OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans

TO: Chief Executive Officers of All National Banks and National Bank Operating Subsidiaries, Department and Division Heads, and All Examining Personnel

INTRODUCTION AND PURPOSE

The Office of the Comptroller of the Currency (OCC) has taken a variety of steps to guard against national banks becoming involved in predatory and abusive lending practices.[1] One dimension of the OCC's concern in this area relates to the need for national banks to exercise appropriate diligence when they make or purchase loans that are originated through mortgage brokers or other intermediaries. National banks should have in place procedures and standards adequate to ensure that their broker arrangements and loan purchases do not present unwarranted risks.

Accordingly, the OCC is issuing this advisory letter to alert national banks and their operating subsidiaries (collectively referred to as national banks) to the risks they may confront if they make loans through brokers or obtain loans through purchase transactions that contain terms or reflect practices that may be characterized as abusive or "predatory." Such loans present significant legal, reputation, and other risks, in addition to the heightened credit risk assumed in cases where the borrower lacks the ability to repay the loan without resorting to liquidation of the collateral. This guidance applies to (1) traditional broker transactions in which a mortgage broker refers an application to the bank and the loan is closed in the bank's name; (2) "table funded" loans that are closed in the name of a third party, but in which the bank provides the loan funds and immediately acquires the loan; and (3) loan purchase transactions where the loan is initially made and funded by a third party who subsequently sells the loan to the bank (whether or not the bank performs or participates in the underwriting of the loan).[2] Although the specific nature and degree of the risks presented may vary among these different categories of transactions, the general principle of this guidance — that banks must maintain strong and appropriate controls over all loan origination and purchase functions, including loan sourcing, processing, underwriting, and closing — pertains to them all.

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[1] *See, e.g.,* OCC Advisory Letter 2003-2 (Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices), February 21, 2003 (OCC Guidelines to Guard Against Predatory Lending); OCC Advisory Letter 2002-3 (Guidance on Unfair or Deceptive Acts or Practices), March 22, 2002; OCC Bulletin 2001-6 (Expanded Guidance for Subprime Lending Programs), January 31, 2001; OCC Advisory Letter 2000-11 (Title Loan Programs), November 27, 2000; OCC Advisory Letter 2000-10 (Payday Lending), November 27, 2000; OCC Advisory Letter 2000-7 (Abusive Lending Practices), July 25, 2000.

[2] This guidance is applicable both where the bank intends to hold the brokered or purchased loan in its portfolio and where it intends to resell the loan or pool it for securitization.

The OCC expects that national banks will take affirmative steps to address the risks of these transactions through, among other things, appropriate due diligence, mortgage broker agreements, and ongoing monitoring of their third-party relationships. This advisory letter provides specific recommendations for accomplishing these objectives.

National banks that fail to address these risks may be subject to supervisory and other actions by the OCC. Moreover, the OCC will take such actions as may be appropriate to address misconduct by mortgage brokers and other third parties that deal with national banks, and will work closely with agencies having primary enforcement authority over such third parties to combat predatory lending practices.

BACKGROUND

Recent reports indicate that a majority of all home mortgages, and approximately 50 percent of subprime loans, are originated through mortgage brokers.[3] Similarly, a large proportion of mortgages are sold by the initial creditor to loan purchasers in secondary market transactions.[4]

These arrangements serve legitimate needs of the parties involved, and the public interest, in a wide variety of ways. The greater number and diversity of participants in the mortgage market enhances competition, allows for the more flexible and efficient performance of origination services and allocation of credit risk, and provides borrowers with greater convenience and access to credit, particularly in areas that are traditionally underserved.

At the same time, however, these arrangements may present risks for participating parties, including the risk that they will become implicated in predatory lending practices. Such practices — in addition to causing great harm to borrowers — may expose participants to significant legal liability and reputation risk, and subject the ultimate lender to the high credit risk of lending to a borrower who lacks the ability to repay the loan without resorting to collateral.

