

This document serves as a standard template for a **Residential Mortgage Credit Policy**. It is designed to balance the bank's risk appetite with regulatory requirements to ensure a sound, compliant, and profitable loan portfolio.

1. Objective and Regulatory Compliance

The primary objective is to establish uniform standards for the origination of high-quality residential mortgages. All loans must comply with:

- **Ability-to-Repay (ATR) Rule:** Federal law requires the bank to make a reasonable, good-faith determination that the borrower can repay the loan.
 - **Qualified Mortgage (QM) Standards:** To gain "Safe Harbor" legal protection, loans should generally avoid risky features (e.g., interest-only periods, negative amortization) and adhere to a **43% DTI cap**.
 - **Fair Lending Laws (ECOA & FHA):** Prohibits discrimination based on race, religion, national origin, sex, marital status, or age.
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2. Core Evaluation Metrics (The Quantitative Pillars)

The bank utilizes four primary metrics to determine the "strength" of a loan application.

A. Credit Score (Character)

The FICO score is the primary indicator of the borrower's willingness to repay.

Tier	FICO Score	Policy Action
Elite	760+	Lowest rates; maximum flexibility on DTI.
Standard	700 - 759	Standard pricing and guidelines.
Lower	620 - 699	Requires manual underwriting and higher reserves.
Ineligible	< 620	Automatic denial (unless specific government

		program).
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B. Debt-to-Income Ratio (Capacity)

This measures the borrower's ability to manage monthly payments.

- **Front-End Ratio:** Proposed Housing Expense / Gross Monthly Income.
- **Back-End Ratio (Total DTI):** Total Monthly Debt / Gross Monthly Income.

Formula:

$$\text{DTI} = \frac{\text{Monthly Debt Payments (Housing + Other)}}{\text{Gross Monthly Income}} \times 100\%$$

- **Target:** $\leq 36\%$
- **QM Limit:** $\leq 43\%$ (Exceptions up to 50% allowed only with significant "Compensating Factors").

C. Loan-to-Value Ratio (Collateral)

LTV protects the bank against market fluctuations.

Formula:

$$\text{LTV} = \frac{\text{Loan Amount}}{\text{Appraised Property Value}} \times 100\%$$

- **LTV $\leq 80\%$:** Standard. No Private Mortgage Insurance (PMI) required.
- **LTV $80.1\% - 97\%$:** Requires PMI and higher credit score.
- **LTV $> 97\%$:** Generally ineligible for portfolio loans.

D. Cash Reserves (Capital)

Borrowers must demonstrate "post-closing liquidity" to handle emergencies.

- **Standard Requirement:** 2 months of PITI (Principal, Interest, Taxes, Insurance) in liquid accounts.
- **High-Risk Loans:** 6–12 months of PITI required.

3. The Underwriting & Decisioning Workflow

The following flowchart outlines how a file moves from application to final decision.

I. Documentation & Verification

- **Income:** 2 years of W-2s and tax returns; 30 days of pay stubs.
- **Assets:** 2 months of consecutive bank statements (all pages).
- **Identity:** Government-issued ID and OFAC clearance.

II. Appraisal Review

A bank-approved, independent appraiser must confirm the property value. The underwriter must review the report for:

- **Net/Gross Adjustments:** Ensure the property isn't being overvalued compared to neighbors.
- **Safety Issues:** Identifying structural issues that threaten the collateral.

III. Final Decision Types

1. **Approved:** Meets all policy guidelines.
2. **Approved with Conditions:** Approved pending specific items (e.g., "provide proof of house sale").
3. **Suspended:** Information is missing or contradictory; cannot proceed to decision.
4. **Denied:** Does not meet minimum FICO, DTI, or LTV requirements.

4. Adverse Action (Denials)

In the event of a denial, the bank must issue an **Adverse Action Notice** within 30 days. This document must explicitly state:

- The specific reason for denial (e.g., "Insufficient Income" or "Delinquent Credit History").
- The name of the credit reporting agency used.
- The borrower's right to a free copy of their credit report within 60 days.

5. Exception Management

No policy can cover every scenario. Exceptions may be granted by the **Chief Credit Officer (CCO)** if "Compensating Factors" exist, such as:

- Extremely high cash reserves (\$>24\$ months).
- A significant down payment (\$>40\%\$).
- Documented potential for substantial future income growth.

Would you like me to create a **Sample Underwriting Checklist** that a loan processor would use to organize these files before the underwriter sees them?