



# STATED INCOME LOANS

ESTABLISHING STANDARDS OF REASONABLENESS

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### Reasonableness Program Benefits

- More prudent origination of loans
    - » Correlate information throughout the file at time of underwriting
    - » Utilize available products, tools and information
    - » Provide comprehensive training throughout the origination organization
    - » Develop an effective Quality Assurance Plan
    - » Appropriate testing of origination policies and processes
    - » Frequent and timely reporting/feedback identifying policy, process or training needs
    - » Meet (or exceed) and sustain your company's quality expectations
  - Opportunities to improve loss mitigation efforts/practices
    - » Reducing losses on defaulting loans and/or repurchases
    - » Leverage your investor and MI relationships through improved contract terms
    - » Effectively (quickly and appropriately) react to Investor, MI and Industry feedback/environment
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### History

- Originally created for borrowers with
    - » Nontraditional income arrangements
    - » Complex earning and asset structures
    - » All-cash businesses with high write-offs.
  - These borrowers were expected to have strong compensating factors:
    - » Excellent credit history
    - » Financial contribution to the property (i.e. Itv related)
    - » Considerable liquid assets
  - The borrower profile demonstrated a reasonable likelihood
    - » The borrower meeting monthly obligations
    - » Despite the absence of traditional income verifications
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### Project Goals

- This project seeks to provide lenders with suggestions to determine
    - » If a borrower is a candidate for a stated income product
    - » If the stated income is, in fact, reasonable
  - These suggestions are not hard and fast rules; there are any number of mitigating factors that may necessitate or preclude the use of a stated income product
  - The goal is simply to provide a lender with a structure in which it can determine
    - » If a stated income product addresses the needs of a particular borrower
    - » If that borrower's stated income can, in fact, be reasonably justified
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### About This Presentation

- Tool to assist the underwriter during the loan approval process
  - Tool to assist developing stated income loan best practices
  - Presentation was developed around the underwriter documentation review
  - Application section addresses all types of information listed on the application and does overlap with other documentation requirements addressed in the presentation
  - Income, employment and assets are also addressed separately
  - Objective was to re-enforce the importance of reasonableness in all areas
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### Profiles of Stated Income Borrower

1. Loan transaction
2. Application information
3. Income
4. Assets
5. Credit

*Does your loan file contain enough information about these five loan profiles to reasonably support your decision?*

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### Loan Transaction

- Is the loan transaction consistent with the level of stated income?
    - » Debt to income ratio
    - » Max qualifying ratio
    - » Payment shock
    - » Loan to value
    - » Verified assets or reserves
    - » Are the down payment funds commensurate with the stated income?
    - » Realistic transaction (e.g. no significant commute, second home in non-vacation area)
  - Other factors
    - » Financial contribution to transaction
    - » Property type
    - » Occupancy
    - » Secondary financing
    - » Arm's length
  - Ensure support for these factors are well documented in the loan file
-

# Loan Transaction

## Examples of Supported Transaction Structures

- This is a purchase of a primary residence
    - » Current home is being sold
    - » Upgrading from one SFD to a more expensive SFD
    - » Borrower's housing payment is a moderate increase
    - » The LTV is 80% with a CLTV of 90%.
    - » The borrower's increase in housing payment is minimal
  - This is a cash-out refinance of a primary residence
    - » Cash-out funds will be used for home improvements
    - » Occupied home for 5 years, no other real estate owned
    - » Appraised value is well supported based upon acquisition cost of the property and reasonable appreciation the past 5 years
    - » DTI based on stated income is less than maximum.
    - » LTV 85%, prior equity line is being paid off and closed
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### Application Information

#### Is the application information consistent throughout the file?

- Can they afford this home/loan?
  - Is the application complete?
    - » What additional information do I need, if the application is incomplete?
  - Does the information correlate throughout the file?
    - » Transaction type & property Info
      - Purchase transaction makes sense for age, profession and income of borrower
      - Significant cash out refinance, is borrower self employed with high stated income and how leveraged is the borrower's credit?
      - If high income level yet down payment is borrowed, gifted or fully leveraged, does this make sense for the borrower's profile?
      - Is overall monthly housing payment significantly increasing?
-

