. **General:** Similar to the Pre-Examination section of Module 2, this section covers general questions intended to reflect management policies and the nature of the institution’s Covered Transaction activity.

B. **Consumer Contact/Origination:** Covers marketing as well as direct origination or retail activity. This section may be used alone for the examination of mortgage brokers or for a limited scope examination of a lender. This section may be combined with other sections for a comprehensive lender evaluation.

C. **Indirect Origination Through Third Parties:** Covers indirect origination activity through mortgage brokers or other lenders.

D. **Underwriting:** Covers the activity of “making” or “funding” loans, by focusing on the underwriting activity of lenders. For lenders with retail or origination business units, this section should be combined with Consumer Contact/Origination.

E. **Operational Management:** Covers personnel, training, systems, monitoring and reporting for Covered Transactions.

F. **Servicing:** Covers monthly payment statements and accounting controls.

G. **Secondary Market:** Covers exposure risk in secondary market transactions.

H. **Non-Owner Occupied Investor Loans:** Covers non-owner occupied investment properties. This section is provided for agencies with jurisdiction over non-owner occupied lending, or in situations where the examiner believes investment lending may have an adverse impact on the safety and soundness of the institution.

**Scoping**

**Full Scope Examination**

A full scope examination would typically consist of off-site preparation and review, followed by an on-site examination of records and practices, including interviews of staff and possibly borrowers. Follow up to the on-site examination would normally consist of an exit review, a report of examination and a response by institution management where necessary.

A full scope examination of each type of institution should include the following:

- **Mortgage Broker:**
  1. Module 2: Pre-Examination, Consumer Contact/Origination, and Practices for Institutions to Avoid sections
  2. Module 3: All
  3. Module 4: General and Consumer Contact/Origination sections

- **Lender or mortgage bank without retail activity:**
  1. Module 2: Pre-Examination section, Indirect Origination subsection of the Consumer Contact/Origination section, Underwriting section, Operational Management section, Servicing and Secondary Market sections (If the
institution does not service or does not sell loans, the examiner would not employ these sections.), and Practices for Institutions to Avoid section
2. Module 3: All
3. Module 4: General section, Indirect Origination Through Third Parties section, Underwriting section, Operational Management section, and Servicing and Secondary Market sections (If the institution does not service or does not sell loans, the examiner would not employ these sections.)

- **Lender or mortgage bank with retail activity:**
1. Module 2: Pre-Examination section, Consumer Contact/Origination section, Underwriting section, Operational Management section, Servicing and Secondary Market sections (If the institution does not service or does not sell loans, the examiner would not employ these sections.), and Practices for Institutions to Avoid section
2. Module 3: All
3. Module 4: General section, Consumer Contact/Origination section, Indirect Origination Through Third Parties section, Underwriting section, Operational Management section, and Servicing and Secondary Market sections (If the institution does not service or does not sell loans, the examiner would not employ these sections.)

- **Investment Lending review:** The examiner in charge should include the Investment Lending sections of Modules 2 and 4 with the appropriate examination type from above.

**Limited Scope Examination**

An agency may conduct a limited scope examination entirely off-site through review of an institution’s response to the MEGs Information and Data Request and Institution Questionnaire. While such a review is limited to the veracity of the institution’s response, it nevertheless can be a valuable tool for monitoring or in situations where the volume of Covered Transaction activity does not merit a full examination of the institution. Examiners should also consider using other state’s MEGs examination reports in situations where it is impractical to conduct their own examinations.

The institution’s complaint activity should be reviewed in conjunction with any limited scope examination. Additionally, a limited scope examination may include portions of any of the sections deemed appropriate. Any limited scope review should be clearly indicated in the report of examination with a notation that reliability is limited to the institution’s stated responses.

**General Issues**

Regardless of the scope chosen, the examiner should evaluate the institution’s compliance with consumer protection laws, proper underwriting standards, and risk management practices. The examiner should use the provisions of the Guidance and Statement to address risk management broadly. At a minimum, the examiner should evaluate whether the institution has adequate controls for compliance risk, reputation risk, and litigation risk as well as adequate disclosure of risks to borrowers.

Note: those institutions with sound Covered Transaction origination practices, underwriting and risk management controls will not be subjected to criticism merely for offering such products. However, the examiner should also be aware that written policies and procedures are no substitute for actual sound practices.
The MEGs Examiner Checklist consists of questions intended to prompt the examiner for specific review. Much of the checklist can be completed from a thorough, off-site review of the response to the MEGs Information and Data Request and Institution Questionnaire. Other sections will require file-level review and possibly interviews of institution staff and borrowers.

