U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FEDERAL HOUSING ADMINISTRATION

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FHA Loan Review System Basics
Today's webinar begins
at 2:00 PM (Eastern)
We will be underway shortly

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Q&A Session

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- Online at: www.hud.gov/answers.
- Via email at: answers@hud.gov.
- Via phone at: 1-800-Call-FHA (1-800-225-5342)

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- FHA Lenders page:
  https://www.hud.gov/program_offices/housing/sfh/lender

- FHA FAQ page:
  https://answers.hud.gov/FHA/s/

- Single Family Housing Archived Webinars (On Demand) page:
  https://www.hud.gov/program_offices/housing/sfh/events/sfh_webinars

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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Office of Lender Activities and Program Compliance
FHA Loan Review System Basics
August 23, 2023

Presented by the Quality Assurance Division:
Jack Higgins, Director
Derek Taylor, Management & Program Analyst
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Last Updated: 8/14/2023

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Agenda

Overview

Defect Taxonomy

Using the Loan Review System

Resources

Q&A

Overview

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Overview

- The Loan Review System (LRS) is the electronic platform for most Federal Housing Administration (FHA) Title II Single Family quality assurance review processes:
  - Various post-endorsement loan reviews
  - Lender monitoring reviews
  - Test cases for lenders seeking Unconditional Direct Endorsement (DE) authority
  - Lender self-reporting of fraud/misrepresentation and other material findings

- Does not impact the standard origination process

- Implemented FHA's Defect Taxonomy

Defect Taxonomy

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Defect Taxonomy

- Handbook 4000.1 Appendix 8.0

- The method FHA uses to identify defects at the loan level

- Provides useful feedback through structured categorization of defects

- Balances FHA's risk management and quality assurance business processes

Appendix 8.0 – FHA Defect Taxonomy (09/22/2020)

APPENDIX 8.0 - FHA DEFECT TAXONOMY (09/22/2020)

Effective for Loan Reviews as of 01/01/20

I. **PURPOSE**
The Defect Taxonomy is FHA's method of identifying defects **at the loan level.**

A) The Defect Taxonomy provides:
– useful data and feedback through structured categorization of defects and their sources, causes and severities.
– balance between FHA's risk management and quality assurance business processes.

B) The Defect Taxonomy **does not:**
– Establish a universal statement on all monitoring or enforcement efforts by FHA.
– Address FHA's response to patterns of loan-level defects, regardless of severity.
– Limit FHA's actions with regard to fraud or misrepresentation.
– Establish standards for administrative or civil enforcement action, which are currently set forth in law.
– Preclude FHA from referring any violation of any severity to HUD's Mortgagee Review Board, Departmental Enforcement Center, Office of Fair Housing and Equal Opportunity, or other HUD offices for findings that, in FHA's judgment, warrant such referral.
– Affect or override FHA's normal process for referral of fraud, waste, or abuse to the Office of the Inspector General.

II. **CORE CONCEPTS**

A) **Defect Areas**
Underwriting loan reviews are categorized into nine defect areas that represent fundamental characteristics of a loan's eligibility for FHA insurance. Defect areas are organized following a consistent pattern of sources, causes, severity tier descriptions and potential remedies.
– Applicable HUD policies are provided for reference; they are subject to change and may not be all-inclusive.

B) **Sources and Causes**
Sources and causes describe Findings in greater detail based on HUD policy requirements. An individual Finding is identified in the Loan Review System (LRS) by its specific defect area, source, and cause.

C) **Severity Tiers**
There are four potential severity tiers, one of which is assigned to each Finding based on the size and nature of the deviation from FHA requirements. Severity tiers indicate whether a lender response is required in LRS.
– **Tier 1 and 2** Findings are unacceptable, requiring a lender response.
  • Lenders may rebut any unacceptable Finding by responding in LRS with supporting documentation.
– **Tier 3 and 4** Findings are deficient and do not impact a loan's eligibility for FHA insurance.
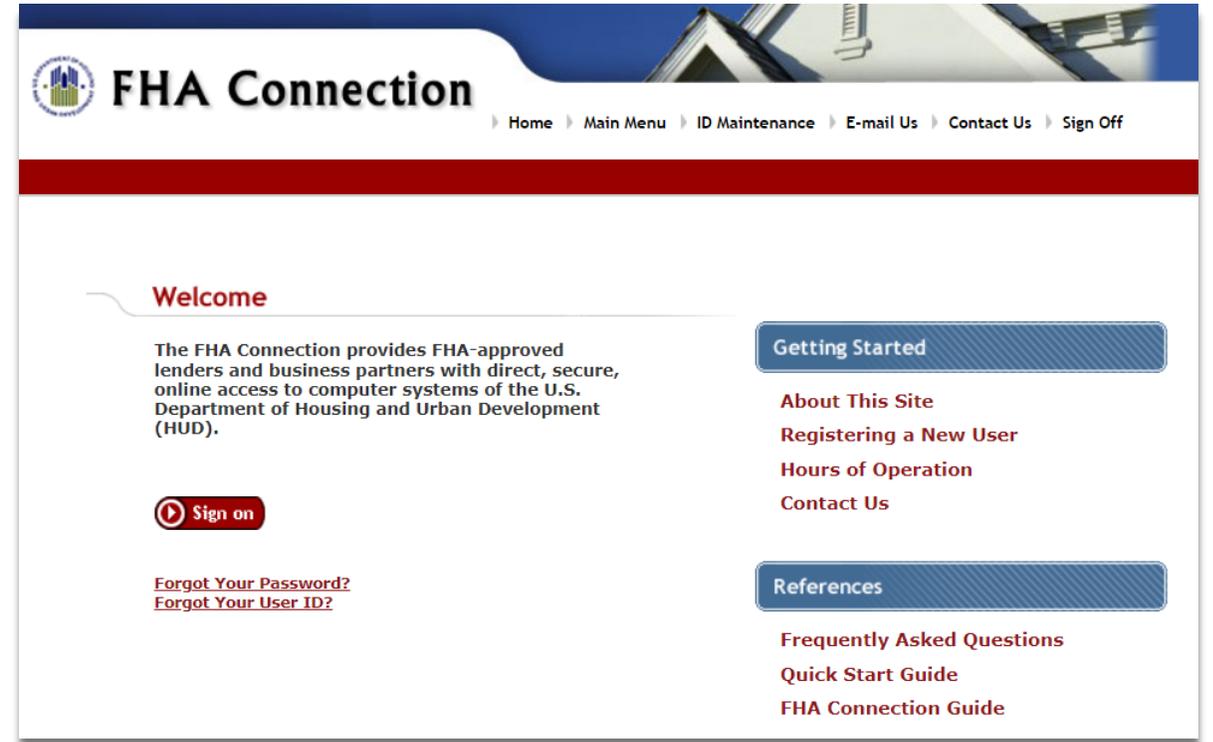 • These Findings do not require a lender response, but optional responses can be submitted in LRS.

