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CHAPTER 3. GENERAL LOAN SERVICING

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3.01 INTRODUCTION

 a. Servicers are responsible for reporting loan events electronically on all current loans to VA throughout the life of the loan in accordance with 38 CFR 36.4317. Late reporting is a regulatory infraction that may affect a servicer’s tier ranking. Occasionally, servicers may need to report information through email, telephone, fax, or letter. Information may also be received directly from borrower(s) contacting VA regarding their loan such as escrow inquiries, payment disputes, etc.

 b. Servicers must service VA loans within the requirements of VA regulations. Each servicer determines the best approach to fit individual borrower circumstances and is required to comply with all applicable local, state, and Federal laws, such as the Real Estate Settlement Procedures Act (RESPA), and regulations governing the VA Home Loan program.

3.02 REQUIREMENTS FOR A SERVICING ORGANIZATION

 a. VA expects servicing organizations to operate in a manner consistent with industry standards and in compliance with VA requirements and RESPA. Specifically, servicers must comply with:

 1. Servicing operations requirements (38 CFR 36.4350(b)). All borrowers must be informed of the procedures and systems available for obtaining answers to inquiries and reminded of these systems at least annually. Servicers must also provide toll-free or collect calling services at an office capable of responding to requests for information.

 2. Quality control procedures (38 CFR 36.4350(i)). VA requires servicers to have internal controls in place that periodically assess the quality of servicing of VA loans and assure VA servicing standards are met. Servicers must conduct an internal assessment of their servicing activity at least annually. This includes:

 (a) Collecting and maintaining appropriate data on delinquency rates, loss mitigation options,

and foreclosure rates to enable servicers to evaluate the effectiveness of collection efforts.

 (b) Determining how VA delinquency and foreclosure rates compare with individual

servicer’s loan portfolios and with rates in reports published by the industry, investors, and others.

 (c) Analyzing significant variances between the servicer’s foreclosure and delinquency rates

and those found in reports and publications, and taking appropriate corrective action.

 (d) Adhering to requirements for responding to written borrower inquiries to include current

RESPA guidelines.

 3. Electronic reporting requirements (38 CFR 36.4319). Holders of VA-guaranteed loans must report certain events to VA according to VA-specified timeframes. This applies to all VA-guaranteed loans that are of type 2 or 6, except for loans where the mortgage purpose type is for a manufactured (mobile) home not affixed to a permanent foundation. Events must be reported electronically or, for events that are not reported electronically, by telephone, e-mail, fax, or letter so that VA loan technicians can enter the information into the VA Loan Electronic Reporting Interface (VALERI).

 (a) Electronic reporting requirements do not apply to loans where the mortgage purpose

type is for a manufactured (mobile) home not affixed to a permanent foundation, or loans VA sold to private lenders under 38 CFR 36.4600. The reporting requirements of the 38 CFR 36.4200 series and 38 CFR 36.4600, respectively, still apply to these loans.

 b. VA recognizes that the holder of the VA loan as defined in 38 CFR 36.4301 is ultimately responsible for compliance with VA regulations, however, for performance measurement purposes, VA will monitor servicer compliance with these reporting requirements. A servicer is defined as the servicing agent of a holder or the holder itself if the holder is performing all servicing functions on a loan. [Refer to the document titled VA 4600 Repurchase and Mobile Home Loan Information at: <http://www.benefits.va.gov/HOMELOANS/servicers_valeri.asp>.

3.03 SERVICER PERFORMS GENERAL LOAN SERVICING ACTIVITIES

 a. Servicers are required to comply with general loan servicing requirements for VA-guaranteed loans and must follow the appropriate procedures for:

 1. Maintenance of records (38 CFR 36.4333). Servicers must maintain a record of loan

payments received, disbursements made, and dates of all transactions for each account until VA ceases to be liable as a guarantor on the loan or, if VA paid a claim on the guaranty, until 3 years after VA paid the claim. If servicers are unable to support a claim with complete accounting records, VA assumes that all payments were received and applied as scheduled during the period for which no records were provided. Servicers must also maintain records supporting a decision to approve any loss mitigation options for a minimum of three years following receipt of any incentive payment for the option. These records shall include, but not be limited to, credit reports, verifications of income, employment, assets, liabilities, and other factors affecting the obligor’s credit worthiness, worksheets, and other documents supporting your decision.