A. Pre-Examination

<table>
<thead>
<tr>
<th>GENERAL</th>
<th>Y N</th>
<th>Examiner Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Examiner note:</strong> This section should be completed regardless of the scope of the examination or size or type of the institution. The questions in this section are general triggers intended to stimulate broad consideration by the examiner. For full scope examinations the examiner should review each loan file identified from A.2 below.</td>
<td></td>
<td>[Document supporting evidence and note determinations and findings made.]</td>
</tr>
<tr>
<td>A.1 Does management have a clear understanding of its responsibilities for Covered Transactions? What evidence is there that management clearly understands the risks associated with Covered Transactions? <strong>Examiner note:</strong> Consider response to questionnaire, policies, procedures and underwriting guidelines, interviews of management and staff, and the actual lending practices of this institution.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.2 Have any complaints been filed with the agency against the institution relevant to Covered Transactions? <strong>Examiner note:</strong> Review complaints against responses to the Information and Data Request and Institution Questionnaire.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.3 Has the institution previously been reviewed as part of the examination of a federal regulator? <strong>Examiner note:</strong> Obtain a copy of the exam report if possible and discuss the findings with the federal regulator where necessary.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.4 Has the institution been examined by any other state? <strong>Examiner note:</strong> Obtain a copy of the exam report if possible and discuss the findings with the state regulator where appropriate.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

OVERVIEW OF POLICIES AND PROCEDURES

**Examiner note:** Obtain and thoroughly review all policies and procedures related to Covered Transactions.

| A.5 Do written policies and procedures adequately cover (as applicable): | | |
| A.5a | | Consumer contact as well as direct and |
indirect (third party) origination of Covered Transactions?

| A.5b | • Underwriting and risk layering? |
| A.5c | • Internal controls, monitoring and reporting? |
| A.5d | • Loan servicing, accounting and training? |
| A.5e | • Secondary market activity? |
| A.5f | • Investment lending? |
| A.6 | Does institution have a disproportionate or high level of Covered Transactions originated as an exception to existing policies and procedures? |

### B. Consumer Contact/Origination

#### MARKETING/PROMOTIONAL MATERIALS

| B.1 | Do promotional materials and other product descriptions, including oral statements or scripts, provide information about the costs, terms, features, and risks of Covered Transactions that can assist consumers in their product selection decisions, including information about payment shock, negative amortization, prepayment penalties, and the cost of reduced documentation? |
| B.2 | Do promotional materials and other product descriptions provide clear and balanced information about the relative risks of these products? |
| B.3 | Do promotional materials appear to lead payment option ARM borrowers to select a non-amortizing or negatively-amortizing payment (e.g. through format or content of solicitation)? |
| B.4 | Are product descriptions provided when the consumer makes an inquiry to the institution about a mortgage product and receives information about Covered Transactions, or when marketing relating to Covered Transactions is provided by the institution to the consumer, rather than just upon the submission of an application or at consummation? |
| B.5 | Does institution market Covered Transactions to borrowers with subprime credit characteristics? |

**DIRECT ORIGINATION (for providers that deal directly with consumers)**

| B.6 | Does institution provide information about Covered Transactions in a timely manner before disclosures | Y | N | Examiner Notes

[Document supporting evidence and note determinations and findings made.]
<table>
<thead>
<tr>
<th></th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>B.7</td>
<td>Does institution apprise consumer of potential increases in payment obligations for these products, including circumstances in which interest rates or negative amortization reach a contractual limit?</td>
</tr>
<tr>
<td>B.8</td>
<td>For hybrid ARMs, does institution apprise consumer of the difference between initial rate and fully indexed rate, including the components and methods of calculation?</td>
</tr>
<tr>
<td>B.9</td>
<td>When negative amortization is possible under the terms of a Covered Transaction, are consumers apprised of the potential for increasing principal balances and decreasing home equity, as well as other potential adverse consequences of negative amortization?</td>
</tr>
<tr>
<td>B.10</td>
<td>For payment option ARMs, are borrowers encouraged to select a non-amortizing or negatively-amortizing payment (e.g. through oral statements)?</td>
</tr>
<tr>
<td>B.11</td>
<td>Are communications designed to provide clear and balanced information about the risks of these products to minimize consumer confusion regarding Covered Transactions?</td>
</tr>
<tr>
<td>B.12</td>
<td>If the institution originates a Covered Transaction in which the lender may impose a penalty in the event that the consumer prepays the mortgage, are consumers alerted to this fact and to the amount of any such penalty?</td>
</tr>
<tr>
<td>B.13</td>
<td>If the institution originates both reduced and full documentation Covered Transactions and there is a pricing premium attached to the reduced documentation program, are consumers alerted to this fact?</td>
</tr>
<tr>
<td>B.14</td>
<td>Examiner note: The exclusion of escrowed reserves for taxes, insurance and other items from the borrower’s monthly payment is a significant element of the transaction that the borrower should be fully aware of. Consider the following questions when assessing the institution’s performance in this area:</td>
</tr>
<tr>
<td>B.14a</td>
<td>If the borrower’s monthly payments will not include escrowed reserves, are they fully informed of this fact in a clear and understandable manner well before closing?</td>
</tr>
<tr>
<td>B.14b</td>
<td>Are borrowers informed of the requirement to pay for real estate taxes and insurance in addition to their loan payments, a reasonable estimate of the costs, and the possibility that taxes and insurance costs can be substantial and may change over time?</td>
</tr>
<tr>
<td>B.14c</td>
<td>Are borrowers informed that failure to make real estate tax payments may result in the loss of their home?</td>
</tr>
<tr>
<td>-------</td>
<td>----------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>B.14d</td>
<td>Are borrowers informed that failure to maintain hazard insurance on their property may result in the lender “force placing” hazard insurance and billing the costs of such insurance to the borrower?</td>
</tr>
<tr>
<td>B.15</td>
<td>Does institution make comparisons between loans with escrowed reserves and loans without escrowed reserves such that the borrower might be confused about the payment structure of the loan?</td>
</tr>
<tr>
<td>B.16</td>
<td>SUMMARY: Do institution’s sales communications appropriately inform borrowers of the risks of Covered Transactions?</td>
</tr>
</tbody>
</table>

