CrossCheck Compliance

Mortgage Chat

Q1 2025

Ask CrossCheck

Welcome to CrossCheck's *Mortgage Chat*, an informational series. CrossCheck Compliance addresses topics that arise as lenders originate, underwrite, and fund their residential mortgage products. These insights are intended to help clarify investor requirements regarding underwriting and quality assurance as well as provide best practices.

If you are grappling with a mortgage question, we invite you to send your query to **Ask CrossCheck**. Our team of mortgage experts are ready to provide the guidance and support you need.

ACES Mortgage QC Industry Trends — Q2 2024

In November 2024, ACES Quality Management (ACES), an industry-leading risk management software provider, released its Mortgage QC Industry Trend Report for Q2 2024. ACES noted an overall critical defect rate of 1.81% for Q2 2024, a significant 14.56% increase from the prior quarter and the highest rate since Q1 2023. Income/Employment defects still remain the leading category with appraisal defects increasing the most (98%) from the previous quarter. One of the more interesting findings was in the area of product types where ACES noted improved performance in FHA and VA loans, with modest declines in the defect rates. However, loan defects in USDA production, albeit a smaller sample size, rose significantly by 370%. The rise in the critical defect rate across all categories underscores the importance of a lender's quality control program.

Source: https://www.acesquality.com/resources/reports/q2-2024-aces-mortgage-qc-industry-trends

Fraud Awareness

In January 2024, the Federal National Mortgage Association (FNMA) issued a fraud alert regarding appraiser identity theft. A significant number of loans were identified with appraisals completed by unlicensed appraisers using the identities of licensed appraisers. The red flags to look out for, noted by FNMA, include:

- Contact information on page six of the Fannie Mae Form 1004 may be different from the licensed appraiser.
- Email information reflects a name other than the licensed appraiser.
- Signatures appear to be forged and/or cut and pasted.
- The appraiser was paid with proceeds going directly to a fraudulent mailing address.

FNMA recommends performing due diligence when retaining services of an appraiser should include confirmation of the appraiser's identify and license validity.

Source: https://singlefamily.fanniemae.com/mortgage-fraud-prevention

Fraud Awareness - Continued

In December 2024 FNMA issued guidance on verifying occupancy. The red flags to look out for, noted by FNMA, include:

- Property insurance includes inconsistencies with the occupancy type.
- The loan file indicates borrower is not residing in the subject property on an owner-occupied refinance.
- The subject property is in a vacation area.
- The borrower is downgrading to a smaller home or a home of less value than their current residence.
- Unrealistic commuting distance to current employment.
- The appraisal was marked tenant-occupied or vacant.
- Appraisal interior photos indicate subject is vacant on a refinance.
- Tax returns support subject as a rental.
- The sales contract indicates an assumed lease.
- The borrower is currently renting or living with relatives and purchasing an investment property or 2nd home.
- The borrower is retaining their current residence to convert to an investment and purchasing a new home.

In addition to the more common owner-occupied misrepresentation, reverse occupancy can occur. Reverse occupancy occurs when the borrower claims rental income to qualify for the mortgage, but instead moves in and occupies the property therefore no longer receiving the rental income that was used for qualifying.

FNMA mentions that “a strong QC environment can help lenders detect red flags and uncover discrepancies during the reverification of occupancy.”

Source: https://singlefamily.fanniemae.com/news-events/quality-insider-reduce-risk-when-you-strengthen-your-occupancy-reverification-process

Agency LDP / GSA Requirements

In keeping with the theme of fraud awareness and prevention, the Department of Housing and Urban Development specifies that a seller/servicer must follow a written procedure for checking all employees, including management, involved in the origination or servicing of mortgage loans (including application through closing and servicing) against the U.S. General Services Administration (GSA) Excluded Parties List (EPL), the HUD Limited Denial of Participation List (LDP List), and the Federal Housing Finance Agency's (FHFA) Suspended Counterparty Program (SCP) list. If, at the time of hire or any time later, the seller/servicer has determined an individual is on the GSA, LDP, or SCP list, the seller/servicer may not permit that employee to manage or perform origination or servicing functions, irrespective of the reason the individual is on such list.

Parties that are to be checked against the exclusionary lists include, but are not necessarily limited to, the borrower, co-borrower, loan originator/loan officer, loan origination company, property seller, listing agent, listing agent's company, seller agent, selling agent's company, appraiser, closing agent/officer, escrow company, and title company.

The Veteran's Administration (VA) also requires essentially the same loan participants to be checked against exclusionary lists, but includes builders, repair contractors, and manufactured home manufacturers and dealers as well as manufactured home park operators.

Further, regarding correspondent lending, the seller/servicer must confirm the third-party originator has a documented procedure for checking all employees against the exclusionary lists.