Handbook 4000.1
Last Revised: 11/09/2021
1447

Defect Taxonomy (cont.)

- *The Defect Taxonomy does not:*

  – Establish a universal statement on all monitoring or enforcement efforts by FHA

  – Address FHA's response to patterns of loan-level defects

  – Limit FHA's actions with regard to fraud or misrepresentation

  – Establish standards for administrative or civil enforcement action

  – Preclude FHA from referring any violation of any severity to other Housing and Urban Development (HUD) offices

  – Affect or override FHA's normal process for referring cases to the Office of Inspector General

Defect Taxonomy (cont.)

- Underwriting loan reviews are categorized into nine defect areas that represent fundamental characteristics of a loan's eligibility for FHA insurance:
    1. Borrower Income
    2. Borrower Credit
    3. Loan to Value and Maximum Mortgage Amount
    4. Borrower Assets
    5. Property Eligibility
    6. Property Appraisal
    7. Borrower Eligibility
    8. Mortgage Eligibility
    9. Lender Operations

- Defect areas are organized following a consistent pattern of sources, causes, severity tier descriptions and potential remedies.

Defect Taxonomy (cont.)

- Sources and Causes describe findings in greater detail based on HUD policy
  - An individual finding is identified in LRS by a specific Defect Area, Source, and Cause

- One of four potential severity tiers is assigned to each Finding based on the size and nature of the deviation from FHA requirements

- Severity tiers indicate whether a lender response is required in LRS

- Tier 1 and 2 Findings are unacceptable, requiring a lender response
  - Potential remedies include mitigating documentation, financial remediation or indemnification
  - Lenders may also rebut any unacceptable Finding

- Tier 3 and 4 Findings are deficient and do not impact a loan's eligibility for FHA insurance
  - These Findings do not require a lender response, but optional responses can be submitted in LRS

Using the Loan Review System

User Manual

- Available online:
  https://www.hud.gov/sites/dfiles/SFH/documents/LRSUserManual.pdf

- Troubleshooting access errors

- Step-by-step instructions

- Helpful hints

Loan Review System – Lender User Manual

**Federal Housing Administration
Loan Review System (LRS)**

Lender User Manual
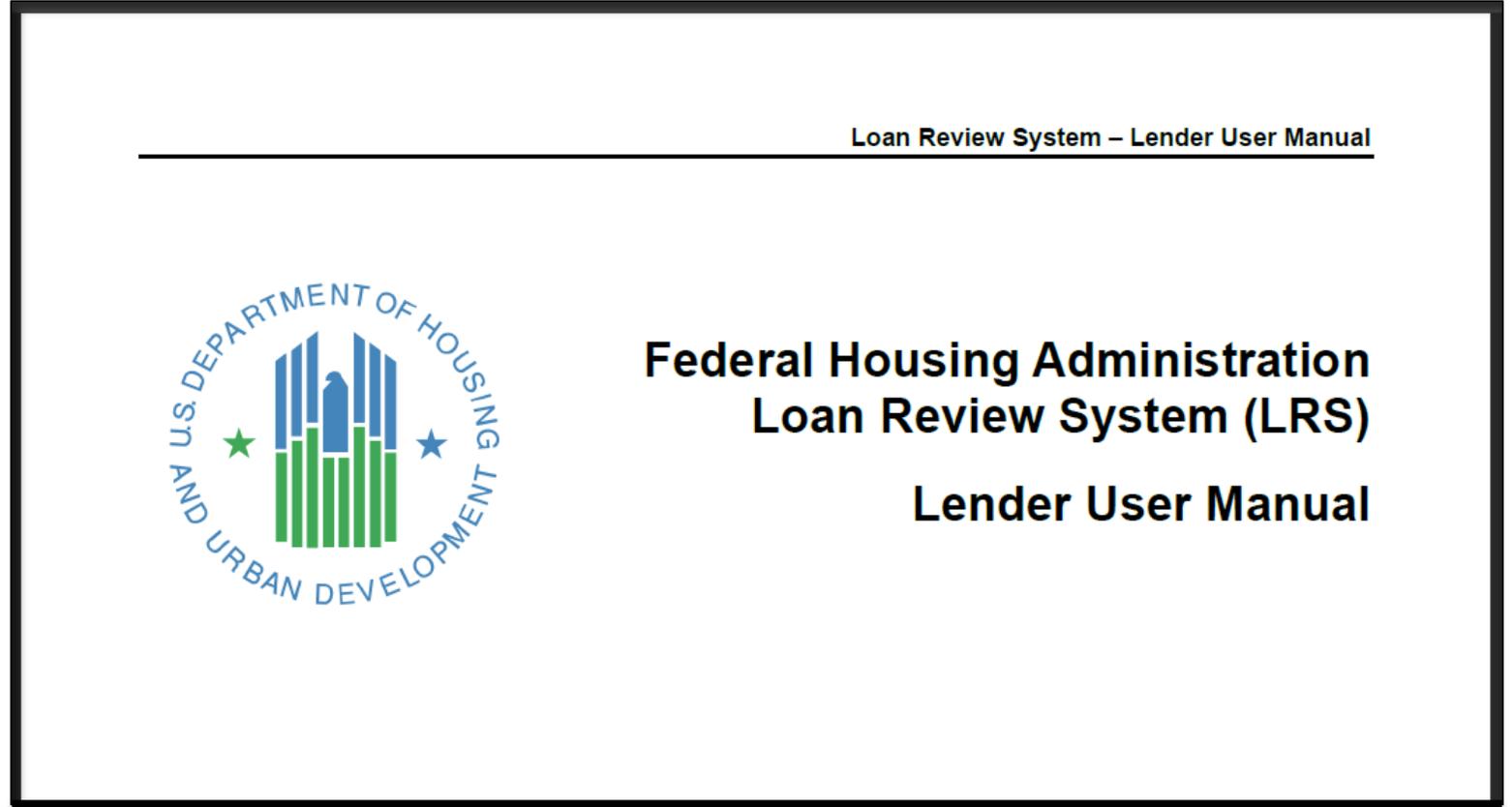
Access

- FHA Connection (FHAC) single sign-on at:
  https://entp.hud.gov/clas/index.cfm

- Lender's Application Coordinator grants access
  - User Registration process for new users
  - User Administration process for existing users

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Access (cont.)

