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Handbook: Trust and Asset Management
Subject: Introduction to Document Custody

Section: 140

Document Custody

Summary: This Regulatory Bulletin announces a new Chapter in the Trust and Asset Management Handbook entitled "Specialty Examinations." The Specialty Examination Chapter will contain Section 140, Introduction to Document Custody.

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SUMMARY OF CHANGES

OTS is issuing a new Trust and Asset Management Handbook Section. Section 140, Introduction to Document Custody, provides examiners with a program to examine an institution's administration of document custody services.

BACKGROUND

Document Custody – The need for document custody services arose primarily with the advent of mortgage-backed and asset-backed securities. The volume of documentation generated and the level of oversight necessary to adequately administer, control, and safeguard the interests of both the issuers and purchasers of those securities made the services of qualified, third-party service providers essential. The primary users of document custody services are the three mortgage-backed securities industry leaders – Ginnie Mae, Fannie Mae, and Freddie Mac. Private financial institutions may also sponsor mortgage-backed and asset-backed securities issues representing residential and commercial mortgages, home-equity loans, student loans, automobile loans, credit card receivables, and various types of lease arrangements. Each issuer of securities has certain eligibility and performance requirements for its document custodians.



— Thomas A. Barnes
Deputy Director

Examinations, Supervision, and Consumer Protection

Introduction to Document Custody

This section addresses the administration of document custody services. Policies and procedures should be evaluated in light of the size and character of the document custody business and the mandates of the contracts governing the relationships.

The need for document custody services (not to be confused with traditional escrow services for holding documents) arose primarily with the advent of mortgage-backed and asset-backed securities. The volume of documentation generated and the level of oversight necessary to adequately administer, control, and safeguard the interests of both the issuers and purchasers of those securities made the services of qualified, third-party service providers essential.

The primary users of document custody services are the three mortgage-backed securities industry leaders – Ginnie Mae, Fannie Mae, and Freddie Mac. Private financial institutions may also sponsor mortgage-backed and asset-backed securities issues representing residential and commercial mortgages, home-equity loans, student loans, automobile loans, credit card receivables, and various types of lease arrangements. Each issuer of securities has certain eligibility and performance requirements for its document custodians. Ginnie Mae, Fannie Mae, and Freddie Mac (the Agencies) have complete manuals on their websites that describe the duties, responsibilities, reporting, controls, and oversight required of their document custodians. The requirements and responsibilities established by the Agencies are considered the industry standard or best practices and are posted on the following sites:

LINKS

 Program

- <http://www.ginniemae.gov/guide/pdf/chap13.pdf>
- <https://www.efanniemae.com/is/doccustodians/pdf/dcreqdoc.pdf>
- <http://www.freddiemac.com/cim/handbook.html>

Other securities issuers have requirements included in the contracts and agreements with their document custodians.

Requirements of a document custodian commonly include the following:

- Subject to federal banking regulation and oversight
- Have physically secure, fire resistant storage facilities
- Employ knowledgeable personnel

- Meet certain financial requirements
- Maintain certain insurance coverage requirements
- Have adequate written policies and procedures
- Have an adequate disaster recovery and business continuation plan
- Have and maintain an adequate document tracking and reporting system
- Have adequate quality control, compliance, and audit programs

The role of the savings association as document custodian is basically two-fold: 1) safekeeping the documents delivered for its physical custody (e.g., mortgages, notes, HUD forms) and 2) certifying that those documents support the loans and loan pools that back the mortgage-backed or asset-backed securities being issued. Specific duties and responsibilities are set forth in the custodial agreement or contract between the savings association as document custodian and the issuer of those securities.

To fulfill its safekeeping obligations, the document custodian is generally required to store the documents in a restricted access secure facility that is resistant to fire and other disasters. The contract with the issuer will describe procedures for acceptance, exchange, and release of documents.

The certification process requires the document custodian to certify that the documents in its control accurately represent the loans and loan pools supporting the securities being issued. Certification provides the issuer with assurance that all required documents have been received by the document custodian, have been properly executed, and comply with the issuer's requirements. If defective documents are received or if documents are missing, the document custodian is required to notify the issuer in a timely manner. The issuer is responsible for correcting or resolving any defects. The document custodian is responsible for verifying that all corrections have been made before certifying any loan or pool. Document custodians who fail to comply with the requirements and standards established by the issuer may jeopardize the marketability of securities supported by the loans or loan pools.

