




A Discussion on Loan Quality and Quality Control

Mortgage Bankers Association of Puerto Rico

October 21, 2015



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Welcome!

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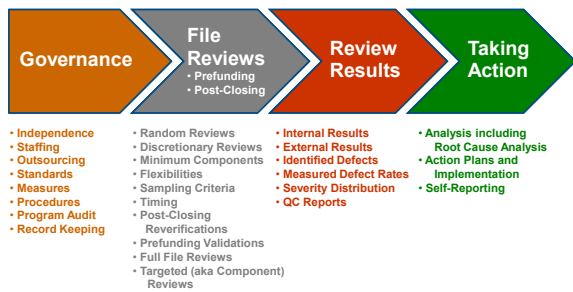
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Fannie Mae's Focus on Quality

- Increases certainty for all
- History shows Quality truly matters
- Fannie Mae's business model makes it so
- Loan Quality correlates to financial exposure
- Quality is a multi-faceted competitive factor

Quality Control - A Road Map



Agenda

Introduction
Part I - Governance • Structure & Staffing • Defect Rates
Part II - File Reviews • Prefunding & Post-closing • Strategic File Reviews
Part III - Review Results • Requirements • Templates & Samples
Part IV - Taking Action • "The Process" • Self-Reporting
Summary

We will pause between each Part for a 10 minute Q&A


We will have an added 10 minutes between Parts II & III

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First, Some Explanations

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Discussion Point

 **Concepts in Practice**

Example

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“Quality is the result of a carefully constructed cultural environment. It has to be the fabric of the organization, not part of the fabric.”

- Philip Crosby



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Governance



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Establishing Adequate Governance & Controls

- Management establishes the firm's governance and control environment; these set the structure and tone for the firm
- Fannie Mae's QC guidelines provide frameworks for Loan Quality governance, controls, and execution

Management's Specific Responsibilities:

- ✓ Claim Ownership
- ✓ Define Accountability
- ✓ Set Standards
- ✓ Establish Goals and Metrics
- ✓ Inform and Educate
- ✓ Monitor and Act

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Loan Quality Governance & Controls

Self-Assessment: Can Management make these statements?

- Here is our target defect rate and the rationale
- Here are our findings including the measured defect rate and trends
- Here's what we are doing to address the key defects
- This is what we expect our actions to accomplish
- This is when we expect to see the results and who's responsible

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QC Reporting Structure, Staffing & Outsourcing

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QC Operations Reporting Structure: Post-Closing

Intent: To preserve the integrity of the process, all post-closing QC employees (including those related to establishing, monitoring, and enforcing procedures) must be independent of the production, underwriting, and closing departments.*

* Fannie Mae will allow an exception in situations when the size of the lender's organization is insufficient to support adequate resources to allow for separation of these functions. In these cases, the lender's QC plan must include the rationale for the lack of separation as well as the controls that have been established to mitigate the potential risks associated with the lack of separation of these functions.

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QC Operations Reporting Structure: Prefunding

Intent: The lender's Prefunding QC process should operate independent of the lender's production department, if practical.

- At minimum, reviews must be conducted by individuals who had no involvement in the processing and underwriting decision of the subject loan

**Not Independent of Production?
Strive to Maximize Objectivity**

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QC Operations Staffing

Intent: Lenders are responsible for ensuring that all individuals conducting QC reviews are adequately trained and have sufficient experience levels relative to the reviews being conducted.

Lenders must:

- Establish minimum requirements for skill set and expertise
- Document minimum job qualifications
- Provide detailed policies and procedures for all employees involved with QC file reviews

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Outsourcing of the QC File Review Process

Intent: Fannie Mae holds the lender fully accountable for its overall QC program and for ensuring that QC loan file reviews comply with Fannie Mae's requirements, regardless of whether the work is performed by the lender itself or by an outsourced QC service provider ("vendor").

- The QC vendor must have written policies and procedures
- The QC vendor staff must possess the qualifications and experience to produce quality reviews and meaningful analysis
- The Lender must fully incorporate the vendor results into its QC Reporting and Remediation processes

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Outsourcing: Reviewing Vendor's Work

Intent: The lender's QC plan must include processes for reviewing the vendor's work to ensure that the lender's requirements and guidelines are applied consistently and that the review results accurately reflect the quality of the lender's loan originations.