- Three possible user roles for lenders
  - Read Only
  - Response Submission
  - Indemnification Submission

Access (cont.)

Access (cont.)

Access (cont.)

- LRS Active Reviews Screen

Binder Request and Delivery

- Lenders with Lender Insurance authority (LI)
  - LI Contact receives FHAC email notification
  - FHAC Binder Selection screen displays all outstanding binder requests
  - LRS Binder Request function shows subset of cases requested for LRS review

- Lenders without Lender Insurance authority (Non-LI)
  - No action necessary – FHA already has endorsement binder submitted in FHA Catalyst
  - LRS selection indicator displayed on Insurance Application screen in FHAC
  - LRS shows each case on the Active Reviews screen when the review starts

Binder Request and Delivery (cont.)

- FHA Catalyst: Case Binder Module
  - Non-LI lenders and LI lenders designated for "paper" binder submission must use FHA Catalyst
  - Includes Conditional Direct Endorsement (DE) Test Case submission for review in LRS
  - LI lenders approved for electronic Case Binder submission must continue to submit through FHAC

- Servicing Reviews
  - Required documents and delivery method may vary depending on selection reason
  - All servicing file requests displayed on LRS Binder Requests screen
  - FHA communicates additional details as needed

Review Levels

Review Level	Under Review by FHA	Response Request
Initial	FHA's initial review	Lender's first opportunity to resolve
Mitigation 1	Review of lender's initial response	Lender's second opportunity to resolve
Mitigation 2	Review of lender's Mitigation 1 response	N/A
Escalation 1	Confirmation of Mitigation 2 decision	Lender's third opportunity to resolve
Escalation 2	Review of lender's Escalation 1 response	N/A
HQ Escalation 1	Confirmation of Escalation 2 decision	Lender's fourth (final) opportunity to resolve
HQ Escalation 2	Review of lender's HQ Escalation 1 response	N/A

Response Timeframes

Review Level	Standard	Lender Monitoring	Test Case	Review Location QC
Initial	15	30	7	-
Mitigation 1	10	10	5	15
Escalation 1	10	10	5	15
HQ Escalation 1	10	10	5	10

Responding to Findings

- Select a case number from the Response Request section of the Active Reviews screen
  - Findings Overview screen opens with the Review Data tab selected on the left sidebar

Responding to Findings (cont.)

- Click the Findings tab or the Address Findings button to begin responding

Responding to Findings (cont.)

- Enter a response in the text box or click the Choose File button to upload a response document

Responding to Findings (cont.)

- Click the Complete Wrap-Up button and confirm that you want to submit responses
  - Double-check the Active Reviews screen to make sure the response was submitted

Self-Reporting to FHA

- All Lenders must self-report in accordance with Handbook 4000.1
  - See section V.A.2.d.iv. for specific guidelines

What to report	When to report it
All Findings of fraud and material misrepresentation	Immediately
Any Material Findings that you are unable to mitigate	No later than 90 Days after the completion of the initial Findings report

Self-Reporting to FHA (cont.)

- Before reporting, ask these questions:
  - Is it fraud?
  - Is the finding material?
  - Was it mitigated within the required timeframe?

- Document your decisions

- When reporting, be prepared for indemnification or other remedy

Self-Reporting to FHA (cont.)
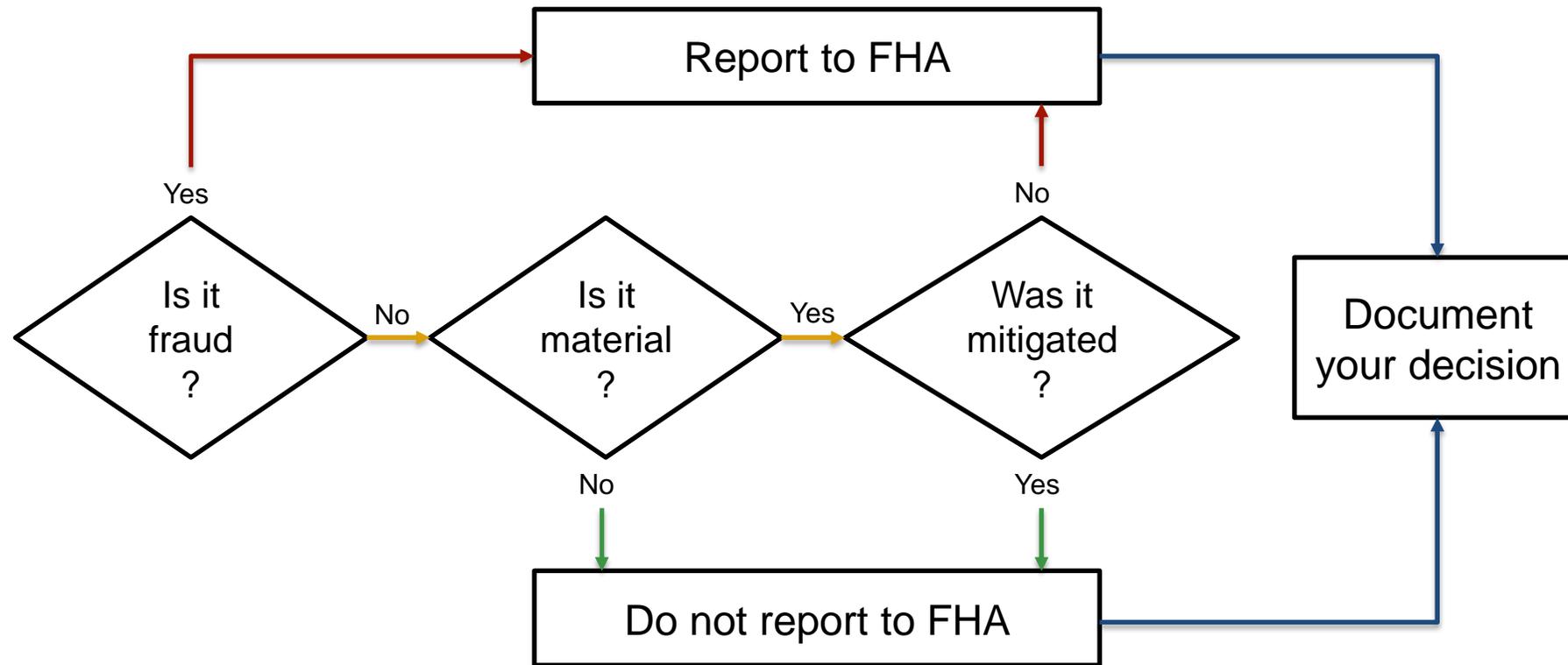
Self-Reporting to FHA (cont.)