 2. Income tax statements (38 CFR 36.4350(2)(c)). VA requires servicers to be fully

compliant with RESPA when providing statements for income tax purposes to borrowers. Servicers are required to provide the borrower with a statement of the interest paid and the taxes disbursed from the escrow account during the preceding year within 30 days after the end of each calendar year. At the borrower’s request, servicers must furnish a statement of the escrow account that enables the borrower to reconcile the account.

 3. Advances (38 CFR 36.4314). Where legally permitted to do so, servicers may advance

any amount reasonably necessary and proper for:

 (a) Maintenance or repair of the security.

 (b) Payment of accrued taxes, special assessments, and ground or water rents.

 (c) Premiums on fire, flood, or other casualty insurance against loss or damage to the property.

 (d) Funding fee of one-half of one percent for a transfer of ownership if it is not paid at the

time of transfer and the loan originated on or after March 1, 1988.

 (e) A servicer may not include advances for payment of condominium or planned unit development homeowners’ association assessments in the accounting between a holder and VA unless these fees are a lienable item that survives a foreclosure under state law.

 4. Prepayments (38 CFR 36.4311). The borrower has the right to repay at any time, without a

premium or fee:

 (a) The entire indebtedness.

 (b) Any amount not less than the next monthly principal installment or $100, whichever is

less.

 (c) Any prepayment less than payment in full, which is made on a day other than an installment due date, need not be credited until the following installment due date, or 30 days after the prepayment, whichever is earlier. For example, if a $150 prepayment is received on March 21, and the monthly installment due date is March 30, the payment should be credited on March 30. This is because March 30 is fewer than 30 days after the prepayment was received.

 (d) The following requirements also apply to prepayments:

 (1) Servicers may accept prepayment amounts which are smaller than the minimum required

by regulation.

 (2) Payment in full must be accepted and credited to the loan account when tendered, and no

interest may be charged thereafter.

 (3) The servicer and the borrower may agree at any time to re-apply prepayments to cure or

prevent a default.

 5. Late Charges (38 CFR 36. 4312). VA allows servicers to assess late charges and certain

other fees in accordance with VA guidelines. VA encourages consideration of waiving fees and charges when it will help a borrower prevent or resolve a delinquency. Late charges may be collected on any installment received more than 15 days after its due date, provided the loan instruments contain a provision for a late charge. In addition, the late installment must be paid before the late charge is collected. The late charge may not be:

 (a) More than four percent of any installment (installment = principal + interest + taxes +

insurance).

 (b) Based on an amount greater than the past due installment.

 (c) Collected from the escrow account or from an escrow surplus without prior approval of the

borrower, in accordance with RESPA.

 (d) Deducted from regular payments.

 (e) A late charge discourages late payments only when the borrower is able to pay on time, but does not do so. If a borrower is cooperative, but unable to pay, or if collection of late charges could prevent a borrower from reinstating a delinquent account, consideration should be given to waiving the late charge.

 6. Other Fees (38 CFR 36.4813). Fees for services outside the scope of the usual mortgage

transaction depend on the terms of the loan agreement and should be determined by the parties involved. Such charges must be reasonable, considering the work involved and the amount customarily charged in the locality. The charges listed below, while not allowable on a claim under the guaranty, are not considered improper when they are customary, agreed to by the parties, permissible under the loan agreement, and are reasonable in amount:

 (a) Loan assumption fees.

 (b) Processing and reprocessing checks that are returned to the servicer for insufficient

funds.

 (c) Substitution of hazard insurance policies during the life of a previously furnished

policy, when substitution is made at the request of the mortgagor.

 (d) Processing partial releases of the mortgaged property.

 (e) Processing subordination agreements.

 (f) Marking the mortgage satisfied if authorized or not prohibited by local law.