### Application Information

- Does the application information correlate throughout the file?
    - » Borrower information
      - Age of borrower consistent with job title and income
      - Years of education consistent with job title and income
      - Not claiming retirement income with receipt of social security income (ie stated income is \$20k)
      - Disposable income
      - Issue date of SSN is consistent with years working in profession
      - Number of years renting/owning consistent with the borrowers age and income
      - Income is consistent with marital status and dependents
        - › Does it appear the borrower may be using household income?
-

### Application Information

- Employment and income
    - » How familiar are you with the employer (e.g. GM versus Bob's Plumbing)?
    - » Any employer red flags (e.g. borrower does not claim to be self employed, but employer telephone and address match borrower's residence)?
    - » Is interest income supported by assets?
    - » Are retirement, SS and disability income supported by borrowers age and employment history (credit report)?
      - › Is there a Current position?
    - » Are alimony and child support supported by marital status and dependents?
-

### Application Information

- Housing expense information
    - » Is the difference between the current payment and the proposed payment reasonable?
      - Is there significant payment shock?
      - Are cumulative assets or reserves adequate to support the proposed payment (particularly if there is a significant increase)?
-

### Application Information

- Asset information
    - » Do the types of assets support stated income level?
    - » Does application show investments consistent with borrower's age and income?
    - » Does the application show retirement savings plans?
      - 401K
      - Annuities
    - » Are their vehicles (model and year) consistent with their income?
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### Application Information

- Schedule of Real Estate Owned (REO)
    - » Does the net rental income or loss look consistent with the value, type and location of property?
    - » Do the taxes and insurance payments look reasonable for the value of the properties?
    - » Is the rental income consistent with area market rents?
    - » Does the rental income appear reasonable for the properties listed on the schedule of REO?
      - Number owned
      - Values
      - Net income
-

# Application Information

- Declarations
    - » Are judgments, bankruptcies, foreclosure and lawsuit questions/answers consistent with information contained on
      - The credit report
      - The preliminary title report
      - Public records
    - » Is permanent resident alien consistent with
      - SSN issuance
      - Licensed, certified, designated and technical professionals
      - Employer size and industry (typically sponsors)
    - » Occupancy
      - Is consistent with transaction type
-

### Income Profile of Borrower

#### Employment

- Underwriter is personally familiar with this type of business?
  - Can the underwriter relate the income to previous experience or knowledge?
  - If Yes to these, then less additional due diligence will be required to determine if the profile and income appears reasonable
  - If No to these, then more due diligence is prudent
    - » Tools and products are available for further analysis (refer to tools section in this presentation).
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### Income Profile of Borrower

#### Employment – Employer

- Does the employer's profile support the borrowers stated income and position?
    - » Employer profile
      - Size of company
      - Number of employees
      - Net worth
      - Licensing requirements
      - Phone listings/advertising
    - » Type of business
      - Licensed professionals, services and manufacturing/labor
      - Geographic location of business
      - Chain/franchise, sole proprietor
-

### Income Profile of Borrower

#### Employment – Validation Methods

- How does the underwriter test for validity?
    - » Internet search of company
      - Advertising
      - Phone and location listings
        - › Reverse search on phone and addresses
      - Licensing
      - Ownership interest
        - › Regulating/governing (state, city, professional) agencies
        - › Reverse searches
    - » Run product/service to determine size of company
      - Type of business
      - Net worth
      - Number of employees
      - Age of company
-

# Income Profile of Borrower

## Employment – Borrower

- Does the Borrower's employment information support the stated income and position?
    - » Position
      - Title
      - Length of time in position
      - Length of time in Industry
      - Previous positions consistent with current position
      - Education
      - Professional designations/certifications
      - Salary vs hourly
    - » Self Employed
      - All of the above for company profile
      - All of the above for position
      - Percentage of ownership
      - Type of ownership (Sole, Partnership, Corp, etc.)
      - Licensing Requirements
-

# Income Profile of Borrower

## Employment verification methods

- Verbal and written VOE
    - » Check for standard fraud red flags
    - » Analyze employers profile & type of business (see other slides)
    - » Independently obtain employers phone number
    - » Contact appropriate personnel @ employer
      - Human Resources
      - Owner of company (confirm this via public records)
    - » Confirm borrowers position
    - » Confirm borrowers dates of employment
  - Additional validation on Written VOE
    - » Check spelling of borrower's title & employer's Title
    - » Check signature of employer
    - » Check name of employer (potential relative?)
-