**INDIRECT ORIGINATION (for institutions funding loans through brokers or other lenders)**

| B.18  | What are the institution’s standards for using third-party originators for Covered Transactions?  
*Examiner note: In consideration of this question the examiner should determine the following:* |
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>B.18a</td>
<td>• Does institution conduct appropriate due diligence of third-party originators including pre-relationship review, transaction underwriting review and post-closing reviews?</td>
</tr>
</tbody>
</table>
| B.18b | • Does the institution have adequate criteria for entering into and maintaining relationships with third-party originators to originate Covered Transactions?  
*Examiner note: Consider whether the institution monitors third party originators for the elements identified under Marketing and Direct Origination above.*  
*Examiner note: Consider whether the institution monitors third party originators for the elements identified under Marketing and Direct Origination above.* |
| B.18c | • Has the institution established criteria for third-party compensation designed to avoid providing incentives for originations inconsistent with the Guidance? |
| B.18d | • Does the institution regularly review a reasonable sample of Covered Loan transactions to determine compliance with underwriting standards and guidance regarding Covered Transactions? |
| B.18e | • Does the institution monitor third parties for appraisal problems, loan documentation, credit problems and consumer complaints? |
| B.19  | Does the institution monitor third-party originations for delinquency or default within 1 to 3 payments after funding? |
| B.20  | When deficiencies are noted in any of the above |
areas, does the institution take immediate action, and if so, what action does the institution take?  
Examiner note: Remedial action may include more thorough application reviews, more frequent re-underwriting, or termination of the third-party relationship.

<table>
<thead>
<tr>
<th>B.21</th>
<th>SUMMARY: Are strong risk management standards present when using third-party originators for Covered Transactions?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**C. Underwriting**

<table>
<thead>
<tr>
<th>QUALIFYING BORrowERS</th>
<th>Y</th>
<th>N</th>
<th>Examiner Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>[Document supporting evidence and note determinations and findings made.]</td>
</tr>
</tbody>
</table>

**C.1**  
Do qualifying standards evaluate borrower’s ability to repay the debt by final maturity at the fully-indexed rate, assuming a fully-amortizing repayment schedule and the need to satisfy monthly or annual payments for taxes, insurance and other similar obligations (e.g. homeowner association fees)?

**C.2**  
Does underwriting include reasonable limitation on potential payment shock at expected payment change dates?  
*Examiner note: Consider whether the institution reviews various scenarios of repricing and the borrower’s capacity to service the debt after repricing.*

**C.3**  
For loans with negative amortization features, does repayment analysis consider the initial loan amount plus any balance increase that may accrue from a negative amortization provision?

**C.4**  
Does the institution use credible market rate to qualify borrower and determine repayment capacity?  
*Examiner note: Review qualifying rate against actual program rate (e.g., from lender rate sheets).*

**C.5**  
Does the institution analyze and limit debt to income (DTI) ratios? Are the limits reasonable in relation to the apparent risk?  
*Examiner note: Pursuant to §226.32(d)(7)(iii) of Regulation Z, a mortgage transaction subject to this section may provide for a prepayment penalty otherwise permitted by law if at consummation, the consumer's total monthly debts (including amounts owed under the mortgage) do not exceed 50 percent of the consumer's monthly gross income, as verified*
by the consumer's signed financial statement, a credit report, and payment records for employment income.

<table>
<thead>
<tr>
<th>C.6</th>
<th>Do the DTI ratio analysis and limits include all of the borrower’s contractual obligations (e.g. car payments, credit cards, etc.)?</th>
</tr>
</thead>
<tbody>
<tr>
<td>C.7</td>
<td>Does the institution consider the borrower’s overall ability to handle financial obligations? For example, for high DTI loans does the institution counsel borrowers on the level of general living expenses and commitments that may be impacted by the borrower’s decision to accept a covered transaction with an unpredictable future payment stream?</td>
</tr>
<tr>
<td>C.8</td>
<td>Does institution rely on credit scores or property value as a substitute for capacity to repay based upon income?</td>
</tr>
<tr>
<td>C.9</td>
<td>Does institution rely on third parties to set or implement underwriting standards for Covered Transactions?</td>
</tr>
<tr>
<td>C.10</td>
<td>SUMMARY: Are underwriting standards appropriate to ensure Covered Transactions are originated in a prudent manner?</td>
</tr>
</tbody>
</table>