- Fraud and material misrepresentation categories:
  - Tier 1: Lender/servicer knew or should have known
  - Tier 4: Lender/servicer did not know and could not have known

- FHA determines if the lender knew or should have known based on whether:
  - An employee of the lender was involved and/or
  - Red flags in the loan file should have been questioned by the lender

- Both categories are referred to HUD's Office of the Inspector General (OIG)

Self-Reporting to FHA (cont.)

- Choose the appropriate Review Type:
  - Use Underwriting for issues that occurred at loan origination
  - Use Servicing for issues related to servicing or loss mitigation

Self-Reporting to FHA (cont.)

- Submit cases in bulk if reporting them for the same issue
  - FHA will request case-specific details if necessary

Self-Reporting to FHA (cont.)

- *Case Not Found* error message means the case number is invalid or not endorsed
  - Reporting to FHA is not required

- *Under Review* or *Pending Review* means there is an active review in LRS
  - Submit the case number and findings to the FHA Resource Center
  - Periodically re-check and attempt to submit the self-report in LRS
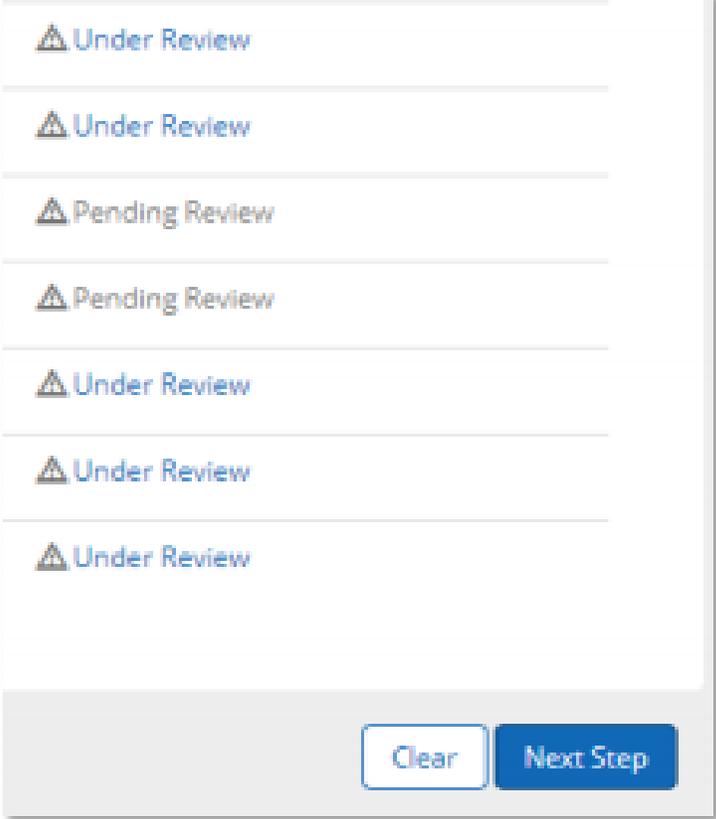
Self-Reporting to FHA (cont.)

- Enter details and submit

Self-Reporting to FHA (cont.)

- LRS automatically directs the review to the DE underwriting lender or current servicer of record
- FHA may take any of the following actions:
  - Close the review based on information provided
  - Initiate a binder request for underwriting reviews or reach out directly for servicing documentation
  - Refer the issue to HUD's Office of Inspector General
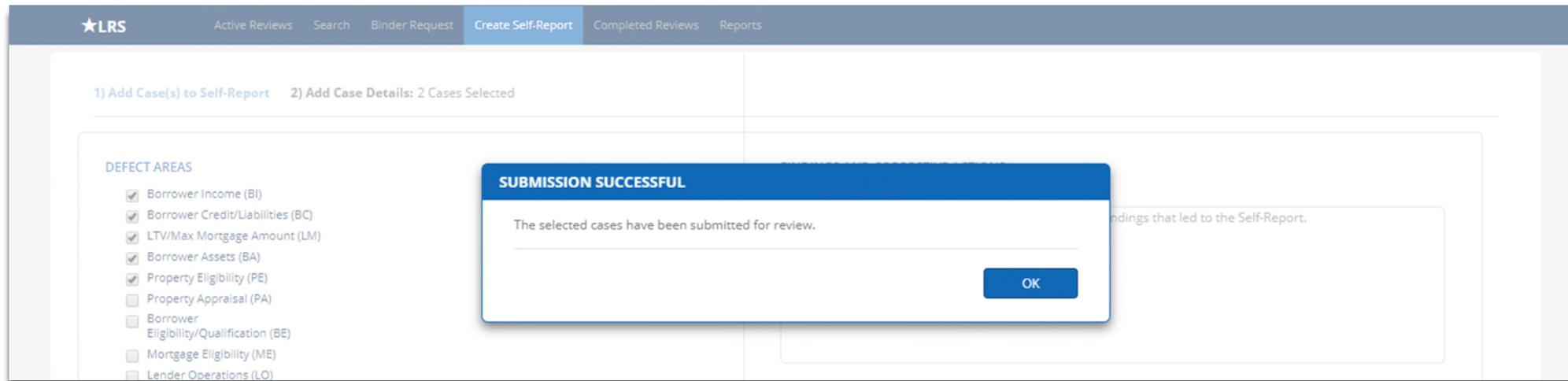
Indemnification