- The lender must perform a monthly review of a minimum of 10% of the post-closing QC sample reviewed by the vendor
- The 10% sample must include loans for which the vendor identified defects and for which no defects were identified
- This review must be performed by the lender itself
- The reviews should be documented

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Discussion Point - Sound Tracking & Monitoring

Closing Month	January-14		
	Completed	Due Date	Days to Target
LENDER:			
- Sample Selected	2/25/2014	2/28/2014	-3
- File Sent	3/6/2014	2/28/2014	6
VENDOR:			
- Verifications Completed	3/26/2014	3/31/2014	-5
- Initial Report Received	4/18/2014	4/15/2014	3
- Rebuttal Response Received	4/25/2014	4/25/2014	0
- Final Decision	4/30/2014	4/30/2014	0
- Management Report	6/10/2014	5/31/2014	10
LENDER:			
- QC Vendor Review Sample Selected	5/15/2014	5/31/2014	-16
- Vendor Documents Received	6/5/2014	6/6/2014	-1
- Review Complete	6/23/2014	6/20/2014	3
- Responses Received from Vendor	6/30/2014	6/30/2014	0

Please see the Loan Quality webpage for more

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Quality Standards & Measures (Severity Levels and Defect Rates)

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Severity Levels

Intent: To effectively evaluate and measure loan quality standards the lender must, at a minimum, identify any loans with a defect and establish a methodology by which all loans with identified defects can be categorized based on severity.

- The lender must define the severity levels appropriate to its organization and reporting needs
- However, the highest level of severity must be assigned to those loans with defects resulting in the loan not being eligible as delivered to Fannie Mae

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Discussion Point - What's the Right Number of Severity Levels?

No. of Levels	Pro's	Con's
2	<ul style="list-style-type: none"> • Meets Fannie Mae requirements • Simple • Minimizes debate 	<ul style="list-style-type: none"> • Majority of defects in 2nd severity level • Depending on culture, may make action planning more difficult
3	<ul style="list-style-type: none"> • Better granularity 	<ul style="list-style-type: none"> • Increases potential for debate
4	<ul style="list-style-type: none"> • Unsure 	<ul style="list-style-type: none"> • Much potential for debate • Is it truly more effective than a three-tier system?

We encourage you to model a similar chart and determine what's best for your firm

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Defect Rates

Key: It is critical to understand the Defect Rate requirements:

- The lender must establish a target defect rate based on the lender's Post-Closing Random QC sample. (Target defect rates can also be established based on Prefunding and Post-Closing Discretionary samples at the lender's option.)
- A target defect rate must be established for the lender's highest level of severity; targets can be established for other levels
- The lender must establish a target defect rate that is as reasonably low as possible
- Performance against target must be measured at least quarterly and reported to management
- The target defect rate must be evaluated, and if necessary reset, at least annually
- The lender must document the rationale for establishing the target rate

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“Measurement is the first step that leads to control and eventually to improvement”

- H. J. Harrington

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A Key Definition

Defect Rate:
The number of loans, expressed as a percentage, reflecting the total loans with defects discovered in the loan review process divided by the total loans reviewed. (Selling Guide Section E-3-04)

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Example - Let's Calculate Defect Rates

A lender's monthly sample consists of 100 loans. There are 14 loans with various defects per the chart below. The lender uses a three tier severity level assessment.

Loan	Severe	Moderate	Minor
1			x
2			x
3			x
4	x		x
5		x	
6		x	x
7		x	
8		x	
9		x	x
10	x		
11	x		
12	x		x
13	x	x	
14	x	x	x

What is the "Severe" defect rate?
 $6/100 = 6.0\%$

What is the "Moderate" defect rate*?
 $5/100 = 5.0\%$

What is the "Minor" defect rate*?
 $3/100 = 3.0\%$

What is the total defect rate?
 $14/100 = 14.0\%$

*Note: Do not count a loan more than once. Default to the most severe level if there are multiple defects in any given loan.

Discussion Point - Defect Rates

- The Defect Rate is the most common measure of quality.
- Fannie Mae considers the Defect Rate a Key Performance Indicator (KPI) for an Enterprise.
- Defect Rates are a proxy for the level of quality in your entire book of business. Please extrapolate to understand the true magnitude.