**RISK LAYERING**

<table>
<thead>
<tr>
<th>C.11</th>
<th>Does institution offer Covered Transactions in conjunction with limited documentation of income? If so, is limited documentation of income the norm or the exception? Examiner note: Review for mitigating factors to support need for stated income loans in relation to loans covered by Subprime Statement.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C.12</td>
<td>Does institution offer Covered Transactions in conjunction with simultaneous second-lien loans? If so, describe how and when second-lien loans are used in conjunction with Covered Transactions.</td>
</tr>
<tr>
<td>C.13</td>
<td>Does institution offer Covered Transactions with a negative amortization feature where borrower has provided no or minimal equity in the loan transaction? If so, what mitigating factors are used to manage risk of default?</td>
</tr>
<tr>
<td>C.14</td>
<td>Does institution offer Covered Transactions where introductory rate (“teaser rate”) is 300 basis points or more below fully-indexed rate?</td>
</tr>
<tr>
<td>C.15</td>
<td>Does institution offer Covered Transactions where borrowers have subprime characteristics (e.g., low credit score)?</td>
</tr>
</tbody>
</table>
| C.16 | Does institution offer Covered Transactions that do not reserve payments into escrow for property taxes and homeowners insurance? If so, is this the norm or
| C.17 | Does institution offer Covered Transactions with extended amortization periods or extended loan terms (see definition of Covered Transactions)? |
| C.18 | Does institution offer Covered Transactions that include two or more risk factors queried in C.11 - 17 above? |
| C.19 | Does institution require mitigating factors when risk layering is present (e.g. higher credit scores, lower LTV, lower DTI, or other mitigating factors)? |
| C.20 | Does institution substitute higher pricing in lieu of sound repayment determinations (e.g. unaffordable loan is priced significantly higher than credit standards would indicate)? |
| C.21 | SUMMARY: Does institution appropriately balance risk layering with mitigating factors when determining borrower’s qualifications? |

**D. Operational Management**

<p>| D.1 | Does the quality control function regularly review a sample of Covered Transactions originated by sales staff and a representative sample of processors and underwriters to confirm that policies are being followed? What happens if violations of policies occur? |
| D.2 | Does the institution track and monitor Covered Transactions originated as an exception to existing policies and procedures? Are high levels of exceptions made? |
| D.3 | Does the institution track defaults and foreclosures and report on the reasons for borrower inability to satisfy debt payments as contracted? |
| D.4 | When control systems or operating practices are found deficient, are business-line managers and third-party originators held accountable for correcting deficiencies in a timely manner? |
| D.5 | Does institution collect and document complaints from its customers? If so, do complaints disproportionately involve Covered Transactions? |
| D.6 | Does institution have adequate system to monitor compliance with specialized requirements (e.g., Guidance and Statement), regulations or laws |</p>
<table>
<thead>
<tr>
<th></th>
<th>related to Covered Transactions?</th>
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</thead>
<tbody>
<tr>
<td>D.7</td>
<td>Does institution provide adequate training to sales personnel regarding Covered Transactions offered and appropriate ways to market these products to consumers (see marketing/origination standards)?</td>
</tr>
<tr>
<td>D.8</td>
<td>Do incentive plans for originators promote sale of Covered Transactions over traditional mortgage loans?</td>
</tr>
<tr>
<td>D.9</td>
<td>Does institution have specialized risk management practices to monitor loan quality and performance of Covered Transactions, including concentrations in particular product types, risk characteristics, borrower characteristics, and origination source?</td>
</tr>
<tr>
<td>D.10</td>
<td>Does institution have risk management practices sufficient to manage level of concentration (high, low) of Covered Transactions? <em>Examiner note: Consider factors below for large institutions or large concentrations of Covered Transactions</em></td>
</tr>
<tr>
<td>D.10.a</td>
<td>• Reporting system to detect changes in risk profile of Covered Transactions quickly.</td>
</tr>
<tr>
<td>D.10b</td>
<td>• Reporting based on full range of product features (loan type, risk layering, underwriting) and terms and borrower characteristics (payment patterns, delinquencies, geographic concentration.</td>
</tr>
<tr>
<td>D.10c</td>
<td>• Management tracks volume and performance against expectations, internal lending standards, and policy limits.</td>
</tr>
<tr>
<td>D.10d</td>
<td>• Management sets limits on volume and performance.</td>
</tr>
<tr>
<td>D.10e</td>
<td>• Management sets and tracks variances to policies and thresholds. Variance analysis is critical to the monitoring of a portfolio’s risk characteristics and should be an integral part of establishing and adjusting risk tolerance levels.</td>
</tr>
<tr>
<td>D.10f</td>
<td>• Management performs stress testing of portfolio for various changes in economic conditions. Does the scope of the analysis include stress tests on key performance drivers such as interest rates, employment levels, economic growth, housing value fluctuations, and other factors beyond the institution’s immediate control? <em>Examiner note: Stress tests typically assume rapid deterioration in one or more factors and attempt to estimate the potential influence on default rates and loss severity. Stress testing should aid an institution in identifying, monitoring and managing risk, as well as developing appropriate and cost-effective</em></td>
</tr>
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</table>
D. 10g
- Management has assessed contingent liability of buy-back risk for poor performance of loans and has capital or other system to address risk.