- Lenders must respond to Tier 1 and 2 findings in LRS with mitigating documentation, financial remediation or other remedy

- When alternative remedies have been exhausted, lenders may resolve unacceptable findings with either a 5-year or Life-of-Loan indemnification agreement

- Indemnifications must be submitted electronically in LRS unless FHA requests otherwise

- Handbook 4000.1 requires all lenders to grant the LRS Indemnification Submission role to individuals authorized to sign indemnification agreements

Indemnification (cont.)

Indemnification Type	Description
5-Year	Most common type of indemnification Applies to most underwriting defects for forward loans Reflects a 5-year sunset provision for performing loans
Life-of-Loan	Used for: • Fraud/misrepresentation about which the lender knew or should have known • Underwriting violations related to the property, maximum insurable mortgage amount, and certain other eligibility and statutory requirements • HECM violations • Servicing violations

Indemnification (cont.)

- Indemnified loans remain insured

- FHA requirements for servicing and payment of mortgage insurance premiums remain in force

- The lender that signed the indemnification must adhere to its terms, but other eligible parties may still submit claims

- When lenders merge, the surviving institution inherits indemnification liability

- HUD's Financial Operations Center (FOC) will bill the responsible party for any amount due

Indemnification (cont.)

- Submitting an indemnification in LRS

LRS Reports

- Lenders can access reports to review their own LRS results, including:
  - Quarterly Loan Review Summary
  - Top Findings
  - Self-Reports
  - Indemnifications
  - Downloadable Data

- All reports and data are automatically filtered to the Lender ID associated with the current user

- Only some MicroStrategy functions are available through LRS, but lenders can use downloadable data to build their own reports

- Compare to the national Quarterly Loan Review Summary:
https://www.hud.gov/sites/dfiles/SFH/documents/sfh_qtrlyLoanRevSummary.pdf

LRS Reports (cont.)

Quarterly Loan Review Summary

Completed Quarter(s): 2021 Q2, 2021 Q3, 2021 Q4, 2022 Q1, 2022 Q2, 2022 Q3, 2022 Q4, 2023 Q1
Location(s): All
Sample: Total

Material Defects

Qtr	# of Loans	Gross #	Gross %	Net #	Net%
2021 Q2	5,835	3,853	66.0%	540	9.3%
2021 Q3	5,513	3,501	63.5%	494	9.0%
2021 Q4	5,430	3,381	62.3%	382	7.0%
2022 Q1	5,846	3,559	60.9%	455	7.8%
2022 Q2	4,382	2,560	58.4%	243	5.5%
2022 Q3	7,795	4,809	61.7%	688	8.8%
2022 Q4	6,319	4,199	66.5%	513	8.1%
2023 Q1	8,095	5,224	64.5%	773	9.5%
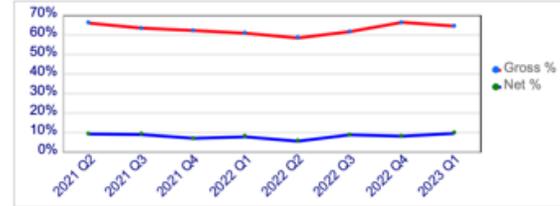
Review Ratings #

Quarter	Conforming	Deficient	Mitigated	Remediated	Indem	Other
2021 Q2	1,322	660	3,313	20	479	41
2021 Q3	1,317	695	3,007	23	442	29
2021 Q4	1,400	649	2,999	31	323	28
2022 Q1	1,550	737	3,104	24	387	44
2022 Q2	1,322	500	2,317	13	208	22
2022 Q3	2,066	920	4,121	18	643	27
2022 Q4	1,344	776	3,686	12	481	20
2023 Q1	1,846	1,025	4,451	25	732	16
Total	12,167	5,962	26,998	166	3,695	227

Review Ratings %

Quarter	Conforming	Deficient	Mitigated	Remediated	Indem	Other
2021 Q2	22.7%	11.3%	56.8%	0.3%	8.2%	0.7%
2021 Q3	23.9%	12.6%	54.5%	0.4%	8.0%	0.5%
2021 Q4	25.8%	12.0%	55.2%	0.6%	5.9%	0.5%
2022 Q1	26.5%	12.6%	53.1%	0.4%	6.6%	0.8%
2022 Q2	30.2%	11.4%	52.9%	0.3%	4.7%	0.5%
2022 Q3	26.5%	11.8%	52.9%	0.2%	8.2%	0.3%
2022 Q4	21.3%	12.3%	58.3%	0.2%	7.6%	0.3%
2023 Q1	22.8%	12.7%	55.0%	0.3%	9.0%	0.2%
Total	24.7%	12.1%	54.9%	0.3%	7.5%	0.5%
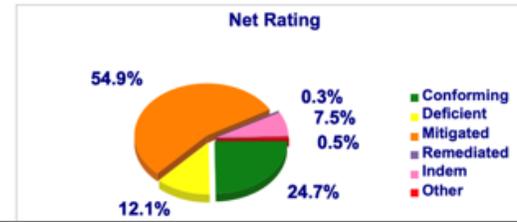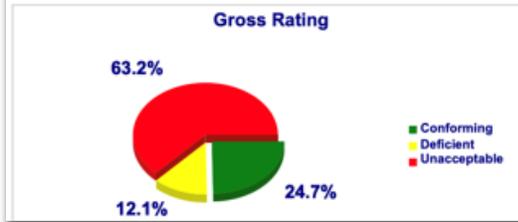
LRS Reports (cont.)