Federal laws and regulations that govern mortgage and other lending transactions do not contain a comprehensive definition of "predatory" or "abusive" lending practices. However, the OCC believes that a fundamental characteristic of predatory lending is the provision of credit to borrowers who simply cannot afford the credit on the terms being offered. Typically, such credit is underwritten predominantly on the basis of the liquidation value of the collateral, without regard to the borrower's ability to service and repay the loan according to its terms, absent resorting to that collateral. When a loan has been made based on the foreclosure value of the collateral, rather than on a determination that the borrower has the capacity to make the scheduled payments in accordance with the terms of the loan, the lender is effectively relying on its ability to seize the borrower's equity in the collateral to satisfy the obligation (including accrued interest) and to recover the typically high fees associated with such credits. As a result, such credits experience foreclosure rates higher than the norm.

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[3] *See* United States Department of the Treasury and United States Department of Housing and Urban Development, *Curbing Predatory Home Mortgage Lending: A Joint Report* (June 2000) (Treasury-HUD Joint Report), at 38, available at [http://www.treas.gov/press/releases/reports/treasrpt.pdf]. For a general discussion of characteristics of "subprime" lending, *see* OCC Bulletin 2001-6 (Expanded Guidance for Subprime Lending Programs), January 31, 2001; OCC Bulletin 99-15 (Subprime Lending: Risks and Rewards), April 5, 1999; and OCC Bulletin 1999-10 (Interagency Guidance on Subprime Lending), March 3, 1999.

[4] *See* Treasury-HUD Joint Report at 39-44.

Predatory loans often include features that are designed to strip away or reduce borrowers' equity in the collateral for the loan, and thus enhance the likelihood of foreclosure. The mechanisms by which this "equity stripping" may occur are various, and include lending without regard to repayment ability, "loan flipping" (refinancings that occur in circumstances that result in little or no economic benefit to the borrower, with the objective of generating additional loan points, loan fees, prepayment penalties, and fees from financing the sale of credit-related products), and "fee packing" (including in the loan principal amount such costs as points, mortgage broker fees, prepayment penalties on a prior loan, and charges for related products such as credit insurance). The potential for abuse is exacerbated when these fees and other charges far exceed those that would reflect the true costs and risks of the transaction, or are assessed and included in the loan principal without the borrower's informed consent. Finally, predatory lending may often involve fraudulent, deceptive, or high-pressure sales tactics, particularly against older borrowers, or persons who are, or are perceived to be, less financially sophisticated or otherwise vulnerable to abusive practices (for example, persons with limited access to mainstream sources of credit).[5]

RISKS OF PREDATORY BROKERED AND PURCHASED LOANS

Credit Risk

As noted above, a departure from fundamental principles of loan underwriting — lending without a determination that a borrower can reasonably be expected to repay the loan from resources other than the collateral security for the loan, and relying instead on the foreclosure value of the borrower's collateral — generally forms the basis of abusive lending. Such transactions are not consistent with established lending standards[6] and raise fundamental safety and soundness issues. A loan made without regard to the borrower's ability to service and repay the loan in accordance with its terms, without resorting to collateral, presents significant safety and soundness concerns, and making or purchasing such loans on a regular basis is inconsistent with safe and sound banking practices. Such loans may pose both a higher risk of default and a higher potential loss exposure at default.

Studies of predatory lending have indicated that national banks and other federally supervised depository institutions generally are not engaged in this sort of unsafe and unsound — and abusive — lending practice. By contrast, because of the less intensive supervision of mortgage brokers and other intermediaries, as well as other factors (such as the fact that they do not intend to take on the ultimate credit risk of the loan), there is a particular risk that such intermediaries will be tempted to engage in abusive practices such as lending without regard to repayment ability. Thus, mortgage broker and loan purchase transactions may present a heightened risk that supervised institutions will acquire loans that are made without a reasonable expectation that the borrower will be able to repay the loan as structured. Moreover, this credit risk would be increased in circumstances where the loan decision relies on an appraisal that has inflated the true value of the collateral, which may be more likely where the third party, who does not bear the ultimate credit risk, selects the appraiser.[7]

Legal Risk

Predatory and abusive loans originated through brokers or by third-party lenders also present a wide range of heightened legal risks for national banks, and could subject them to both supervisory action and civil liability. For example, borrowers victimized by oppressive loan

[5] *See generally* OCC Guidelines to Guard Against Predatory Lending.
[6] *See* 12 CFR 34, D. *See also* 12 CFR 30, Appendix A.
[7] *See generally* 12 CFR 34, C.

terms or other unscrupulous conduct of a mortgage broker or loan originator may have remedies against the ultimate creditor under common law theories of fraud or unconscionability.