Concepts for Determining Target Defect Rates

Questions for our Audience:

**What is your firm's target defect rate?
and
How was that rate determined?**

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Defect Rates and Financial Risk

A Defect Rate is one representation of financial risk your business faces from a lack of quality.

Top Severity Level Target Scenario Analysis:

Critical Defect Rate*	x	Loan Production in Units	=	Repurchase Risk
1%	x	500/month	=	5 loans/month
2%	x	500/month	=	10 loans/month
5%	x	500/month	=	25 loans/month
10%	x	500/month	=	50 loans/month

* signifies an eligibility breach

Next: Quantify the number of loan repurchases by the financial impact!

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Financial Exposures for Defective Loans

Considerations:
(note: this is not meant to be an all-inclusive list)

Loss Reserves	Repurchases
Cost of Capital	UPB of Defective Loan (-)
Opportunity Cost	Operational Costs (-)
Operational Costs	Loan Premium Recapture (-)
Market and Investor Perception	Property Maintenance (-)
Earnings Impact	Imputed Accrued Interest (-)
	"Scratch and Dent" Loan Sale (+)
	Loan Interest (+)
	Property Sale (+)
	(+) potential revenue
	(-) potential expense

Managing defective loans and associated factors such as loss reserves, repurchases, foreclosures, and REOs will require time, administration, and certain expertise.

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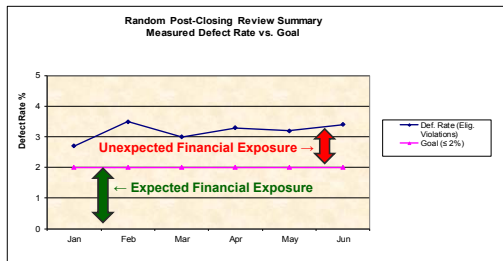
Analyzing Potential Financial Impact



In this example, let us assume the lender has determined the average cost of a defective loan is \$50,000.

- **Average Cost = \$50,000**
- **1% Defect Rate with 500 loans/month production yields 5 defective loans per month**
→ **\$250,000 exposure/month; \$3 million/year**
- **Average Cost = \$50,000**
- **5% Defect Rate with 500 loans/month production yields 25 defective loans per month**
→ **\$1.25 million exposure/month; \$15 million/year**

Example - Measured vs. Target Defect Rate Trending



- Once you have defined your target defect rate it is critical to track and trend your results against the goal.
- Lenders must have actions that address defect trends.

Summary

Looking at the Defect Rate Cycle-



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Miscellaneous Governance Topics

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Record Retention and Response to Fannie Mae Requests

Intent: The lender must retain all written and electronic records that are created as part of a QC review process for a minimum of three years.

- These records include documentation of QC reports, QC review findings, and corrective actions
- The lenders must provide Fannie Mae with a copy of its records upon request

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Audit Review of the QC Process

Intent: The lender must have an audit process to ensure that its QC process and procedures are followed by the QC staff, and that assessments and conclusions are recorded and consistently applied.


- Results of the QC audit must be distributed to senior management
- Management must distribute the results to the appropriate areas within the organization
- An action plan must be established for remediation or changes to policies or processes, if appropriate
- The lender must provide a copy of the QC audits and the audit of the QC process to Fannie Mae upon request

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Let's address any questions



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End of Part I

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File Reviews



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QC File Review Overview

Intent: The lender must establish processes to evaluate and monitor the overall quality of mortgage production through prefunding and post-closing reviews.

- Reviews are to assess loan quality and eligibility, and to confirm the underwriting decision is well justified
- Reviews further must, at a minimum, confirm:
 - the loan meets Fannie Mae's underwriting requirements
 - all documentation to support the decision is in the file
 - the property provides acceptable collateral
 - the loan complies with all federal, state, and local laws & regulations

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A Snapshot on QC File Reviews