- Step-by-step instructions are included in the LRS User Manual
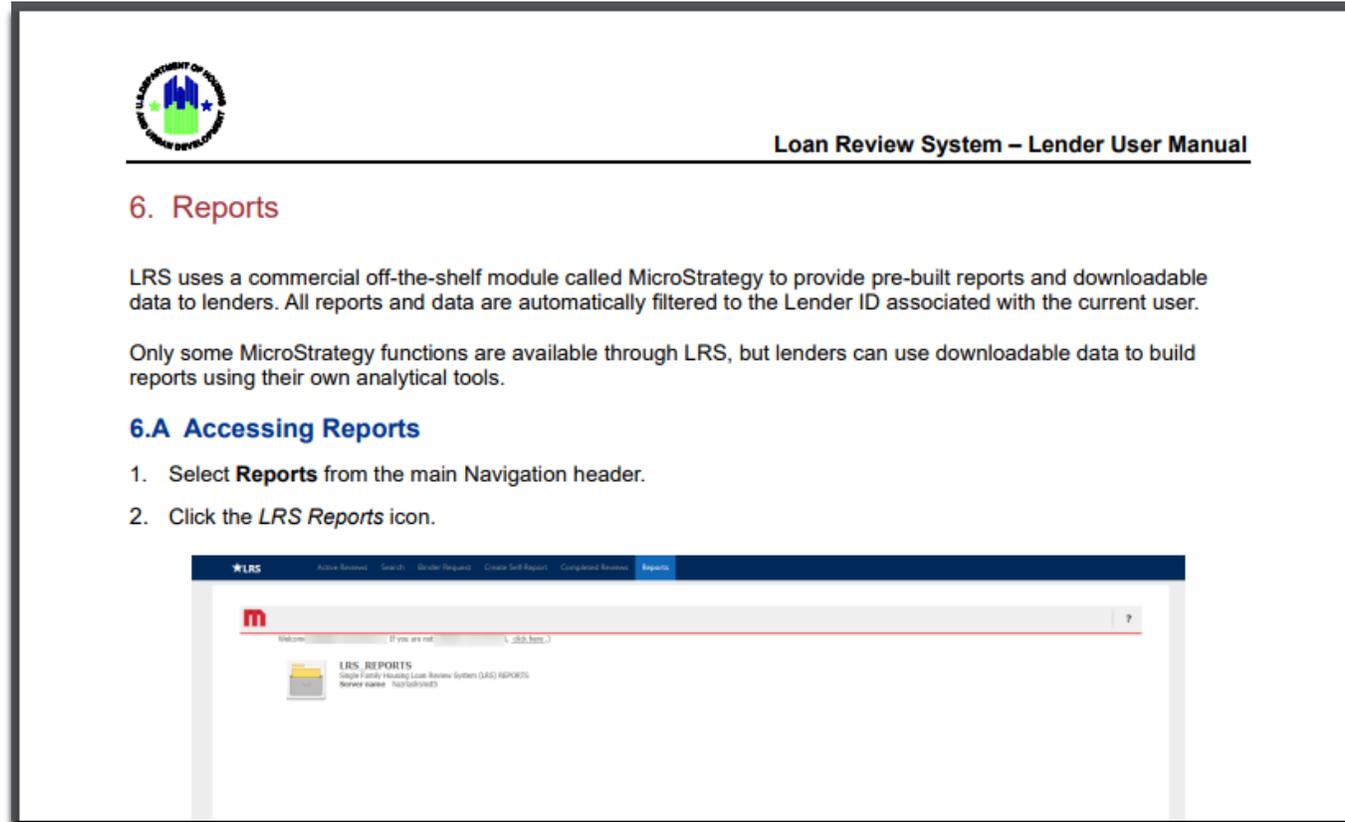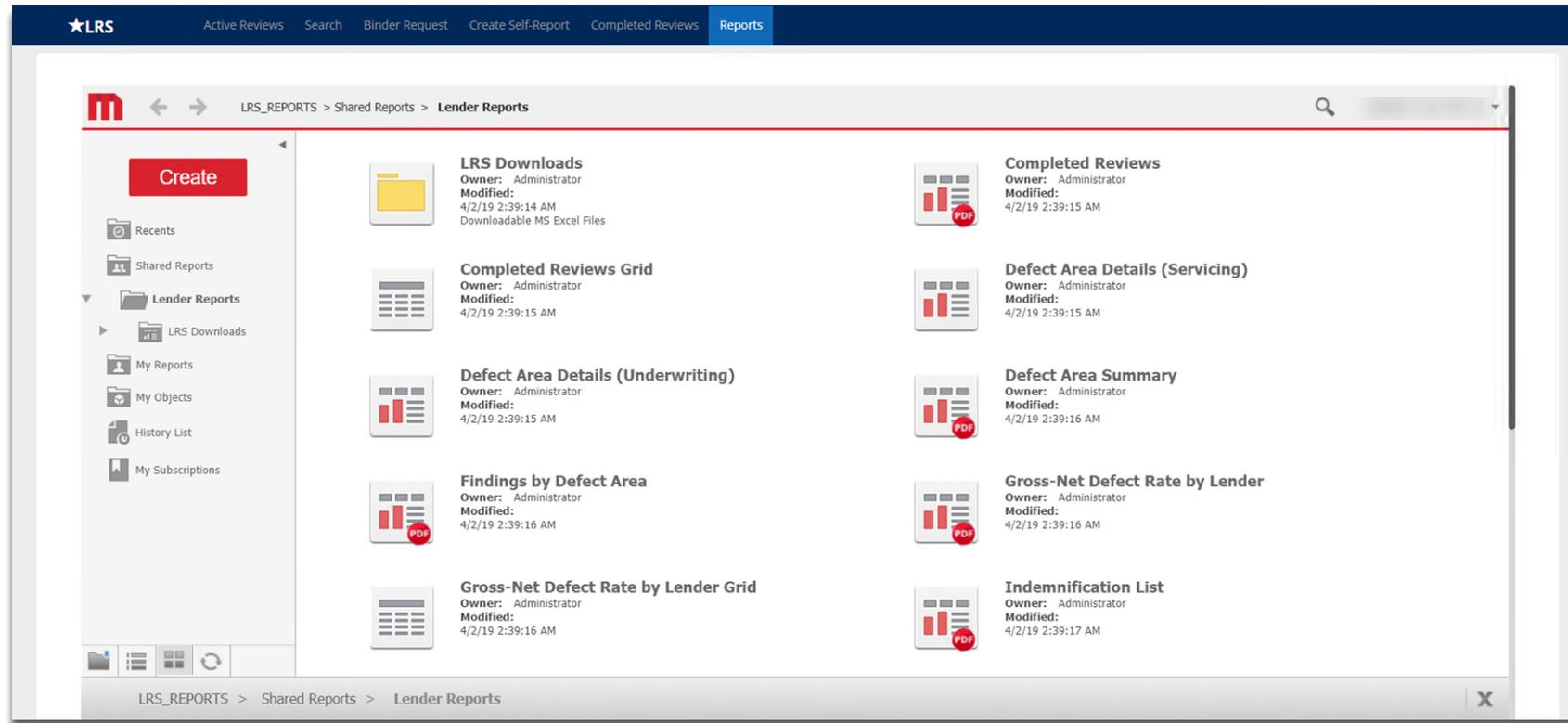
LRS Reports (cont.)