In addition, predatory loans originated through mortgage brokers, or purchased from third-party lenders, may subject national banks to liability or supervisory action under a wide range of federal consumer protection laws. For example, in typical mortgage broker transactions, the loan will be closed in the name of the bank as the initial creditor, and thus, the bank generally will have direct liability for any violations of law committed in connection with the loan. In addition, the bank could be liable under agency, "common enterprise," or other theories for violations committed by the broker, and may be jointly and severally liable with the broker —for example, under the Real Estate Settlement Procedures Act (RESPA) — for violations it is deemed to commit in conjunction with the broker. Even in table-funded or purchase transactions, a bank may have liability for violations of law as a successor or assignee of the original creditor.

The legal risks of originating or purchasing predatory loans include the following:

- *TILA and RESPA*. Mortgage lending activities are generally subject to the disclosure requirements and substantive protections of the Truth in Lending Act (TILA) and RESPA. Under TILA, the failure to provide timely and accurate disclosures of the cost of mortgage credit may result in mandatory administrative reimbursement of excess finance charges; statutory damages and other civil liability; and the borrower's right to rescind the entire transaction. TILA provides that actions generally may be brought against assignees if the violation for which the action is brought is apparent on the face of the disclosure statement.[8] Thus, for example, if a mortgage broker prepares a TILA disclosure statement on behalf of a national bank, and that disclosure understates the finance charge (for example, by failing to reflect the broker's fee accurately), the bank would be subject to a restitution order, civil liability, and potential rescission of the loan. Violating RESPA's ban on kickbacks and certain other types of payments and charges would expose the bank to extensive civil liability (three times the amount of the charge for the settlement service in question) and criminal sanctions. Thus, if a broker engages in fee-splitting or gives or accepts referral fees in violation of these provisions, and is found to be acting as agent for or in conjunction with a national bank, the bank may be subject to these legal risks.

- *HOEPA*. High-cost mortgage loans originated through brokers or by third-party lenders must comply with the substantive protections and disclosure requirements set forth in the Home Ownership and Equity Protection Act (HOEPA). Among other things, HOEPA prohibits creditors from engaging in a pattern or practice of making certain high-cost loans based on the homeowner's equity without regard to repayment ability. HOEPA's substantive protections also restrict many of the other loan terms and structures often cited in discussions of predatory lending practices, including refinancings that may constitute loan flipping; payments to home improvement contractors; balloon payments; prepayment penalties; and negative amortization. Civil liability for HOEPA violations may include restitution of *all* the finance charges and fees paid by the consumer. HOEPA provides that assignees are subject to all claims and defenses that could be brought against the original creditor, unless the assignee can demonstrate "that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by [TILA], the itemization of the amount financed, and other disclosure of disbursements," that the mortgage was covered by HOEPA.[9]

[8] 15 USC 1641(a) and (e).
[9] 15 USC 1641(d).

- *Fair Lending Laws*. Predatory lending practices also can raise fair lending concerns. Predatory lenders often target identifiable groups of consumers that are (or are perceived to be) less financially sophisticated, currently have less access to mainstream lenders, or are otherwise vulnerable to abusive practices. If this targeting is based on age, race, national origin, gender, or other prohibited bases under the law, the abusive practices may represent violations of the Equal Credit Opportunity Act (ECOA) or the Fair Housing Act. Even if such targeting has been performed directly by a mortgage broker in soliciting applications, the creditor making the loan could nevertheless be subjected to civil lawsuits and government enforcement actions. ECOA also provides for successor liability by defining the term "creditor" to include "any assignee of an original creditor who participates in the decision to extend, renew, or continue credit."[10]