 7. Payment of taxes (38 CFR 36. 4316). Security instruments uniformly require the obligor

to pay taxes timely to prevent a lien with priority over the mortgage. Most security instruments require maintenance of an escrow account by the servicer to ensure timely payments. Since VA requires the holder to maintain the priority status of the mortgage lien, servicers must have internal controls in place to confirm tax payments by the holder or the obligor. VA will not reimburse late tax penalties should a claim be filed.

 8. Insurance. VA has specific requirements related to insurance. Servicers are responsible

for complying with VA regulations and following the guidelines described in this section as they relate to:

 (a) Hazard insurance (38 CFR 36. 4329). It is the servicer’s responsibility to ensure that

insurance policies are maintained in an amount sufficient to protect the security against risks or hazards and to the extent customary in the locality. VA recommends coverage that is the lesser of the insurable value of the property or the current loan principal balance. The borrower may take out a larger policy, if desired. Subject to reasonable requirements of mortgagees, borrowers may choose their insurance carrier.

 (b) Flood insurance (38 CFR 36. 4329). VA requires flood insurance on loans closed on or

after March 2, 1974, and located in a special flood hazard area designated by the Federal Emergency Management Agency (FEMA). In these areas, flood insurance is usually available under the National Flood Insurance Program and may also be available through private insurers. The amount of insurance should be the lesser of the outstanding balance of the loan or the maximum amount of coverage available.

 (c) Force placed insurance. Force placed insurance is a special policy purchased by the

servicer to cover the loan when the borrower’s insurance lapses or is cancelled. If insurance coverage cannot be obtained except at a high premium and the servicer is requesting reimbursement for an advance to pay for force placed insurance, the following information should be provided to VA at the time of claim submission:

 (1) Amounts advanced by the servicer to obtain and/or continue yearly or monthly force

placed insurance coverage.

 (2) The effective date for force placed insurance.

 9. Escrow accounts (38 CFR 36. 4350). Although VA does not require servicers to collect

periodic deposits for tax and insurance or maintain a tax and insurance account, they may do so if authorized under the terms of the security instruments. Servicers must comply with the provisions of RESPA and properly apply or disburse any surplus balance accordingly.

 10. Application of funds (38 CFR 36. 4316(b)). Payments received from the borrower must

be applied in accordance with the terms of the mortgage instruments. Servicers must comply with the provisions of RESPA for the timely application of funds.

 (a) Partial payments received from the borrower and held in a suspense account should be applied as soon as the aggregate of funds is sufficient to be applied as a full installment. Payments should not be applied first to other amounts due (i.e., attorney fees and costs) unless specifically agreed to by the borrower in writing or by court order.

 (b) Ineligible partial payments must be returned to the borrower within ten days. Refer to

Chapter 4, Delinquent Loan Servicing, Partial Payment, of this handbook for more information on handling partial payments.

 11. Legal proceedings (38 CFR 36. 4321). Any time VA is named as a party to a legal

proceeding on a VA-guaranteed loan (including probate and bankruptcy proceedings), servicers must provide copies of notices about the legal action to the VA Regional Counsel with jurisdiction over the loan. Servicers must also provide copies of notices to the United States Attorney in that area, so that an appropriate answer to the action can be filed. VA no longer requires servicers to send copies of all legal or procedural papers on regular foreclosures or other actions taken (e.g. motions for relief in bankruptcy cases), unless VA is named as a party to the proceedings.

 (a) If a Veteran has filed one or more bankruptcies and his or her loan is at least 61 days delinquent, the bankruptcy must be reported to VA electronically. In addition, bankruptcy status updates must be reported electronically each time a significant event with respect to the bankruptcy occurs. Refer to Chapter 4, Delinquent Loan Servicing, of this handbook for information on reporting bankruptcy events.