- LRS uses a module called MicroStrategy to provide pre-built reports and data
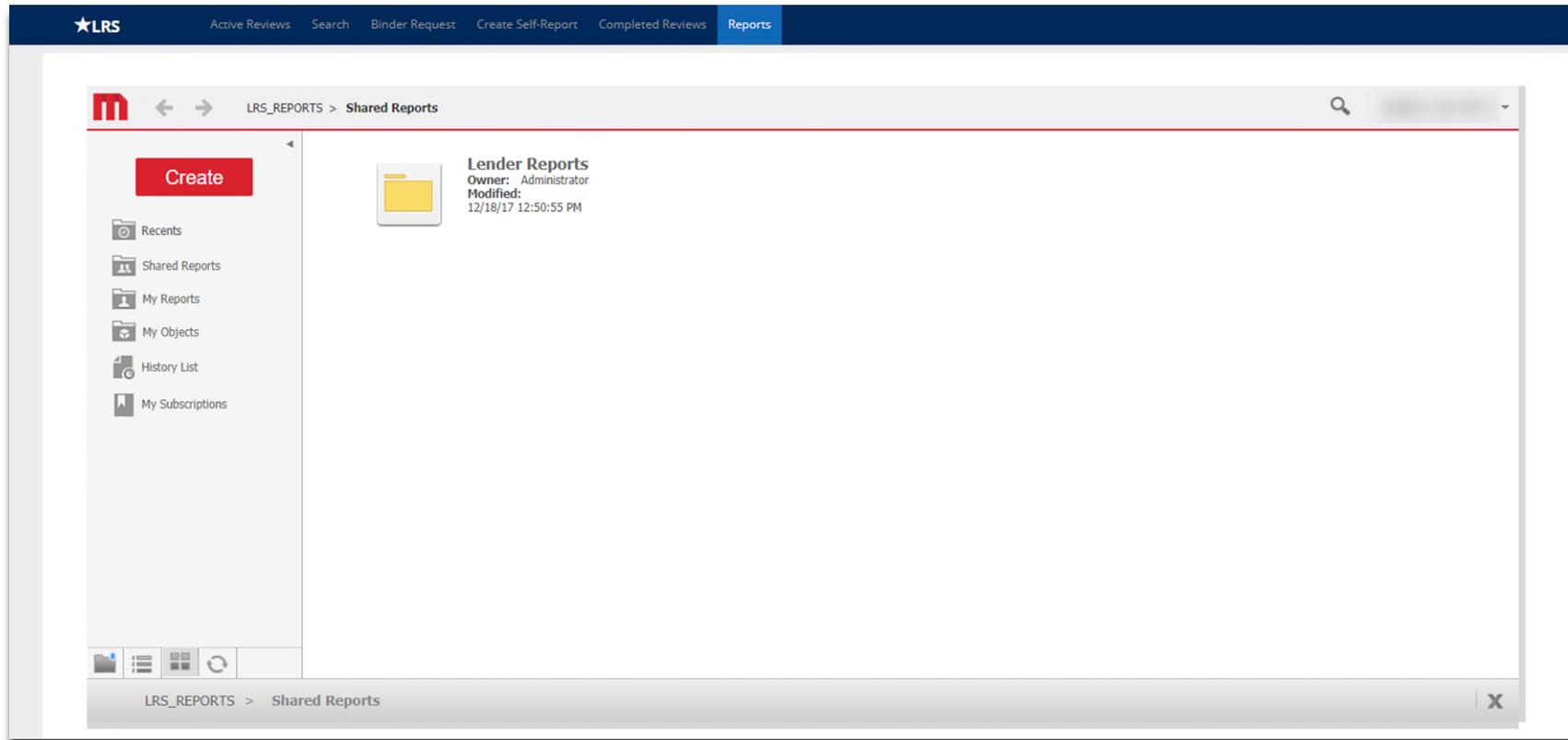
LRS Reports (cont.)

- Canned reports
  1. Click on any icon in the Lender Reports folder

LRS Reports (cont.)

- Canned reports
  2. Choose the preferred start/end dates and any other options from the filter screen
  3. Click the Export button to run the report

LRS Reports (cont.)

- Indemnification List
  - Click the INDEM LETTER hyperlink to view/download the executed Indemnification Agreement

Indemnification List
Agreement Date between 05/14/2017 and 08/14/2017

Case Number	LRS Review ID	Endorsement Date	Agreement Date	Agreement Number	Term	Expiration Date	Document Link
					Life of Loan	04/10/2047	INDEM LETTER
					Life of Loan	12/29/2046	INDEM LETTER
					Life of Loan	12/29/2046	INDEM LETTER
					Life of Loan	12/27/2031	INDEM LETTER
					5 Year	06/01/2022	INDEM LETTER
					5 Year	12/27/2021	INDEM LETTER
					Life of Loan	12/30/2046	INDEM LETTER

LRS Reports (cont.)

- Lender Self Report List
  - Lender Self Report List Summary is a PDF with basic information on self-reported cases
  - Choose Lender Self Report List Details for sortable data (Excel format)

LRS Reports (cont.)