### Asset Profile of Borrower

- Key parameters
    - » Consistent structure with level of the stated income
      - Liquid assets
      - Real estate equity
      - Net worth
      - Non-liquid assets
      - Source of down payment
      - Asset accumulation matches with years on the job/years employed in the profession
    - » Asset accumulation matches with years on the job/years employed in the profession
    - » Adequate reserves
  - Other inconsistencies between income and assets
    - » Small amounts in checking and savings for higher income borrowers
    - » No or very small retirement accounts (IRAs and 401k)
    - » Mismatch of down payment amount and real estate equity with stated income (i.e. stated income borrower can afford a \$500,000 primary residence, but is only purchasing \$100,000 residence with 3% down payment)
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# Asset Profile Of Borrower

## Asset Verification Methods

- Check for standard fraud flags
  - Analyze asset profile & type of depository (see other slides)
  - Independently confirm depository address and phone numbers
  - Confirm type of accounts
  - Confirm names on accounts
  - Confirm length of accounts
  - Check spelling of borrower's title & employer's title
  - Check signature of depository
  - Check title of depository signature
-

# Credit Profile of Borrower

## Credit Report Review Methodology

- Credit history
    - » Number of outstanding trade lines
    - » Length of credit history
    - » Payment history
    - » Credit limits and outstanding balances
      - Based on length of employment, job position, salary and age
  - The credit history should be reviewed for
    - » Open and closed accounts, age of trade
      - Reason cited for any account closure
    - » Identify authorized user
      - Request additional information to determine actual account holder and relationship with authorized user
      - Accounts with no direct relationship should be discarded and the profile analysis adjusted accordingly
-

### Credit Profile of Borrower

#### Credit History Reasonableness Test

- High-income earners are typically well balanced credit users
  - Type of credit includes
    - » Mortgages
    - » Auto / Installment loans
    - » Major credit lines (VISA, MasterCard, American Express, Diners Club)
    - » Minor credit lines (department store, gasoline, cell phone)
    - » Collections
  - Credit limits in comparison to
    - » Date opened (consider age of the mortgagor)
    - » Job position
    - » Length of employment
    - » Length of time in the respective industry
    - » Salary
-

## Credit Profile of Borrower

### Negative Items on a Credit Report

- Delinquencies should be judged in the context of life events
    - » Change in marital status
    - » Family deaths
    - » Illness
    - » Job loss
  - Is there a pattern of delinquencies?
  - Collection accounts should be reviewed for
    - » Type of collection
    - » Amount of uncollected balance
    - » Date of opening of collection
    - » Date of payoff of collection
    - » Life events
-

### Third Party Documents and Tools

- 4506-T
  - Credit reports
  - Verification of assets
  - Verbal or written verification of employment
  - Public records
  - Salary & analysis tools
  - Professional designation or license
  - Education certification or degree
  - Better Business Bureau
-

### Third Party Documents and Tools

IRS 4506T in place of a CPA letter

- Does not verify income unless the client requires income validation
  - A 4506 Vendor can verify the borrower files their taxes with the government, their earnings are properly classified, their Social Security number and the longevity of their business earnings
  - Type of income (Wages, Schedule C or E, Interest, etc.) and the
  - NAICS (North American Industry Classification System) code and description associated with the business
  - Same report can also return a Yes or No answer to an income input by the customer
  - Also available for wage-earners to demonstrate their earnings by employer and longevity
    - » Check with your IRS 4506T vendor for these products or the internet for mortgage fraud prevention tools.
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## Third Party Documents and Tools

### Credit Report Headers

- Besides reporting the high-credit, amount owed and payment status of the consumer's credit accounts, the credit report also contains
    - » Recent inquiries, reported address and employer information.
  - The credit report will also list
    - » Fraud Alerts
    - » Social Security number issues
    - » Additional Social Security numbers associated with the credit file
    - » Other warnings developed by the credit industry.
  - A credit report is a fee-based service and reviewing all the elements reveals a pattern that will assist in determining whether the credit profile "fits" with the stated earnings.
    - » For example, a consumer who has several credit cards with a high-limit of \$2,500, a credit history of less than 10 years, apartment addresses and retail employment listed will be unlikely to earn \$12,000 or more per month. Limited or no credit history would also be an indication that high monthly earnings are unreasonable for a particular borrower.
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### Third Party Documents and Tools