- *FTC Act*. Finally, predatory loans may involve violations of the Federal Trade Commission Act (FTC Act), which makes unlawful "unfair or deceptive acts or practices." Practices involving fraud, misleading conduct, or material omissions of information concerning costs, risks, or other terms and conditions may violate the prohibition against deception. Under relevant precedents, this prohibition is violated by representations, omissions, acts, or practices that are material and are likely to mislead a *reasonable consumer in the audience targeted by the advertisement or other practice*. Loans with unconscionable terms may also involve violations of the prohibition against unfair acts or practices. Evidence of practices such as loan flipping, equity stripping, or the refinancing of loans made under governmental or nonprofit programs with terms favorable to the borrower may be indicative of unfair or deceptive practices that violate the FTC Act.[11] Violations of the FTC Act would subject a national bank or its operating subsidiary to supervisory action by the OCC.

In addition to raising the foregoing issues under federal consumer protection laws, abusive loans also may be inconsistent with various safety and soundness regulations and guidelines.[12]

Other Risks

Predatory lending also has generated concern and criticism because of the harm that abusive loans may cause for families and communities, and because such loans are perceived as inconsistent with national policies, including the goals of fair access to credit, community development, and the promotion of stable homeownership by the broadest spectrum of America. For these reasons, predatory lending creates the risk that a bank will be perceived unfavorably in its community, in the marketplace, and by the general public. Even though the abusive practices in question may have been perpetrated by a third party, the bank that makes or purchases the loans may be tarnished, and seen as an institution that does not consistently treat its customers fairly. When a mortgage loan has been underwritten without regard to the borrower's ability to repay the loan absent resorting to collateral, the institution holding the loan at the time of foreclosure thus may face significant reputation risk (as well as credit risk).

Lending practices that violate the fair lending laws, the FTC Act, the consumer protections in HOEPA, or TILA's rescission provisions, or that evidence other illegal credit practices, also may adversely affect an institution's rating under the Community Reinvestment Act (CRA).[13]

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[10] 15 USC 1691a(e). *See* 12 CFR 202.2(l).
[11] *See* OCC Guidelines to Guard Against Predatory Lending, at 4-6.
[12] *See, e.g.,* 12 CFR 30, Appendix A, and 12 CFR 34, C and D.
[13] *See* 12 CFR 25.28(c). *See also* Interagency Questions and Answers Regarding Community Reinvestment, Q&A ___.28(c)-1, 66 *Fed.Reg.* 36620, 36640 (July 12, 2001). A bank that engages in a pattern or practice of extending

Because CRA performance must be considered in connection with various applications for depository facilities, including branch applications and bank merger transactions, predatory lending may impede a bank's strategic plans to expand its operations or to combine with another organization.

Safety and soundness concerns may also arise where lending practices effectively foreclose access to a secondary market. Government-sponsored enterprises (GSEs) active in the secondary market for mortgage loans have taken a number of affirmative steps to reduce the possibility that they will purchase abusive loans. These steps include a refusal to purchase loans with certain terms, and plans to cease business with lenders whose practices are inconsistent with the GSE's principles against predatory lending. Thus, a bank making or obtaining loans reflecting predatory terms may run the risk of losing an important source of liquidity for its mortgage portfolio or general funding for its operations. Moreover, the bank could be forced to keep in its portfolio loans it had expected to sell, thereby exposing it to greater default risk and risk of loss. Similarly, banks may be required to repurchase predatory loans that they may have sold to third parties, under the terms of the applicable purchase and sale agreement, and may have limited legal or practical ability to require the broker or originator through which it acquired the loan to do the same.

RECOMMENDED PRACTICES

National banks should take affirmative steps to mitigate the risks of acquiring predatory and abusive loans through broker or purchase transactions. A bank's policies and procedures relating to brokered and purchased loans should be adequate to ensure that the loans it obtains comport with the bank's general lending and other policies applicable to loans that the bank makes directly, and with applicable safety and soundness standards and consumer protection laws.