Document Custody Program

EXAMINATION OBJECTIVES

To determine the adequacy and effectiveness of the savings association's administration of its document custody services, particularly as they relate to mortgage-backed securities issued by Ginnie Mae, Freddie Mac, and Fannie Mae (the Agencies). Consider whether:

- Effective policies, procedures and internal controls have been established;
- Management and staff are knowledgeable;
- Actions and decisions are documented and supported; and
- Deficiencies are identified and promptly corrected.

EXAMINATION PROCEDURES

LEVEL I

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The typical Level I and Level II procedures have been combined in Level I for this program. Level I procedures first focus on a review of the scoping materials. The next step consists of interviews with personnel to confirm their qualifications and levels of expertise, determine if practices conform to written guidelines, establish whether any significant changes in personnel, operations, or business practices have occurred, and ascertain whether new products or services have been introduced. Level II procedures focus on a further analysis of documents such as policies, reports, agreements, and contracts typically collected during Level I procedures. Neither the Level I nor the Level II procedures should include any significant verification or audit-type procedures.

1. Review examination scoping materials. Scoping material should include:
 - Institution's risk profile
 - PERK documents
 - Previous examination reports
 - Work papers from the previous examination

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2. Review policies, procedures, and internal controls related to the acceptance, administration, and termination of document custody relationships to determine their adequacy given the number and complexity of document custody relationships and the requirements of document custody customers.

3. Review staffing to determine whether it is sufficient and has the appropriate level of expertise to administer the document custody services.

4. Determine whether the document custodian has ever been removed from participation in any issuer's (e.g., Agencies) mortgage-backed securities program, the reasons for removal, and evidence of re-approval.

5. Review Board and committee minutes to determine that document custody decisions and actions are appropriately documented.

6. Determine whether management has appropriately addressed the following:

- Have effective policies, administrative and operational procedures, and internal controls been implemented to address requirements for reviewing, processing, maintaining, tracking, and releasing loans and loan pool documents?
- Have effective audit, compliance, and risk management programs been established?
- Does management have the appropriate level of expertise to oversee the document custody function?
- Are appropriate management reporting systems in place?
- Have adequate disaster recovery, business continuation, and business resumption plans been established and tested?

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- Are computer systems periodically reviewed and tested for proper information security controls (both physical security and logical security)?
-

The completion of the Level I procedures may provide sufficient information to make a determination as to the condition of the document custody function. If you cannot form a conclusion as to the condition of the document custody function from the information obtained through the Level I procedures, proceed to Level II.

LEVEL II

The Level II procedures in this examination program are the typical Level III procedures that include verifications and transaction testing such as those often performed by auditors. It is not the intent nor should it be standard practice to duplicate or substitute for audit activities. These Level II procedures should only be performed for specific purposes in specific situations that require more detailed review to reach supportable conclusions.

7. Select a sample of loan files for review. As appropriate, include coverage of all administrative personnel, all business locations, and a representative number of pools and individual loans. If necessary, select additional files considering:
 - loans or pools involved with pending or threatened litigation;
 - loans or pools for which complaints have been received; and
 - loans or pools reviewed internally which exhibit identifiable concerns.
-
8. Determine the method with which the institution identifies the loan files that are held in custody.
 - Is each file assigned a unique number that identifies the type of loan or loan pool, e.g., single-family, manufactured home, construction loan, home equity conversion, adjustable rate mortgage, Ginnie Mae, Fannie Mae, Freddie Mac, Mortgage Electronic Registration System, etc.?

