

WAC 208-620-613 When I develop policies and procedures to implement the federal guidelines on applicable conventional residential mortgage loans, what topics must be included? The policies and procedures must include, at a minimum, underwriting standards, risk management, consumer protection, and control systems. If you only broker residential mortgage loans under your CLA license, your policies and procedures must comply with WAC 208-660-500. For purposes of this section, the definition of "subprime" and "subprime loans" is taken from the *2001 Interagency Expanded Guidance for Subprime Lending Programs* (an attachment to SR 01-4 (GEN), January 31, 2001, by the Board of Governors of the Federal Reserve System, Division of Banking, Supervision and Regulation).

(1) Underwriting standards. To ensure that underwriting standards are consistent with prudent lending practices, the underwriting standards should include, at a minimum, an analysis of borrower characteristics, loan product attributes, and the borrower's ability to repay the obligation.

(a) Analysis of borrower characteristics. The analysis must include tolerances for combining borrowers with certain characteristics with certain nontraditional loan products.

The criteria or range of reasonable tolerances should consider the characteristics listed in the *2001 Interagency Expanded Guidance for Subprime Lending Programs*.

(b) Loan product attributes. Products with the following attributes, when combined with the borrower characteristics above result in higher risk. The risks are increased if borrowers are not adequately informed of the product features and risks.

- Low initial payments based on a fixed introductory rate that expires after a short time and then adjusts to a variable index rate plus a margin. Because initial and subsequent monthly payments are based on these low introductory rates, a wide initial spread means that borrowers are more likely to experience negative amortization, severe payment shock, and an earlier than scheduled recasting of monthly payments. Loans made to subprime borrowers must not contain any provisions that may lead to negative amortization.

- Very high or no limits on how much the payment amount or the interest rate may increase.

- Limited or no documentation of the borrower's income. Stated income is only acceptable if there are mitigating factors that clearly minimize the need for direct verification of repayment capacity. Licensees generally must be able to readily document income using recent W-2 statements, pay stubs, or tax returns. An exception to this is when the loan product underwriting itself contemplates reduced documentation (for example, FHA loans).

- Substantial prepayment penalties or prepayment penalties that extend beyond sixty days prior to the date the interest rate will reset.

- Simultaneous second lien loans. When features are layered, mitigating factors should be present to support the underwriting decision and the borrower's repayment capacity.

(c) Ability to repay. For all nontraditional mortgage loan products, the analysis of a borrower's repayment capacity must include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. In addition, for prime borrowers qualifying for loan products that permit negative amortization, the repayment analysis must be based on the initial loan amount plus any balance increase that may accrue from the

negative amortization provision. The analysis should avoid over reliance on credit scores as a substitute for income verification. The higher a loan's credit risk, either from borrower characteristics or loan features, the more important it is to verify the borrower's income, assets, and outstanding liabilities.

(2) Risk management. The scope of the risk management activities should be determined by the volume of nontraditional mortgages originated or used as investment. Licensees that target subprime borrowers through tailored marketing, underwriting standards, and risk selection must ensure that such programs do not feature terms that could become predatory or abusive. Policy topics should include, at a minimum:

(a) Acceptable product attributes;

(b) Production, sales and securitization practices;

(c) Limits on risk layering. When features are layered, licensees should demonstrate that mitigating factors support the underwriting decision and the borrower's repayment capacity. Mitigating factors could include higher credit scores, lower LTV and DTI ratios, significant liquid assets, mortgage insurance, or other credit enhancements;

(d) Growth and volume limits by loan type;

(e) Performance measures. Incentive programs should not produce high concentrations of nontraditional products. Design performance measures and reporting systems that provide early warning for increased risk;

(f) Management reporting and quality control. Focus on the high risk lending activities. Monitor and document compliance with underwriting standards. Quality control should include regular audits of nontraditional loan products. Perform due diligence in establishing and maintaining relationships with third party originators. Third party originations must meet the underwriting standards. Document and respond in writing to all complaints. Take immediate remedial action which could include more thorough application reviews, more frequent reunderwriting, or terminating the third party originator;

(g) Secondary market activity. The risk management practices should be commensurate with the nature and volume of activity and should include contingency planning for response to reduced demand in the secondary market. Establish a policy on repurchase practices.

(3) Consumer protection.

Communication with borrowers. Providers must focus on information important to consumer decision making; highlight key information so that it will be noticed; employ a user-friendly and readily navigable format for presenting the information; and use plain language, with concrete and realistic examples. Comparative tables and information describing key features of available loan products, including reduced documentation programs, also may be useful for consumers. Specifically:

- Promotional materials and other product descriptions must provide information about the costs, terms, features, and risks of non-traditional mortgages that can assist consumers in their product selection decisions.

- Licensees must apprise borrowers of potential increases in payment obligations. The information should describe when structural payment changes will occur and what the new payment would be or how it was calculated.

- If negative amortization is possible under the terms of a non-traditional mortgage product, borrowers must be advised of the potential for increasing principal balances and decreasing home equity as a consequence of the borrower making minimum payments.

- Borrowers must be alerted to the fact that the loan has a pre-payment penalty and the amount of the penalty.
- Borrowers must be made aware of any pricing premium based on reduced documentation.
- Monthly statements must provide information that enables borrowers to make informed payment choices, including an explanation of each payment option available and the impact of that choice on loan balances. For example, the monthly payment statement must contain an explanation, if applicable, next to the minimum payment amount that making this payment would result in an increase to the borrower's principal loan balance.

(4) Control standards. Actual practices must be consistent with the written policies and procedures. Employees must be trained in the policies and procedures and performance monitored for compliance. Incentive programs should not produce high concentrations of nontraditional products. Performance measures and reporting systems should be designed to provide early warning of increased risk.

[Statutory Authority: RCW 43.320.040 and 31.04.165. WSR 12-18-047, § 208-620-613, filed 8/29/12, effective 11/1/12. Statutory Authority: RCW 43.320.040, 31.04.165, 2009 c 120, and 2009 c 149. WSR 09-24-090, § 208-620-613, filed 12/1/09, effective 1/1/10. Statutory Authority: RCW 43.320.040, 19.144.070, 2008 c 78. WSR 09-01-159, § 208-620-613, filed 12/23/08, effective 1/23/09.]