Prior OCC guidance on third-party relationships sets out measures national banks should employ to implement effective risk management processes.[14] In addition to implementing this prior guidance, national banks should take the following specific steps to address the risks of obtaining predatory loans in broker or purchase transactions:

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credit without assessing the borrower's ability to repay the loan — in addition to violating HOEPA in some circumstances — is not helping to meet the credit needs of the community consistent with safe and sound operations, and has acted contrary to the OCC's safety and soundness regulatory guidelines. *See* 12 CFR 30, Appendix A. Such an activity or practice also may adversely affect the OCC's evaluation of the bank's CRA performance. *See* OCC Guidelines to Guard Against Predatory Lending.

[14] *See* OCC Advisory Letter 2000-9 (Third-Party Risk), August 29, 2000 (recommendations for vendor management programs) and OCC Advisory Letter 2001-47 (Third-Party Relationships: Risk Management Principles), November 1, 2001 (recommendations for third-party risk management process, including risk assessment and strategic planning, due diligence in selecting third-party providers, and contracting and oversight issues). *See generally* OCC Advisory Letter 2002-3 (Guidance on Unfair or Deceptive Acts or Practices), March 22, 2002; OCC Bulletin 2001-6 (Expanded Guidance for Subprime Lending Programs), January 31, 2001; OCC Bulletin 99-15 (Subprime Lending: Risks and Rewards), April 5, 1999; OCC Bulletin 99-10 (Interagency Guidance on Subprime Lending), March 3, 1999; and OCC Banking Circular 181 (REV) (Purchases of Loans in Whole or in Part-Participations), August 2, 1984. *See also* United States Department of Housing and Urban Development, *Mortgagee Letter 2002-21 (Due Diligence in Acquiring Loans)*, September 26, 2002.

Establishment of Policies and Procedures

National banks should have clear procedures for entering into and continuing relationships with third-party mortgage loan brokers and originators, and standards that delineate underwriting and appraisal requirements[15] and unacceptable characteristics for brokered and purchased loans.[16] These policies should also delineate, if applicable, the circumstances under which the bank will make through a broker, or acquire in a purchase transaction, loans with features that have been associated with abusive lending practices.[17] As appropriate, bank policies should address specific matters such as:

- Frequent, sequential refinancings;
- Refinancings of special subsidized mortgages that contain terms favorable to the borrower;
- Single-premium credit life insurance or similar products;
- Negative amortization;
- Balloon payments in short-term transactions;
- Prepayment penalties that are not limited to the early years of a loan;
- Financing points, fees, penalties, and other charges;
- Interest rate increases upon default;
- Mandatory arbitration clauses; and
- Acquisition of loans subject to HOEPA.[18]

In addition, policies should address the maximum points and other charges that may be imposed on brokered and purchased loans, as well as the use of overages and yield-spread premiums as compensation vehicles. In the case of brokered loans, these policies should address total compensation to the broker and the lender, and establish limits on broker compensation. The OCC notes that some national lenders have already implemented these types of limits. Banks also should have policies to help ensure that interest rates and other pricing terms for brokered and purchased loans reasonably reflect the costs and risks of making such loans.

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[15] *See generally* 12 CFR 30, Appendix A, and 12 CFR 34, C and D.

[16] Guidelines developed by GSEs active in the secondary market for mortgage loans may provide a useful reference or starting point for national banks in establishing or enhancing their policies and procedures in this area. *See, e.g.,* Freddie Mac, "Protecting Borrowers from Predatory Lending Practices," (1997; revised 2002), available at [http://www.freddiemac.com/corporate/affordhouse/predlend/apl_fact.html]; Fannie Mae, "Fannie Mae Chairman Announces New Loan Guidelines to Combat Predatory Lending Practices," News Release (April 11, 2000), available at [http://www.fanniemae.com/newsreleases/2000/0710.jhtml]. *See generally* Freddie Mac, *Discover Gold Through Quality: Wholesale Originations Best Practices* (June 1999; supplemented April 2000), available at [http://www.freddiemac.com/dgtq]. Banks may wish to familiarize themselves with these guidelines in order to understand clearly the characteristics of loans that are not acceptable to these GSEs. National banks purchasing mortgage-backed securities of issuers other than these GSEs should make reasonable efforts to determine whether such issuers use standards (e.g., like the standards of those GSEs) to prevent the inclusion of loans with predatory characteristics in their mortgage pools. Appropriate due diligence to reduce risks in such "private label" transactions would include both a review of the issuer's efforts to avoid predatory loans and, to the extent such information is available, the general reputation of the issuer and the originator(s) of the loans.