 12. Servicemembers Civil Relief Act (SCRA). The SCRA provides relief for Veteran borrowers called to active military service. Relief applies to loan obligations the Veteran incurred prior to their current period of service. Veterans are eligible for relief if their ability to maintain the loan obligation has been materially affected by entry into military service. The Act also applies to Reservists and National Guard members called to active military duty.

 a. VA does not administer the Act, but seeks to ensure that Veterans receive all protections to which they are entitled. Enforcement of the Act is delegated to any court of competent jurisdiction of the United States or of any state. VA advises servicers to consult counsel to ensure compliance with all provisions of the Act, as well as any local statutes that may require the extension of forbearance.

 b. At claim, servicers report SCRA-related data for purposes of interest determination. VA will not include interest on the obligation in excess of six percent for the period of time the Veteran was eligible for the rate reduction provisions of the Act. For more information on SCRA, refer to the VA Loan Guaranty website at: http://www.benefits.va.gov/homeloans/.

3.04 SERVICER REPORTING REQUIREMENTS (38 CFR 36.4317)

 a. General loan events reported on current loans provide a snapshot of how each loan is performing and allows VA to forecast future liabilities. The following events are required to be reported by the servicer on current VA-guaranteed loans:

 1. Monthly Loan Status Update. VA requires servicers to report a Monthly Loan Status

Update (MSU) for all VA loans that are current or fewer than 61 days delinquent. Each update includes the unpaid principal balance and the payment due date. If a loan becomes at least 61 days delinquent, servicer will then report a monthly Delinquency Status Update rather than the MSU.

#####  2. Servicing Transfers. There are two event servicers must report when they sell and

##### purchase loans. The servicer selling the loan must report the Servicing Transfer-Transferring Servicer event and the servicer purchasing the loan must report the Servicing Transfer-Receiving Servicer event. This process enables both servicers to report accurate data.

 3. Release of Liability. Servicers must report the Release of Liability event, regardless of the

loan status, when an obligor has been released from liability. A mortgagor remains liable on the VA-guaranteed mortgage indebtedness unless he or she is released from personal liability. Assumptions of loans for which loan commitments were made on or after March 1, 1988, must have the prior approval of VA or a VA automatic lender. With some exceptions, approval of an assumption of a loan releases the Veteran from any future liability to VA, including liability for any loss resulting from the default of the purchaser or subsequent owner of the property. Failure to secure approval could lead to the acceleration of the loan after the transfer.

 (a) Assumptions and releases of liability are generally processed by holders and include a funding fee and processing charge. The release of liability agreement does not release the Veteran’s entitlement, unless the person assuming the loan is a Veteran who has entitlement available to use as a substitute. VA Loan Production (LP) is responsible for examining releases of liabilities that servicers have completed and providing guidance. For more information, refer to the VA Lender’s Handbook, Chapter 5, Topic 7.

 4. Transfer of Ownership (38 CFR 36.4309, 38 CFR 36.4303(l)). Servicers are required to

report the transfer of ownership event, regardless of the loan status, when they learn that an authorized transfer of ownership has been completed. VA requires this event to determine the liable obligor on the loan.

 (a) VA requires servicers to report the Transfer of Ownership event in VALERI when the title holder of the property securing a VA-guaranteed loan changes. Servicers are required to process a release of liability on loans originated on or after March 1, 1988, before reporting the transfer of ownership. A release of liability is not required before reporting a transfer of ownership on a loan originated before March 1, 1988. VA requires the transfer of ownership event to determine the liable obligor on the loan. If the loan is or becomes 61 or more days delinquent, VA expects liable obligors to participate in any effort to cure the delinquency.

 (b) Servicers should advise any borrower who contacts them regarding a transfer of ownership

that they may remain liable to VA for any loss that may occur as a result of a future default and subsequent claim payment. The borrower should execute a release of liability with the servicer to protect them should the loan go into default.

 (c) LP is responsible for providing servicers with guidance for processing assumptions and

releases of liability in connection with transfers of ownership.

#####  5. Unauthorized Transfer of Ownership (38 CFR 36.4309). Servicers are required to notify

##### VA via telephone call, email, fax, or letter after learning of an unauthorized transfer of ownership. This information is required to determine whether the unauthorized transfer led to foreclosure and a subsequent claim on the loan. An unauthorized transfer is a transfer of ownership made on a loan originated on or after March 1, 1988, without the prior approval of VA or an automatic lender.

