



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

January 5, 2011

Mortgagee Letter 2011-02

To: **ALL APPROVED MORTGAGEES**

Subject Quality Control Requirements for Direct Endorsement Lenders

Purpose of this Mortgagee Letter This Mortgagee Letter clarifies FHA's Quality Control requirements in light of recent changes to the lender eligibility criteria for participation in FHA programs (refer to Section 203 of the "Helping Families Save Their Homes Act of 2009" (HFSH Act); Final Rule FR 5356-F-02, "Continuation of FHA Reform: Strengthening Risk Management through Responsible FHA-approved Lenders"; and Mortgagee Letter 2010-20). This Mortgagee Letter also clarifies Quality Control requirements for servicing transfers and loan sales, reporting of fraud and material deficiencies, and the required timeframes for mortgagees to review rejected applications.

Effective Date All requirements contained in this Mortgagee Letter are effective immediately. HUD Handbook 4060.1, REV-2 will be revised at a later date to reflect the program changes outlined in this Mortgagee Letter.

Information Collection Requirements The information collection requirements contained in this document are pending approval by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and will be assigned an OMB control number once it has been approved. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Affected Topics

HUD Handbook 4060.1, REV-2, Sections 7-3 (H)(1), 7-3 (H)(2), 7-3(J), 7-6(C), 7-6 (D), 7-6(E), and 7-8 (A)(1), Section 7-12(E)
HUD Handbook 4060.1, REV-2, Section 8-3

Changes to Basic Quality Control Requirements The adoption and implementation of a Quality Control Plan is a required element of a lender's application for approval to participate in FHA programs. Beginning January 1, 2011, FHA will neither approve applications for approval as a loan correspondent, nor monitor lenders acting in such capacity for the purpose of the origination of loans submitted for FHA insurance. All

lending entities performing in the capacity of a loan correspondent will thereafter be referred to as Sponsored Third Party Originators. Consequently, all FHA-approved mortgagees will be responsible for performing quality control reviews of their Sponsored Third Party Originators. The procedures used to review and monitor Sponsored Third Party Originators must be included in a mortgagee's FHA-approved Quality Control Plan. At a minimum, these procedures must include the requirements outlined in Paragraph 7-6 of HUD Handbook 4060.1, REV-2.

Review and Documentation

All FHA-approved mortgagees, including those in sponsored relationships must have a Quality Control Plan that requires the review of loans that are originated or underwritten. For those mortgagees that have Sponsored Third Party Originators, the Quality Control Plan must require the review of loans originated and sold to the mortgagee by each of its Sponsored Third Party Originators. Mortgagees must determine the appropriate sample amount of each Sponsored Third Party Originator's loans to review based on volume, past experience, and other factors specified by the Department in Paragraph 7-6(C) of HUD Handbook 4060.1, REV-2. In addition, Sponsors must document the methodology used to review Sponsored Third Party Originators, the results of each review, and any corrective actions taken as a result of their review findings. A report of the Quality Control review and follow-up that includes the review findings and actions taken, and the 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. Quality Control review records must be made available to HUD upon request.

Early Payment Defaults

In addition to the loans selected for routine quality control reviews, mortgagees must review all loans that are originated or underwritten by their company and that are originated by their Sponsored Third Party Originators that go into default within the first six payments (referred to as early payment defaults). Handbook 4060.1, REV-2 defines early payment defaults as loans that become 60 days past due within the first six payments. Mortgagees must perform reviews of early payment defaults within 45 days from the end of the month the loan is reported as 60 days past due. The Early Payment Default review report and follow-up, including review findings and any actions taken, along with procedural information (as specified in HUD Handbook 4060.1 Rev.-2, Paragraph 7-6 (E)), must be retained by the mortgagee for a period of two years.

Sale and Transfer of Loans

Mortgagees are responsible for determining whether the *Mortgage Change Record* was reported accurately to HUD via the FHA Connection on servicing transfers or sales of loans. Mortgagees' Quality Control Plans must contain a

requirement to ensure the review of all *Mortgage Change Records* for accuracy as discussed below:

For cases involving the transfer of legal rights to service FHA-insured loans:

- The transferee must report the change of legal rights to service to HUD
- The transferor should verify that the change of legal rights to service has been reported, and that all details contained in the report are accurate

For cases involving the holder's sale of loans:

- The holder (seller) must report the sale of loans to HUD
- The buyer must confirm that the sale of loans has been reported, and that all details contained in the report are accurate

**Reporting of
Fraud and
Material
Deficiencies**

If a mortgagee discovers potential fraud or other serious material deficiencies, it must be immediately reported to the Department via the Neighborhood Watch Early Warning system, as required in Handbook 4060.1 Rev.-2, Paragraph 7-3 (J). Management is expected to review and respond accordingly to each instance of fraud or other serious material deficiency, indicating what steps if any have been taken to cure and/or resolve these violations. All corrective actions taken in response to instances of fraud or other serious material deficiencies should be reported to the Department via the Neighborhood Watch Early Warning System. Mortgagees must monitor all loans they originate, underwrite or service for potential fraud or serious material deficiencies throughout the lifecycle of the loans.

**Rejected
Applications**

In order to ensure that mortgagees' operations are in compliance with fair lending regulations, the Department requires that rejected applications must be reviewed within 90 days from the end of the month in which the decision was made, following the requirements set forth in Handbook 4060.1, REV-2, Paragraph 7-8 (A).

**Responses to
Information
Requests**

FHA approved mortgagees may receive official correspondence from the Department for various purposes, including, but not limited to on-site compliance reviews, Office of Inspector General (OIG) audits, advertisement/website issues, Departmental or Congressional inquiries, and documentation requests for self reports submitted to the Neighborhood Watch Early Warning system. Mortgagees are expected to respond to Departmental correspondence within the timeframe established by HUD and include a detailed description and appropriate documentation on any refuted findings. Failure to comply within the specific timeframe established by the Department may result in sanctions by the Mortgagee Review Board pursuant to the provisions of 24 C.F.R. Part 25. In order to ensure that all Departmental correspondence reaches the intended recipient(s) mortgagees are responsible for updating principal staff listings and company contact information (i.e., mailing addresses, telephone numbers, email addresses and domain names) in FHA Connection on a regular basis.

Questions

If you have questions concerning this Mortgagee Letter, please call 1-800-CALLFHA (1-800-225-5342). Persons with hearing or speech impairments may reach this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

Signature

David H. Stevens

Assistant Secretary for Housing-Federal Housing Commissioner