[17] Policies in this area also should ensure adequate documentation of the borrower's ability to service the debt, including verification of income and obligations, consistent with 12 CFR 30, Appendix A, and other applicable law. In addition, as appropriate, policies should address the use of multiple borrowers to satisfy debt-service coverage ratios to protect against reliance on the income of third-party guarantors or other obligors whose relationship to the borrower or to the collateral suggests that they may not, in fact, be relied upon to repay the loan, as structured, if necessary, to prevent default or foreclosure. Finally, policies in this area should also address debt-to-income and loan-to-value ratios to mitigate the risk of lending without regard to ability to repay.

[18] HOEPA imposes specific disclosure requirements and substantive restrictions on closed-end loans secured by a consumer's principal dwelling, other than a reverse mortgage or a loan to finance the acquisition or initial construction of the home, that are high-cost because they exceed specified federal statutory and regulatory interest rate and fee thresholds. *See* 15 USC 1639 and 12 CFR 226.32.

Finally, bank policies and procedures should reflect and support the need for strong and appropriate controls over all mortgage origination functions, including loan sourcing, appraisals and other aspects of loan processing, underwriting determinations, and loan closings. These controls will vary, of course, with the risks presented by different types of transactions. In developing policies and procedures, institutions should carefully consider the strengths, capabilities, and incentives of the third parties with whom they may be doing business. In mortgage broker transactions, for example, banks may well determine that it is appropriate to restrict brokers to loan sourcing functions, and to require and ensure that processing functions, underwriting determinations, and loan closings be conducted independently. Similarly, for loan purchase transactions, bank policies should establish clear standards relating to the degree of the bank's involvement in the underwriting decision, and appropriate controls will vary in accordance with this involvement. If a national bank has not made the initial underwriting decision, it should take the steps necessary and appropriate to determine that such loans have been underwritten consistently with the bank's policies.

Due Diligence

National banks also should perform thorough due diligence, including background checks, before entering into relationships with mortgage brokers or third-party originators. These efforts should include a review of the third party's:

- General competence;
- Business practices and operations, including potential conflicts of interest;
- Reputation;
- Financial capacity and condition;
- Internal controls; and
- Record of compliance with applicable licensing, consumer protection, and other laws.

In addition, these reviews should include an assessment of any litigation, enforcement actions, or pattern of consumer complaints. The due diligence process should also include a risk assessment and plans to address identified risks. Based on this due diligence, national banks should develop approved lists of brokers and originators with whom the bank may transact business.

Broker and Originator Agreements

National banks should have written agreements with third-party brokers and originators that specifically and clearly address the rights and responsibilities of each party. Risks identified in the due diligence process should be addressed in these agreements, and, if such risks cannot be adequately mitigated, the agreement should not be consummated.

In addition, agreements with brokers and originators should specifically address the bank's lending policies with regard to loan features such as those described above, and should contain the third party's express agreement to abide by those policies. Brokers and originators also should specifically agree (1) to comply with all applicable laws, including safety and soundness regulatory standards applicable to national banks and laws prohibiting lending discrimination and unfair or deceptive practices, and (2) to make best efforts to ensure that the loans offered to borrowers are consistent with their needs, objectives, and financial situation. The institution should reserve the right not to make or purchase, and to put back to the broker or originator, any loans failing to comply with these standards.