- LRS provides three downloadable datasets that lenders can use to create their own reports:
  - *Review-Selection Data* contains fields that apply to each review
  - *Review Level Data* contains fields that apply to each review level
  - *Findings Data* contains fields that apply to each finding logged

- Each dataset begins with a common group of fields, which can be used to link data for more advanced analytics

LRS Reports (cont.)

- Downloadable Data
    1. Click on the *LRS Downloads* folder and choose a dataset
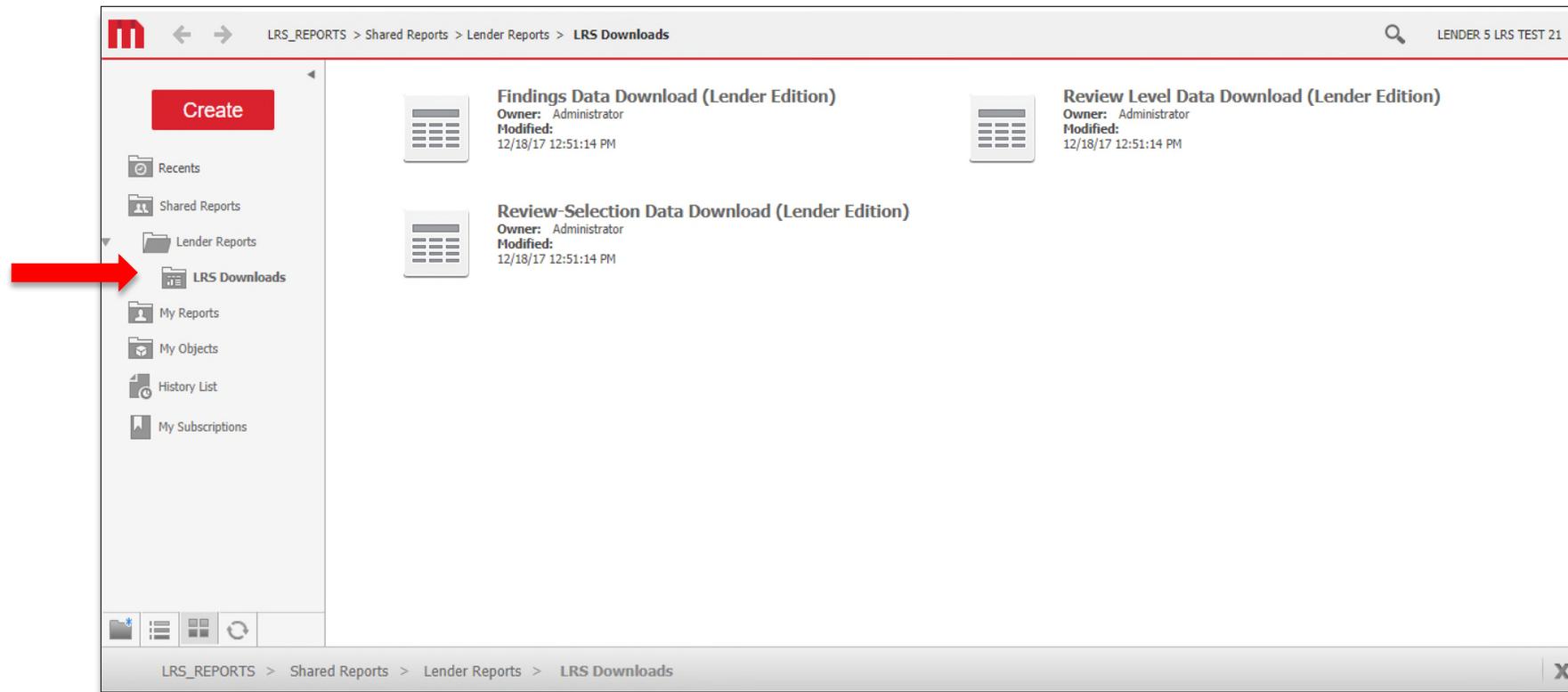
LRS Reports (cont.)

- Downloadable Data
    2. Choose from available filters and click *Run Report*

LRS Reports (cont.)

- Downloadable Data
    3. Click the *Export* button in the header

LRS Reports (cont.)

- Downloadable Data
  4. Choose from available options and click the *Export* button again

LRS Reports (cont.)

- Downloadable Data
    5. Data will be exported with the options applied

Resources

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Resources

- LRS Information Page
  - User Manual
  - Defect Taxonomy
  - Webinars

Resources (cont.)

	Option	Point of Contact	Hours Available	Comments
1	FHA Knowledge Base – FAQs	www.hud.gov/answers	24/7/365	Knowledge Base web page includes option to email questions.
2	Email	answers@hud.gov	24/7/365	
3	Telephone	1-800-CALL-FHA (1-800-225-5342) Persons with hearing or speech impairments may reach this number by calling the Federal Relay Service at 1-800-877-8339.	8:00 AM to 8:00 PM Eastern M-F	Voicemail is available after hours or during extended wait periods.

FHA INFO emails: Frequent email notifications of new policies and training opportunities for anyone who signs up. Subscribe at: https://www.hud.gov/program_offices/housing/sfh/FHA_INFO_subscribe

Helpful Links

- LRS Information Page

  https://www.hud.gov/program_offices/housing/sfh/lender/loan_review_system

- FHA Catalyst: Case Binder Module Page

  https://www.hud.gov/program_offices/housing/FHACatalyst/casebinder

- FHA Single Family Information Page

  https://www.hud.gov/program_offices/housing/sfh

- Single Family Housing Policy Handbook 4000.1

  https://www.hud.gov/program_offices/housing/sfh/handbook_4000-1

- FHA National Servicing Center

  https://www.hud.gov/program_offices/housing/sfh/nsc

- Subscribe to FHA INFO Notices
  https://www.hud.gov/program_offices/housing/sfh/FHA_INFO_subscribe

Q&A

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Q&A Instructions

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• If viewing webinar through computer or smartphone, click *Raise Hand* icon. You will receive onscreen message to unmute yourself - click *Unmute Myself* button. When prompted by moderator, provide your name, company affiliation, then ask your question.	• To ask a question, press *9 to be placed in queue. Webinar moderator will unmute your phone and you will hear an automated voice message stating *You Are Unmuted.* When prompted by moderator, provide your name, company affiliation, then ask your question.

Thank you for joining us today!

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