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- Are pooled loans assigned a single account number for the pool? Does the institution use subaccount numbering?
-
9. Review document custody relationships to determine compliance with the terms of the governing custodial agreements.
-
10. Review document custody relationships to determine that appropriate documentation is maintained addressing:
- Confirmation of loan file documents submitted by issuers/sellers/servicers.
 - Verification of data in the loan documents.
 - Notification of defective (missing, incomplete, or inconsistent) documents to the issuer/seller/servicer in a timely manner.
 - Release of loan documents in response to written requests from issuer/servicer.
-
11. Review document custody relationships to determine that receipt of delayed or missing loan documents is timely and reflected accurately on the recordkeeping system.
-
12. Review closed and/or transferred loan files and loan pools to determine adherence to established termination/transfer policies and procedures.
-
13. If the institution serves as document custodian for the Agencies, has the institution addressed the general requirement that the activities be handled through a trust department:
- That is physically separate and vertically independent from the mortgage origination and loan servicing functions?

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- That has obtained prior approval from its primary regulator to exercise general fiduciary powers that are not limited to maintaining custody of documents for issuers?
 - That is subject to periodic review or inspection by the primary regulator?
-

14. If the institution is a master document custodian, and employs custodial subcontractors, does it have procedures in place to:

- Determine that it meets the requirements to be a master document custodian established by the Agencies/issuers for which it is acting?
 - Determine the qualifications of custodial subcontractors?
 - Adequately oversee the activities of the custodial subcontractors and demonstrate that it maintains the necessary resources to guarantee the operations of any subcontractor?
-

15. Review fee calculation, billing and collection procedures. Review fees that are outstanding and the reasons.

EXAMINER'S SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

(UITRS Rating is not assigned)

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WORK PAPER ATTACHMENTS - 140P

The following comments and questions are offered as a tool and reference for the examiner:

Definition of Document Custodian

A document custodian maintains custody of mortgage notes and other mortgage documents for and on behalf of a trustee, seller/servicer, or investor.

Typically, an institution will serve as a document custodian to a mortgage-backed securities (MBS) industry leader – Ginnie Mae, Fannie Mae, or Freddie Mac (Agencies or Issuers) as well as private sponsors of MBS and asset-backed securities.

To serve as a document custodian, an institution must adhere to certain requirements and responsibilities. The requirements and responsibilities established by the Agencies are considered to be the industry standard or best practices and are posted on the following sites:

- <http://www.ginniemae.gov/guide/guidtoc.asp>
- <https://www.efanniemae.com/is/doccustodians/pdf/dcreqdoc.pdf>
- <http://www.freddiemac.com/cim/handbook.html>

The sites also include sample agreements and forms.

Primary Role of Document Custodian

The document custodian's primary role consists of three functions:

- **Review** all the loan documents submitted by the issuer/seller/servicer for each pool or loan package.

When documents are delivered to the document custodian, they are accompanied by a cover sheet. The document custodian is responsible for verifying that all necessary documents have been received and must verify the note is the original note, is complete, and has the appropriate chain of endorsements and assignments. The Agencies require document custodians to verify specific data within the note and other loan documents.

- **Certify** to the appropriate Agency that the documents submitted by the issuer/seller/servicer accurately represent the pooled mortgages in accordance with the Agency's requirements.

Once the document custodian verifies the accuracy of the data and that the documents comply with the Agency's requirements, the document custodian must certify the loans or loan pool.

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- **Hold** all loan documents in safekeeping for the life of the pool or loan package.

The document custodian must not release custody documents unless it receives a written request by an authorized party as indicated in the custodial service agreement. If documents are transferred to a different document custodian at any time after an MBS pool is issued, the new document custodian must recertify the pool by indicating that it has received all required documents and that any new documents required in connection with the transfer satisfy the Agency's requirements.

The institution acting as document custodian must maintain continuous custody and control of all documents deposited with it on behalf of the Agencies, and shall hold the documents in secure and fireproof facilities, in accordance with customary standards for a document custodian. The customary standards are stated in each Agency's handbook or guide, and are also highlighted in the custodial agreements. The Agency or investor may or may not require segregation of their particular loan files; but the Agencies require fireproof storage that has a minimum of two hours protection and vaults equipped with fire extinguishers.

If the institution serves as document custodian for private investors, there may be additional requirements established by each private investor. The institution should have adequate compliance controls (sometimes called Quality Control or QC program) that would facilitate the performance of its document custody services on behalf of Agencies and private investors.