Agreements also should protect banks against risk by:

- Ensuring that no inappropriate compensation incentives exist to induce brokers or originators to treat borrowers in a discriminatory manner, or otherwise unfairly;
- Providing for indemnification to the bank upon breach of the agreement;
- Enabling banks to exit the arrangement through clear termination rights and procedures; and
- Providing for the bank's (and the OCC's) ability to access all records of the third party necessary to enforce and ensure compliance with the agreement and to audit the third party's operations.

In addition, agreements should stipulate clear minimum performance standards and service levels.

If necessary, existing agreements with brokers and originators should be revised to conform to the above requirements.

Individual Loan Review (Quality Control Review)

National banks should verify that brokers and originators have established policies and procedures sufficient to ensure that loans to be originated or purchased by the bank will comply with applicable laws and the bank's policies. In appropriate circumstances — for example, at the outset of the third-party relationship, or after a particular risk has been identified — banks should conduct an appropriate documentation review to confirm that transactions comply with the bank's policies and legal requirements. As a general matter, banks should also periodically perform such a documentation review on a random sampling of broker and purchase transactions. Where banks do not reunderwrite each loan, this file sampling should be adequate to ensure that loans are being underwritten consistently with the bank's policies.[19] Loan reviews also should be sufficient to protect against potential fraud in these transactions.

In addition, with respect to brokered loans, the bank should have in place a process for review of written agreements between the borrower and the broker to ensure that the agreements conspicuously disclose the fees to be paid to the broker for its services, contain a specific request for such broker services at that fee, and include a signed and dated acknowledgment of receipt by the consumer before the broker commences services. The bank should also retain copies of this documentation.

Monitoring and Management Information Systems

Mortgage lenders need effective management information systems to monitor the performance of brokers and originators from whom they acquire loans. Institutions should be able to carefully monitor, track, and evaluate a third party's compliance with the terms of its contract, including minimum performance standards and service levels. National banks should follow OCC guidance, as applicable, on monitoring the financial condition, operations, and internal controls of third-party brokers and originators with whom they establish relationships.[20] They also should carefully monitor such third parties' record of compliance with applicable laws and bank policies.

[19] *See* OCC Banking Circular 181 (REV) (Purchases of Loans in Whole or in Part-Participations), August 2, 1984, at 4.
[20] *See* OCC Advisory Letter 2001-47 (Third-Party Relationships: Risk Management Principles), November 1, 2001, at 13.

In addition to such general monitoring, national banks should adopt criteria and procedures for additional targeted reviews, as appropriate, of brokers or originators whose loans exhibit unacceptable default, foreclosure, or complaint rates; broker fees that significantly exceed market rates or that do not comply with bank policies; potential violations of law or bank policies; or other risks.[21] Targeted reviews may also be appropriate for brokers or originators whose concentrations suggest that borrowers may have been targeted on the basis of age, race, national origin, or gender. Management information systems must be adequate to identify brokers or originators whose loans show these risk characteristics.

Corrective Action

When brokers or originators are found to have violated bank policies, applicable laws, or the provisions of their agreements, other than on a clearly isolated and inadvertent basis, institutions should take prompt and appropriate corrective action, including modification of loan terms and termination of the relationship with the third party in question.

CONCLUSION

National banks may confront risks when they obtain loans through brokers or through purchase transactions that contain or reflect abusive lending practices. This advisory letter summarizes those risks and conveys the expectation of the OCC that national banks will take affirmative steps to avoid them. Failure to do so could raise serious supervisory concerns, and could result in supervisory or other actions directed against national banks, their operating subsidiaries, and the third-party brokers and originators involved in the transactions.

For further information concerning the matters discussed in this advisory letter, please contact the Community and Consumer Law Division at (202) 874-5750, the Compliance Division at (202) 874-4428, or the appropriate supervisory office.

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[21] Documentation reviews may indicate problems such as: (1) an absence of signatures or dates on documents, or missing documents, or evidence that signatures were made on blank documents or were forged; (2) significant variations between the preliminary disclosures required to be provided to customers under TILA or RESPA and the final charges appearing on closing documents; (3) fees that appear to be duplicative, or otherwise unearned and unwarranted; or (4) materially misleading statements or omissions with respect to the costs, benefits, risks, and burdens of the transaction or some aspect thereof.