 (a) When a servicer reports an unauthorized transfer of ownership, a regulatory infraction for an unauthorized transfer of ownership will be added to the loan. If the servicer fails to report the unauthorized transfer by the seventh day of the month following the month in which they discover that the unauthorized transfer occurred, a regulatory infraction for late reporting will also be included. Refer to Chapter 18, Regulatory Infractions, of this handbook for information regarding regulatory infractions. Servicers should attempt to contact the borrower and execute a retroactive release of liability upon hearing of an unauthorized transfer of ownership. Servicers should not accelerate the loan if the loan is performing.

 (b) LP is responsible for examining releases of liabilities servicers have completed and providing guidance. For more information, refer to the VA Lender’s Handbook, Chapter 5, Topic 7.

 6. Partial Release of Security (38 CFR 36.4327). Servicers are required to report the Partial

Release of Security event, regardless of the loan status, when they have released the lien on a portion of the security for the loan. A partial release of security releases a portion of a secured property from the lien. For example, partial releases may involve requests from the state or local government to widen a roadway. Occasionally, borrowers request that portions of their properties be released so that they may subdivide or provide gifts of land to their children or to another recipient. In most cases, the borrowers are paid an amount of consideration for the property. Servicers must follow guidelines established by VA to complete partial releases of security. These guidelines include:

 (a) No obligated borrower is released from liability.

 (b) The servicer must obtain a VA appraisal on the security, the portion to be released, and the

value of the remaining security prior to making a decision regarding a partial release request with the exception of cases such as eminent domain. To order a VA appraisal for a partial release of security, the servicer must contact the C&V office of the Regional Loan Center (RLC) with jurisdiction over the state in which the property is located. Regarding eminent domain cases, if the information provided by, or on behalf of, the borrower is insufficient for making a decision, the borrower must agree to pay for the cost of a VA appraisal.

 (c) The consideration received for the release should be equal to the fair market value of the

property being released. In state or local Government cases, the amount of the consideration is rarely negotiable, and the property will be taken by eminent domain if the servicer does not grant the release. In these cases, the only decision to be made is the disposition of the compensation. No VA appraisal is required for state and local Government property acquisitions.

 (d) The consideration received for the release must be applied to the principal balance unless

the loan to value (LTV) ratio is 80 percent or lower. The LTV ratio is calculated using the current principal balance of the loan and the value of the security remaining after the release. For example, a borrower is offered $10,000 for a portion of the security on her/his loan. The consideration is appropriate, and the value of the remaining security will be $190,000 after the release. The principal balance of the loan is $160,000, but the balance must be $152,000 ($190,000 x 0.80) to meet VA’s LTV ratio requirement before the consideration can be released to the borrower. In this case, the servicer must apply $8,000 of the consideration to reduce the principal balance and the remaining $2,000 can be released to the borrower. Failure to apply the $8,000 to reduce the principal balance is a regulatory infraction for a claim adjustment.

 (1) The loan must be current if a portion of the consideration is given to the borrower.

 (2) If delinquent, a portion of the proceeds may be used to bring the loan current.

 (3) The portion of the property still subject to the lien must be fit for dwelling purposes.

 7. Loan Paid in Full (38 CFR 36.4303). The Loan Paid in Full event is reported by the

servicer when the loan obligation has been fully satisfied by receipt of funds. This event should not be reported when a servicer is transferring the servicing rights to another servicer or when a loan has been terminated or acquired by VA.

 8. Contact Information Change. VA requires servicers to report the Contact Information Change event, regardless of the loan status, for all VA loans when they become aware of changes with the borrower’s contact information.

 9. Occupancy Status Change. VA requires servicers to report the Occupancy Status Change

event, regardless of the loan status, for all VA loans when they become aware of any change in occupancy of the property.

3.05 VA MONITORS GENERAL LOAN EVENTS WHEN NECESSARY

 a. VA uses the information provided from general loan events to manage its portfolio of active loans and measure servicer compliance with regulatory requirements. VA does not review all general loan events at the time they are reported, but general loan event information is critical to gaining a complete understanding of the activity on a loan when VA:

 1. Reviews the adequacy of servicing on a loan.

 2. Conducts a review of an incentive, acquisition, or claim payment.

 3. Conducts a post audit.