Examples of Document Custodian Weaknesses

- Improper certification or recertification – e.g., certifying a mortgage that has data or document discrepancies, which have not been corrected.
- Inadequate tracking and reporting system – e.g., inability to track loan numbers and servicer numbers, inability to monitor the receipt of notes and related documentation, inaccurately accounting for documents transferred or released.
- Improper physical safekeeping of documents – e.g., loan documents are not maintained in a secured facility and/or the facility is not properly fireproofed (less than two hours).
- Inadequate insurance coverage – e.g., lack of sufficient coverage through a financial institution bond, equivalent policy, and errors and omissions insurance policy.
- Releasing loan documents without proper written request from the appropriate party.
- Inadequate disaster recovery plan.
- Inadequate written policies and procedures.
- Noncompliance with Agency and/or investors requirements for document custodians.

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Risks in Document Custodian Activities

- Compliance Risk – noncompliance with custodial agreements and Agency requirements.
- Operational Risk – inadequate systems to track and account for loans that are placed with document custodian for safekeeping; inadequate technology; inadequate disaster recovery plan.
- Reputation Risk – extreme noncompliance with Agency requirements may result in the revocation of an institution’s ability to serve as document custodian for Agency issues.

Optional Topic Questions

Preacceptance Review

<ul style="list-style-type: none"> • Do policies and procedures identify requirements for the preacceptance review for new document custody relationships?
<ul style="list-style-type: none"> • Does the preacceptance review consider provisions of the governing instrument (document custodial agreement) relative to legal sufficiency, administrative complexity, and any unusual duties imposed?
<ul style="list-style-type: none"> • Does the review identify any real or potential conflicts? • To avoid the appearance of a conflict of interest, institutions that serve as document custodian for loans that it or an affiliate originated must ensure that the document custody function is separate from mortgage origination, selling, or servicing. The Agencies have guidelines related to self-custodians (refer to the links in the “Role of Document Custodian” segment).
<ul style="list-style-type: none"> • Is the potential profitability of the account considered?

Account Approval - Approval of New Document Custody Relationships

<ul style="list-style-type: none"> • If the board of directors does not approve all new business, has there been proper delegation of acceptance authority to a committee or individual officers, with guidelines established for decision-making?
<ul style="list-style-type: none"> • Is there documentation of approvals in appropriate minutes, reports or files?
<ul style="list-style-type: none"> • Has the institution documented its decision-making process for accepting document custody relationships, including an assessment of risk?

Account Administration - Administration of Document Custody Relationships

<ul style="list-style-type: none"> • Does the institution use checklists or other methods to ensure receipt of all necessary documents for each loan?
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| <ul style="list-style-type: none"> • How does the institution verify the note and related documents as well as other documentation and information delivered to it for safekeeping for each loan? |
| <ul style="list-style-type: none"> • Are tickler files maintained to ensure that all document discrepancies are resolved and do they address time periods for completion and names of responsible persons? |
| <ul style="list-style-type: none"> • Has the institution developed adequate controls and does it maintain a document tracking and reporting system to monitor notes and assignments, track note releases and returns, and identify physical location of notes? |
| <ul style="list-style-type: none"> • Are periodic audits or independent reviews of document custody services performed and documented? |
| <ul style="list-style-type: none"> • Does the document custodian maintain written directions or authorizations received from the appropriate parties (Agencies, sellers, servicers, and investors)? |
| <ul style="list-style-type: none"> • Are timely filings of accountings, certifications, and regulatory reports made to appropriate parties? |
| <ul style="list-style-type: none"> • Are terminated document custody relationships and distributed documents removed from the recordkeeping system on a timely basis? |

Successor Appointments

- | |
|---|
| <ul style="list-style-type: none"> • Does the institution verify that all loan documents have been delivered from a predecessor custodian? |
| <ul style="list-style-type: none"> • Is a certification or recertification submitted timely to the issuer? |

Closed Accounts

- | |
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| <ul style="list-style-type: none"> • Do procedures require the timely distribution of loan and loan pool documents upon receipt of written instructions from the issuer/agency? |
| <ul style="list-style-type: none"> • Are receipts maintained for the delivery of loan and pool documents? |
| <ul style="list-style-type: none"> • Are document custody relationship closing reviews and termination approvals recorded in appropriate committee minutes? |
| <ul style="list-style-type: none"> • Are closed document custody relationships promptly removed from the recordkeeping system? |

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