<table>
<thead>
<tr>
<th>E. Servicing</th>
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<tbody>
<tr>
<td><strong>MONTHLY STATEMENTS – PAYMENT OPTION ARMS ONLY</strong></td>
</tr>
<tr>
<td>E.1</td>
</tr>
<tr>
<td>E.2</td>
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<tr>
<td>E.3</td>
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<tr>
<td>E.4</td>
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</table>

| **ACCOUNTING, TRAINING, AND LOAN MODIFICATION** |
| E.5 | Does the institution have strong controls over accruals, customer service and collections? |
| E.6 | Are policy exceptions made by servicing and collections personnel carefully monitored to confirm that practices such as re-aging, payment deferrals, and loan modifications are not inadvertently increasing risk? |
| E.7 | Do customer service and collections personnel receive product-specific training on the features and potential customer issues with Covered Transactions? |
| E.8 | Does institution maintain and execute special policies and procedures to modify or work-out loans that enter into delinquency or default within 1 to 3 payments after funding or after an increase in payment? |

*Examiner Note: A defaulting loan shortly after funding*
is commonly known as an “early payment default.” Typically, a repurchase of the loan will be automatic for borrowers defaulting at the first payment date; however, the examiner should give special attention to any significant amount of defaults occurring within the first three payments. Further, the examiner should consider the underlying reason for early payment default following a payment reset and not make the assumption that payment increase is the sole trigger of default.

E.9 Are borrowers provided 60 days or more prior to the reset date to refinance without being subject to a prepayment penalty? How are borrowers notified of this reset date and opportunities to avoid application of prepayment penalty?

F. Secondary Marketing

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<tr>
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<th>Y N</th>
<th>Examiner Notes</th>
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</thead>
<tbody>
<tr>
<td></td>
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<td></td>
<td>[Document supporting evidence and note determinations and findings made.]</td>
</tr>
<tr>
<td>F.1</td>
<td>Does the institution have significant secondary market activity in Covered Transactions?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>F.2</td>
<td>Is the sophistication of the institution's secondary market risk management practices commensurate with the nature and volume of activity?</td>
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<tr>
<td>F.3</td>
<td>If the institution has significant secondary market activities are there comprehensive, formal strategies for managing risks?</td>
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<td></td>
</tr>
<tr>
<td>F.4</td>
<td>Has the institution considered how it will respond if there is reduced demand in the secondary market?</td>
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</table>

G. Investment Lending

<table>
<thead>
<tr>
<th></th>
<th>Non-Owner-Occupied Investor Loans</th>
<th>Y N</th>
<th>Examiner Notes</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Examiner note: This section is only applicable to agencies with authority to review investor loans. However, the examiner should consider any potential adverse safety and soundness concerns related to institutions with concentrations in Covered Transaction investor loans.</td>
<td></td>
<td>[Document supporting evidence and note determinations and findings made.]</td>
</tr>
<tr>
<td>G.1</td>
<td>Do standards require borrowers financing non-owner-occupied investment properties to qualify for loans based on their ability to service the debt over the life of the loan?</td>
<td></td>
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<tr>
<td>G.2</td>
<td>Do the loan terms reflect an appropriate combined LTV ratio that considers the potential for negative</td>
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</tbody>
</table>
amortization and maintains sufficient borrower equity over the life of the loan?

| G.3 | Do standards require evidence that the borrower has sufficient cash reserves to service the loan, considering the possibility of extended periods of property vacancy and the variability of debt service requirements associated with Covered Transactions? |

### H. Practices for Institutions to Avoid

<table>
<thead>
<tr>
<th></th>
<th>Examiner note: This section is intended to guide the examiner and institution on practices that the Guidance and Statement advises lenders to avoid. Consideration should be given to promotional materials, oral advertisements and statements as well as, interviews with origination staff and borrowers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>H.1</td>
<td>Does the institution avoid practices that obscure significant risks to the consumer? <strong>Examiner note:</strong> For example, if an institution advertises or promotes a Covered Transaction by emphasizing the comparatively lower initial payments permitted for these loans, the institution also should provide clear and comparably prominent information alerting the consumer to the risks. Such information should explain, as relevant, that these payment amounts will increase, that a balloon payment may be due, and that the loan balance will not decrease and may even increase due to the deferral of interest and/or principal payments.</td>
</tr>
<tr>
<td>H.2</td>
<td>Does the institution avoid promoting payment patterns that are structurally unlikely to occur? <strong>Examiner note:</strong> For example, advertisements that suggest rates of 1% beyond the initial teaser period, or showing monthly payments based only on best case scenarios.</td>
</tr>
<tr>
<td>H.3</td>
<td>Does the institution avoid such practices as: giving consumers unwarranted assurances or predictions about the future direction of interest rates (and, consequently, the borrower’s future obligations); making one-sided representations about the cash savings or expanded buying power to be realized from Covered Transactions in comparison with amortizing mortgages; suggesting that initial minimum payments in a payment option ARM will cover accrued interest (or principal and interest) charges; and making misleading claims that interest rates or payment obligations for these products are “fixed?”</td>
</tr>
</tbody>
</table>
1. Licensees and examined institutions must complete the attached Covered Transaction Summary Sheet (Excel format) and the Institution Questionnaire for its Covered Transactions as defined below.

2. Please provide copies of all policies, procedures, standards and underwriting guidelines for Covered Transactions. Policies should include third-party coverage (e.g. mortgage broker relationships), concentrations and growth limits, underwriting standards, monitoring and review, employee training and secondary market activities. Include the effective date for all policies, procedures, standards and underwriting guidelines.

3. Please provide copies of all marketing materials for Covered Transactions, including, but not limited to printed materials (print ads, brochures, direct mailings, flyers, etc.), radio or television transcripts, telemarketing scripts, Internet screen shots, email solicitations, and any instructions on oral solicitations by sales staff. Include the date and venue for publication of each item.