<p>Mandatory Reviews</p> <p>Prefunding QC Reviews</p> <hr style="border-top: 1px dashed orange;"/> <p>Random Post-Closing QC Reviews</p> <p>Discretionary Post-Closing QC Reviews</p>	<p>Associated Attributes</p> <ul style="list-style-type: none"> ▪ Random and/or Discretionary Selections ▪ Discretionary Reviews can be: <ul style="list-style-type: none"> • Full File and/or • Targeted (aka Component) <p>These must be Full File Reviews</p> <p>These reviews can be: <ul style="list-style-type: none"> • Full File and/or • Targeted (aka Component) </p>
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Prefunding Reviews

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Overview

Intent: Prefunding loan file reviews provide important and timely feedback to the origination staff to allow the lender to identify loans with defects (such as analysis or calculation errors, inaccurate data, or inadequate documentation) prior to closing and prevent the lender from delivering ineligible loans to Fannie Mae.

- Prefunding QC (PFQC) **must** include full file reviews
- As a supplement to the full file reviews, a lender may chose to conduct targeted (aka component) reviews
- Data and analytical tools can be effective aids but isolated use of such tools is not a substitute for PFQC

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Discussion Point - Prefunding vs. Pre-Purchase QC

Business Channel

<p>Retail/ Broker/ Non-Delegated Correspondent</p> <p>Attributes:</p> <ul style="list-style-type: none"> - A fully processed loan - Underwritten and approved by lender - All "prior to doc" conditions cleared (ideally) <p style="text-align: center;">↓</p> <p style="text-align: center;">Prefunding QC</p> <p>What are the objectives?</p> <ul style="list-style-type: none"> - Identify / resolve data or document errors - Test high risk components or controls in place - Identify training needs - Prevent <u>closing</u> defective loans! 	<p>Delegated Correspondent</p> <p>Attributes:</p> <ul style="list-style-type: none"> - A closed loan, not yet purchased - All "prior to close" docs in file - Most closing docs in file <p style="text-align: center;">↓</p> <p style="text-align: center;">Pre-Purchase QC</p> <p>What are the objectives?</p> <ul style="list-style-type: none"> - Assess correspondent's quality standards - Counterparty strength - Prevent <u>purchase</u> of defective loans!
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Timing of Loan File Reviews

- PFQC reviews must be conducted early enough in the origination process so that corrections and/or revisions can be made prior to loan closing.
- Fannie Mae requires reviews to be done when there is sufficient documentation* in the file to perform the required review.

* See Verification of Data and Documents in this section

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Loan Selection Process

- The lender must select loans for its PFQC reviews taking into account the lender’s assessment of the risks inherent in its origination processes, business sources and volume, and product mix, and so on.
- Selections must be reviewed regularly to ensure that the samples selected, including sample size, is appropriate.

We will further discuss Loan Selection Strategies in a few minutes

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Verification of Data and Documents

- At a minimum, PFQC must include a review of the following data and documents to ensure the documents are present and complete, and that the data relied upon in making the underwriting decision is accurate.
 - ✓ Data entered into an automated underwriting system (AUS)
 - ✓ Borrower(s)' Social Security number(s)
 - ✓ Income calculations and supporting documentation
 - ✓ Employment documentation, including verbal verification of employment (VVOE)
 - ✓ Assets needed to close or meet reserve requirements
 - ✓ Appraisal report
 - ✓ Documentation of adequate MI coverage

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Reporting

- Lenders must establish and implement a process to report defects identified in the PFQC reviews, including:
 - ✓ monthly reporting to senior management
 - ✓ communication to the parties responsible for resolving the defects
 - ✓ documentation on the resolution of the defects
- At a minimum, the reports must:
 - ✓ describe the sample selection
 - ✓ include defect trending information
 - ✓ summarize the results into summary report of all PFQC findings

More on Reporting in Part III

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Post-Closing Reviews

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Loan File Review Process

Intent: The post-closing mortgage loan file review process must include a review of the loan to assess the accuracy and integrity of the information used to support the lending decision, the documentation of any defects identified through the review, and an assessment as to whether or not the loan complies with the Selling Guide.

- Review all credit and collateral components for their existence, accuracy, completeness, and compliance with laws and guidelines
- Ensure correct analysis and calculations were applied to the required components
- Validate that the underwriting decision is supported

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Timing of the Post-Closing QC Review Process

- Mortgage loans must be selected for post-closing QC reviews on at least a monthly basis.
- The entire QC process-- selection, review, rebuttal, and reporting-- must be completed within 120 days from the month of the loan closing. The required timelines for each component are:
 - 30 days for loan file selection
 - 60 days for QC review and rebuttal
 - 30 days for reporting

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Loan Selection Processes

- Lenders must select loans through both a random and a discretionary selection process.