Sources:

1. https://singlefamily.fanniemae.com/news-events/quality-insider-reduce-risk-when-you-strengthen-your-occupancy-reverification-process
2. https://guide.freddiemac.com/app/guide/section/3101.1
3. https://benefits.va.gov/WARMS/docs/admin26/m26-07/Chapter_17.pdf

Post-Closing Quality Control: Tax Transcripts

One area that continues to confuse many lenders is the requirements regarding IRS tax transcripts. Fannie Mae and Freddie Mac require tax transcripts to be obtained for each loan selected as part of the random and discretionary samples. Generally, lenders are not required to utilize a borrower's transcript as part of the underwriting of a loan. The seller's guides of Fannie Mae and Freddie Mac are clear on the requirements and state following:

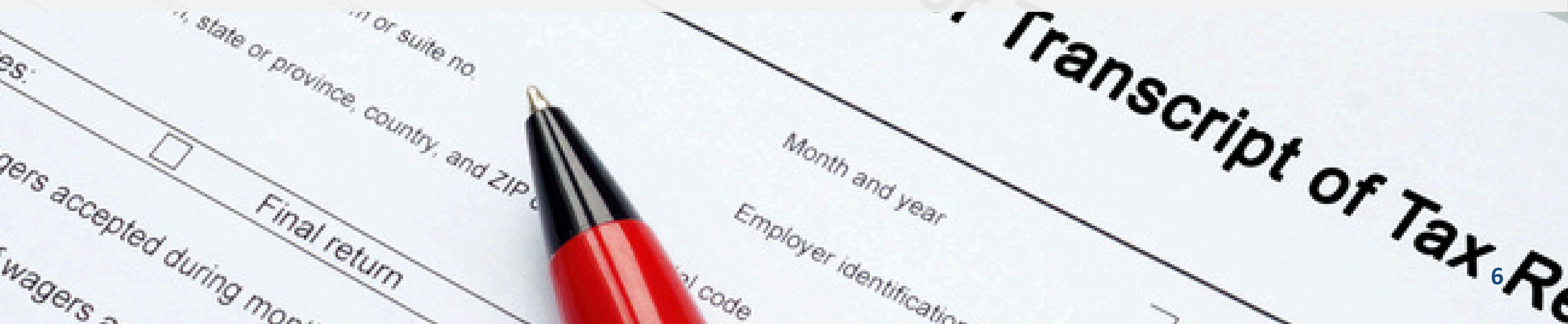
- Fannie Mae requires lenders to include the requirement to submit the IRS Form 4506-C to the IRS (or designee) in their written QC plan. For all loans reviewed through the random selection process (and for loans selected through the discretionary selection process, as applicable), the post-closing QC review must include the lender's submission for tax transcripts to the IRS. Fannie Mae does allow for an exception: Lenders are not required to obtain tax transcripts for a borrower when all of that borrower's income was validated by the DU validation service.
- Freddie Mac requires the lender to obtain the IRS income information using Form 4506-C or an alternate form acceptable to the IRS that authorizes the release of comparable tax information for each Mortgage selected for quality control review. Freddie Mac does allow for an exception: Lenders are not required to obtain tax transcripts for a borrower when the report is accessed directly from a Freddie Mac designated third-party service provider's electronic database.

The above requirement for Fannie Mae would also apply to loans closed under the Federal Home Loan Bank (FHLB) XTRA program.

Lenders that have had their QC programs audited by one of the agencies can attest to the seriousness of not including the transcript requirement in their QC policy and implementing it in the monthly audits.

Sources:

1. https://selling-guide.fanniemae.com/sel/d1-3-02/lender-post-closing-quality-control-review-approval-conditions-underwriting-decisions-and#P7616
2. https://guide.freddiemac.com/app/guide/section/3402.5



Contact Us

CrossCheck Compliance LLC is a nationwide regulatory compliance and risk management consulting firm focused on providing regulatory compliance, internal audit, fair lending, loan review, due diligence, and litigation support services for the financial services industry. The firm's professionals have deep regulatory understanding and operations experience to develop effective compliance strategies and deliver high impact outcomes for clients.

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Todd is a senior mortgage executive with over 25 years of mortgage lending experience. He has operational experience as both a portfolio investor and mortgage banker. The Loan Review practice led by Todd performs pre-funding quality assurance and post-closing quality control, as well as operational audits of origination and quality control departments, and repurchase, fraud, and servicing reviews. Due diligence services include rated securitizations, portfolio purchases/reviews, and mergers and acquisitions. The Litigation Support practice provides expert services including file review, reports, and testimony in relation to mortgage-backed securities, servicing, and repurchase matters.

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Tim is a mortgage executive with more than 20 years of mortgage lending experience. He has had operational experience with several mortgage bankers. As a compliance manager, he has been effective in minimizing regulatory liabilities through guideline development and risk management, in adherence to industry standards. Tim has worked closely with federal and state auditors to manage and improve the loan process through employee training and work flow changes.

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Andrew has been in the mortgage industry for over 20 years with varied experience in sales management, residential and consumer lending, as well as marketing, market analysis, marketing plans, and customer retention. At CrossCheck, Andrew has participated on a variety of engagements including review of loans in mortgage-backed securities subject to litigation, mortgage repurchase requests, fraud reviews, and quality control reviews. Prior to joining CrossCheck, Andrew has been an underwriter for money center banks, mortgage bankers, and mortgage insurance companies.

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