4. Provide a copy (one each) of all communications used with consumers concerning Covered Transactions not included in 3 above. All communications include the following:
   a. Letters, notices, instructions, warnings, etc.
   b. Monthly payment states for each type of Covered Transaction.
   c. Disclosures specific to each type of Covered Transaction.
Include the effective date of each communication if not apparent from the document.

5. Copies of notes, description and program parameters for each type of Covered Transaction.

6. Example copies of any reports produced for monitoring Covered Transactions. Make available to the examiner in charge all reports covering the date of the examination.

7. A list of any complaints filed by borrowers with Covered Transactions.

8. Provide a list of Covered Transactions made that required an exception to written underwriting policies.

9. Provide a list of all institutions with whom you regularly do business that originate or make Covered Transactions, along with the estimated percentage of Covered Transaction activity conducted with each. In other words, if you are an originator, the list should include each lender you have originated Covered Transactions for. If you are a lender, the list should include each originator you have accepted Covered Transaction submissions from.

10. Provide a copy of all regulatory examination reports (state or federal) conducted within two years prior to this examination period.
The following questionnaire is intended to save time and resources for both the institution and the examination team. Unless instructed otherwise, this questionnaire is to be completed and returned as instructed in the examination entry letter. Please answer all questions thoroughly. Simple Yes/No answers are not sufficient for most questions. Please provide further explanation as needed to assist in clarifying the institution’s response and aid the examiner in understanding your practices.

The following questions pertain to Covered Transactions as described below.

**Covered Transactions**

Throughout this document, Covered Transactions refers to any product considered or contemplated in the Guidance and Statement, including:

*Interest-Only Mortgage Loan*—A nontraditional mortgage on which, for a specified number of years (e.g., three or five years), the borrower is required to pay only the interest due on the loan during which time the rate may fluctuate or may be fixed. After the interest-only period, the rate may be fixed or fluctuate based on the prescribed index and payments include both principal and interest.

*Payment Option ARM*—A nontraditional mortgage that allows the borrower to choose from a number of different payment options. For example, each month, the borrower may choose a minimum payment option based on a “start” or introductory interest rate, an interest-only payment option based on the fully indexed interest rate, or a fully amortizing principal and interest payment option based on a 15-year or 30-year loan term, plus any required escrow payments. The minimum payment option can be less than the interest accruing on the loan, resulting in negative amortization. The interest-only option avoids negative amortization but does not provide for principal amortization. After a specified number of years, or if the loan reaches a certain negative amortization cap, the required monthly payment amount is recast to require payments that will fully amortize the outstanding balance over the remaining loan term.

*Subprime ARM products*: ARM products typically marketed to subprime borrowers with the following characteristics:

- Offering low initial payments based on a fixed introductory or “teaser” rate that expires after a short initial period then adjusts to a variable index rate plus a margin for the remaining term of the loan.¹
- Loans for which borrowers are approved without considering appropriate documentation of their income.

¹ For example, ARMs known as “2/28” loans feature a fixed rate for two years and then adjust to a variable rate for the remaining 28 years. The spread between the initial fixed rate of interest and the fully indexed interest rate in effect at loan origination may range from 300 (3%) to 600 (6%) basis points.
• Loans with very high or no limits on how much the payment amount or the interest rate may increase ("payment or rate caps") at reset periods, potentially causing a substantial increase in the monthly payment amount “payment shock.”
• Loans containing product features likely to result in frequent refinancing to maintain an affordable monthly payment.
• Loans that include substantial prepayment penalties and/or prepayment penalties that extend beyond the initial interest rate adjustment period.
• Soliciting and transacting loans where borrowers are provided inadequate information relative to product features, material loan terms and product risks, prepayment penalties, and the borrower’s obligations for property taxes and insurance.

Subprime “extended amortization” products: Adjustable rate and fixed rate products marketed to subprime borrowers with amortization period longer than the term of the loan, such as to require the payment of a balloon amount at the end of the loan term.2

Other Definitions

Reduced Documentation—A loan feature that is commonly referred to as “low doc/no doc,” “no income/no asset,” “stated income” or “stated assets.” For mortgage loans with this feature, a provider sets reduced or minimal documentation standards to substantiate the borrower’s income and assets.

Simultaneous Second-Lien Loan—A lending arrangement where either a closed-end second-lien mortgage loan or a home equity line of credit (HELOC) is originated simultaneously with the first-lien mortgage loan, typically in lieu of a higher down payment.

Institution Questionnaire

A. General

1. Has management established written policies for Covered Transactions, as applicable, for:

   a. Consumer contact as well as direct and indirect (third party) originations?

   b. Underwriting and risk layering?

   c. Internal controls, monitoring and reporting?

   d. Loan servicing, accounting and training?

   e. Secondary market activity?

   f. Investment lending?

2 For example, products known as “50/30” loans feature an amortization period of 50 years with a loan term of 30 years. As a result, at the end of the 30 year term, the borrower is required to make a final balloon payment to repay the remaining principal of the loan.
2. What types of Covered Transactions does the institution originate, make or fund?
   a. Interest Only ARMs
   b. Step ARMs (e.g. 2/28s, etc.)
   c. Payment Option ARMs
   d. Payment Option FRMs
   e. Hybrid ARMs
   f. Extended term (e.g. 40 year amortization) Covered Transactions
   g. Covered transactions where borrowers have subprime characteristics (e.g. low credit score)
   h. Covered Transactions with reduced documentation or no documentation
   i. Covered Transactions with simultaneous second lien mortgages
   j. Covered Transactions with prepayment penalties
   k. Covered Transactions with balloon payments
   l. Covered Transactions with no monthly payments escrowed for taxes, insurance or other charges
   m. Other transactions that would meet the definition of Covered Transactions (describe)

3. What are the institution’s policies for acceptable levels of risk? Please be specific as to practices, accounting procedures and policy exception tolerances.