#### Public Records

- There are several free searches on the internet for information regarding
    - » Businesses and Business status
    - » Addresses
    - » Telephone numbers
    - » Real estate owned, etc.
  - There are also fee-based searches by several companies
    - » Can be customized to perform searches pertinent to the information needed by a lender
  - Most states and counties maintain some form of online record databases
    - » Would be included in both free and fee-based resources
  - Public record searches are an independent resource that provides support for determining the reasonableness of stated income
  - Searches include business existence verification, longevity of the business, ownership of the business, assets of the business, number of employees, what types of reported annual earnings and professional license or registration information
    - » Better Business Bureau will sometimes provide information noted above
-

## Third Party Documents and Tools

### Salary and Analysis Tools

- In recent years the industry has turned to Human Resources' research tools as a means of determining reasonableness of income
  - These tools will typically take reported earnings on professions in geographical areas from multiple HR data sources and provide a report with a range of income probability
  - This is a valuable tool that uses HR data from multiple sources to validate the level of earnings to be consistent with the profession, education and geographic location of the borrower
  - Application data verification or matching tools
    - » Internal and external database information matched to 1003
    - » Known fraud data in their database on individuals, properties, and areas
    - » Typically include transaction and collateral review
  - Risk characteristic analysis
    - » Based on statistical data from lenders footprint and customers
    - » Pattern matching analysis
    - » Delinquency performance characteristics and analysis
-

# Quality Control

Monitoring and reporting on stated income loans

- Recognize determining reasonableness of income is a shared responsibility
    - » Sales
    - » Underwriting
    - » Closing
    - » Quality Control
  - Partner with operations management to build a strong process
    - » Analyze failures to provide feedback and enhance processes
    - » Test effectiveness of processes
    - » Identify training opportunities
-

### Quality Control

#### Monitoring and reporting on stated income loans

- Determine if different processes will be used for different lines of business
    - » Retail versus wholesale
    - » Correspondent
    - » Develop incentives and consequences
  - Expand the current QC program to include selections for these different process risks
    - » Targeted selection
    - » Random selection
      - Stratify population by documentation type
      - Select a separate sample from the population of “stated income loans”
    - » Extensive use of available tools
-

### Quality Control Plan

#### Addressing stated income loans

- Review stated income loans
    - » Address and define reasonableness testing
    - » Review the process for follow through
    - » Ensure questionnaire reflects different processes for reasonableness (they may be different by business unit)
    - » Identify area of responsibility and severity of process mistake
    - » Review loans to identify if a new process would have identified the problem
-

# Quality Control

## Analysis

- Isolate and identify any unique elements in loans with process failures
    - » Look for individuals or combination of individuals such as loan officer and processor or loan officer and underwriter
    - » Look for specific loan attributes such as property type, loan type, occupancy type, etc.
    - » List the percentage of self-employed borrowers vs. salaried borrowers
  - Client issues identified
    - » Loan officers, processors combinations
    - » Geographic concentration
    - » Transaction concentration
-

# Quality Control

## Reporting

- Meaningful and actionable information regarding compliance to requirements
  - Material risk to organization
  - Identify number and type of errors causing repurchases
    - » Conduct the same types of analyses as done for the newly originated loans
  - Partner with management to discuss the results of the review
    - » Ensure any resulting process changes are incorporated into the QC questionnaire
    - » Provide material and ideas for training if requested.
    - » Be prepared to discuss changes, results and benefits with investors and regulators
-

# Consequences

- Repurchases
  - Pool Drops
  - Mortgage Insurance claims not paid
  - Cost
    - » Employee Time associated with negotiating the issue
    - » Relationship with investors
    - » Reserves and cost associated with maintaining reserves
    - » Losses associated with selling at “scratch and dent” pricing
  - Regulatory compliance risk
  - Foreclosures
  - Legal and Reputation risk
-

## Recommendations

- Ensure your organizations controls are adequate and adhered to
  - Know your contracts for “reps and warranties”
    - » Implement appropriate risk mitigation processes
    - » Negotiate with investors, agencies, and MI companies
  - Review the file to determine if there are blatant “red flags”
  - Comprehensive company risk management plan
    - » Collaboration throughout organization
    - » Performance reporting and analytics
    - » Adequate reserves for risk
    - » Adjust and modify policies and processes as needed
    - » Adequate and consistent training programs
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