



Tips in providing a Letter of Explanation (LOX) for Derogatory Credit

This guidance refers to USDA, FHA and VA loans.

Any and all derogatory showing on the credit report must be addressed in an LOX FROM THE BORROWER. The letter must be signed and dated. The letter must reference in detail, what happened to create the negative information, how it was resolved and what the borrower has done to insure the situation will not happen again.

This will include, but is not limited to:

- ◆ Bankruptcy
- ◆ Judgements
- ◆ Late payments
- ◆ Collections
- ◆ Charge offs
- ◆ Foreclosures
- ◆ Short sales
- ◆ NSF or overdrawn account showing on bank statements
- ◆ And any other negative reporting on credit bureaus

The borrower must also provide supporting documentation to validate the letter of explanation. The supporting documentation and explanation must be consistent with other information in the file.

Any reference to financial mismanagement could result in the LOX being rejected or the file being denied, depending on the explanation provided. If the letter does not provide enough information to determine the reason, it will be rejected.

When you submit a letter to explain the derogatory credit, bear in mind that the underwriter, ultimately decides whether to approve or decline your loan. Underwriters deal in facts rather than emotions. Keep your letter concise and specifically address each derogatory.

The letter **MUST** be signed and dated by the borrower – not the Loan Officer or Processor.