4. Does the institution have growth and volume limits by loan type?

5. What are these limits?

B. Consumer Contact/Origination

1. Are product descriptions for Covered Transactions provided to the consumer?

2. At what point in the transaction is this information provided to the consumer?

3. What steps does the institution take to alert consumers to the risks of Covered Transactions, including the likelihood of increased future payment obligations?
4. How is this information communicated?

5. At what point(s) in the transaction is this information provided to consumers?

6. Does the institution incorporate elements designed to help minimize potential consumer confusion and complaints, foster good customer relations, and reduce legal and other risks to the institution?

7. Does the institution apprise consumers of potential increases in payment obligations for Covered Transactions, including circumstances in which interest rates or negative amortization reach a contractual limit?

8. How is this information communicated to the consumer?

9. When negative amortization is possible under the terms of a Covered Transaction, are consumers apprised of the potential for increasing principal balances and decreasing home equity, as well as other potential adverse consequences of negative amortization?

10. How is this information communicated?

11. Does the institution inform the consumer of the difference between initial rate and the fully indexed rate, as well as the highest possible rate achievable in the loan?

12. How and when does the institution inform the consumer of this difference?

13. If the institution may impose a penalty in the event that the consumer prepays the mortgage, are consumers alerted to this fact and to the need to ask about the amount of any such penalty?

14. Is the communication in addition to the TILA disclosure?

15. How and when is this information communicated?

16. If the institution offers both reduced and full documentation loan programs and there is a pricing premium attached to the reduced documentation program, are consumers alerted to this fact?

17. How and when is this information communicated?

18. If the borrower’s monthly payments will not include escrowed reserves for taxes, insurance and other items, are they fully informed of this fact?

19. Are borrowers informed of the requirement to make payments for real estate taxes and insurance in addition to their loan payments, if not escrowed, and the fact that taxes and insurance costs can be substantial?

20. Are borrowers informed that failure to make real estate tax payments may result in the loss of their home?
21. Are borrowers informed that failure to maintain hazard insurance on their property may result in the lender “force placing” hazard insurance and billing the payments to the borrower?

22. How and when is the borrower informed of the information in 17 through 20?

23. For high DTI loans does the institution counsel borrowers on the level of general living expenses and commitments that may be impacted by the borrower’s decision to accept a covered transaction with an unpredictable future payment stream?

C. Indirect Origination through Third Parties

1. Has the institution implemented systems and controls for establishing and maintaining relationships with third parties, including procedures for performing due diligence?

2. What are those systems and controls?

3. If appraisal, loan documentation, credit problems or consumer complaints are discovered in third-party originations, does the institution take immediate action?

4. What remedial actions are taken?

5. What third-party compensation is established for Covered Transactions?

D. Underwriting

1. Do the institution’s standards address the effect of a substantial payment increase on the borrower’s capacity to repay when loan amortization begins?

2. Do qualifying standards recognize the potential impact of payment shock, especially for borrowers with high loan-to-value (LTV) ratios, high debt-to-income (DTI) ratios, and low credit scores?

3. What market rate is used to qualify the borrower and determine repayment capacity?

4. How is the borrower’s repayment capacity evaluated?

5. What payment schedule is used to determine the borrower’s ability to repay the loan (e.g. analyzed rate, monthly payment, and term)?

6. Does the institution consider the borrower’s overall ability to handle financial obligations? For example, for high DTI loans does the institution counsel borrowers on the level of general living expenses and commitments that may be impacted by the borrower’s decision to accept a covered transaction with an unpredictable future payment stream?

7. Does the institution fully consider monthly amounts for taxes, insurance and other items when determining the borrower’s ability to repay the loan?
8. Does the repayment analysis consider the initial loan amount plus any balance increase that may accrue from a negative amortization provision?

9. What LTV limits are allowed for loans with negative amortization features?

10. For high LTV negative amortization loans, what mitigating factors are used to manage the risk of default?

11. What reliance is placed on credit scores when qualifying a borrower?

12. What mitigating factors does the institution require to support the borrower’s repayment capacity when risk layering is present (e.g. higher credit scores, lower LTV and DTI ratios, significant liquid assets, mortgage insurance or other credit enhancements)?

13. Are borrowers qualified based on the ability to repay at the fully-indexed rate with a fully-amortizing term?

14. What limits has management placed on risk layering (see Guidance and Statement for discussion of risk layering)?

15. Are underwriting standards ever ceded to third parties?

16. When and under what criteria are the standards ceded?

17. What are the tolerances for recognizing payment shock? In other words, what triggers and parameters are set to identify situations in which borrowers may be unable to adequately service the debt when the loan is adjusted and/or recast?

18. How is the borrower’s repayment capacity evaluated? What payment schedule is used to determine the borrower’s ability to repay the loan (e.g. analyzed rate, monthly payment, and term)?

19. What are the institution’s standards for reduced documentation or no documentation lending?

20. Do the institution’s product terms consider the spread between the introductory rate and the fully indexed rate and the impacts of future adjustments? In other words, when setting loan terms, is consideration given to the payment shock that can result from very low introductory interest rates (sometimes called “teaser” rates)?

21. What steps does the institution take to minimize the likelihood of disruptive early recastings and extraordinary payment shock when setting introductory rates?

22. Does the institution offer Covered Transactions where introductory rate (“teaser rate”) is 300 basis points or more below the fully-indexed rate?

**E. Operational Management**
1. What performance measures and management reporting has the institution implemented?

2. Are loan terms based on a disciplined analysis of potential exposures and compensating factors to ensure risk levels remain manageable?

3. What analysis is employed?

4. Has management instituted performance measures and management reporting to monitor consumer contact and the origination of Covered Transactions?

5. Does the institution’s monitoring system track originations in key segments such as loan types, third-party originations, geographic area, borrower characteristics, and property occupancy status for Covered Transactions?

6. Does the institution have any employee incentive programs that could produce higher volumes of Covered Transactions?

7. What are those incentive programs and how do they work?

8. Has the institution considered the effect of employee incentive programs on volumes of Covered Transactions?

9. What control systems has the institution designed to address compliance and consumer information concerns as well as the safety and soundness considerations discussed in the Guidance and Statement?

10. Does the institution review consumer complaints to identify potential compliance, reputation, and other risks?

11. Does the quality control function regularly review a sample of Covered Transactions originated by sales staff and a representative sample of processors and underwriters to confirm that policies are being followed?

12. How is the sample selected?

13. When control systems or operating practices are found deficient, are business-line managers held accountable for correcting deficiencies in a timely manner?

14. What accountability measures are employed?

15. How are sales and processing personnel trained so that they are able to convey information to consumers about product terms and risks in a timely, accurate, and balanced manner?

16. As products evolve and new products are introduced, do staff receive additional training, as necessary, to continue to be able to convey information to consumers in this manner?

17. Are sales and processing personnel monitored to determine whether they are following policies and procedures?
18. What tools are used for risk mitigation purposes?

19. How does the institution measure concentrations of certain types of Covered Transactions?

20. Are concentrations monitored by key portfolio characteristics such as loans with high combined LTV ratios, loans with high DTI ratios, loans with the potential for negative amortization, loans to borrowers with credit scores below established thresholds, loans with risk-layered features, and non-owner-occupied investor loans?

21. Does the institution track and monitor Covered Transactions originated as an exception to policies and procedures?

22. Does the institution track defaults and foreclosures and report on the reasons for borrower inability to satisfy debt payments as contracted?

23. Does oversight of third-parties involve monitoring the quality of originations so that they reflect the institution’s lending standards and compliance with applicable laws and regulations?

24. Are variance analyses performed regularly to identify exceptions to policies and prescribed thresholds? Variance analysis is critical to the monitoring of a portfolio’s risk characteristics and should be an integral part of establishing and adjusting risk tolerance levels.

25. Does qualitative analysis occur when actual performance deviates from established policies and thresholds?

26. Does the institution perform sensitivity analysis on key portfolio segments to identify and quantify events that may increase risks in a segment or the entire portfolio?

27. Does the scope of the analysis include stress tests on key performance drivers such as interest rates, employment levels, economic growth, housing value fluctuations, and other factors beyond the institution’s immediate control? Stress tests typically assume rapid deterioration in one or more factors and attempt to estimate the potential influence on default rates and loss severity. Stress testing should aid an institution in identifying, monitoring and managing risk, as well as developing appropriate and cost-effective loss mitigation strategies.

28. Do the stress testing results provide direct feedback in determining underwriting standards, product terms, portfolio concentration limits, and capital levels?

29. Has management assessed the contingent liability of buyback risk for poor performance of loans?

30. Does the institution have sufficient capital or other systems in place to address buyback risk?

**F. Servicing**

1. What controls does the institution have over accruals, customer service and collections?
2. Are policy exceptions made by servicing and collections personnel carefully monitored to confirm that practices such as re-aging, payment deferrals, and loan modifications are not inadvertently increasing risk?

3. Do customer service and collections personnel receive product-specific training on the features and potential customer issues with these products?

4. Does the institution maintain special policies and procedures to modify or work-out loans that enter into delinquency or default shortly after funding or after an increase in payment?

5. What are the institution’s policies concerning prepayment penalty when a borrower refinances a loan prior to the reset date.

G. Secondary Market

1. What are the institution’s formal strategies for managing secondary market risks?

2. Has the institution considered how it will respond to reduced demand for Covered Transactions in the secondary market?

H. Non-Owner Occupied Investor Loans

1. Do the institution’s standards require borrowers financing non-owner-occupied investment properties to qualify for loans based on their ability to service the debt over the life of the loan?

2. Do the institution’s loan terms reflect an appropriate combined LTV ratio that considers the potential for negative amortization and maintains sufficient borrower equity over the life of the loan?

3. Do the institution’s standards require evidence that the borrower has sufficient cash reserves to service the loan, considering the possibility of extended periods of property vacancy and the variability of debt service requirements associated with Covered Transactions?