*Each process is required
Each has unique and valuable purposes*

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Random Mortgage Selections

- The lender must select either:
 - a minimum of 10% of its mortgage loans, or
 - a statistical sample using sound methodology
- The mortgages selected must be representative of the lender's overall book of business (i.e., residential first mortgage originations) including:
 - all the different types of mortgage loans the lender offers
 - mortgage loans originated by each branch
 - mortgage loans by third-party originators
 - manually underwritten loans as well as loans that were processed through automated underwriting system(s) utilized by the lender

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Example - Random Mortgage Selections "In Action"



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Random Mortgage Selections Using Statistical Sampling

- If the lender uses a statistical sampling for its selection process instead of the standard 10% random selection process, it must document the methodology and provide, upon request, a detailed written justification of the methodology, including the following information:
 - the method for making a statistical selection
 - variables used in the selection model and how they are defined-- for example, population size, precision rate, percentage of defect rate, and confidence level
 - the results of periodic evaluations of the process and variables, and establishment of time periods for the evaluations

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Discretionary Mortgage Selections

Intent: The purpose of a discretionary sample is to look for or highlight areas that may pose unique or elevated levels of risk for the lender or to confirm that a particular control or process is working as intended.

- Discretionary QC samples are required
- These selections supplement the lender's random sample
- The lender must establish a process for selecting loans for its discretionary post-closing QC selections
- The selection process must take into account the lender's assessment of its risks

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Concepts for Strategic Loan File Selections and Reviews

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Your Challenge

Strive to Balance

<p>Risks</p> <ul style="list-style-type: none"> ➢ Infinite ➢ Constantly Changing 	<p>Resources</p> <ul style="list-style-type: none"> ➢ Human Capital ➢ Systems and Software ➢ Testing Methods <ul style="list-style-type: none"> • Prefunding QC & Post-Closing Discretionary QC • Full File & Targeted Reviews <p>Goal: Maximize Effectiveness and Efficiency</p>
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QC File Review Flexibilities

Prefunding Reviews (mandatory) → Full File Review with Verifications (Mandatory)
 → Targeted Review (Optional)

No specified minimum percentages or number of loans

Discretionary Post-Closing Reviews (mandatory) → Full File Review with Reverifications and/or Targeted Review

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A Framework to Consider

- Identify Your Potential Risks
- Prioritize the Identified Risks
- Select to Assess these Risks
- Match Your Testing Tools to these Risks
- Test Your Risks
- Analyze the Results
- Act on the Findings
- Repeat

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Your Tool Box

Risk Identification and Prioritization

- Loan Review Results & Reporting
- Other QC Reporting
- Investors' Loan Review Results
- Industry Information
- Feedback from Other Departments
- Calibrations

Risk Testing & Assessment

- Prefunding QC – Full File Review
- Prefunding QC – Targeted File Review
- Post-Closing Random QC – Full File Review
- Post-Closing Discretionary QC – Full File Review
- Post-Closing Discretionary QC – Targeted File Review
- Your Investors' Results
- Calibrations

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Selection Strategies

- Key word - **STRATEGY**
 - ▶ *The skill of making or carrying out plans to achieve a goal*
- Make selections specific to your risks and business
- Leverage the work already done
- Avoid the myths, assumptions, and folklore

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What Are Your Risks?

← Your Origination Spectrum →

Low Risk

Plot Your Risks

Performance
Transactional
Quality
Operational
Financial
Reputational
Regulatory / Compliance
Strategic
Other

High Risk

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Get Specific! Then Plot and Prioritize

← Your Origination Spectrum →

Low Risk	Experienced Standardized Time-Tested Seasoned Established Automated	Staff Products TPOs	New Changing Unknown Unclear Inexperienced Manual Atypical Revised	High Risk
		Transaction Type Appraisers Processes Policies Procedures Controls Remedies Regulations		

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Self-Check, Part I

- I am sampling ____.
- By sampling this particular transaction, I will be assessing these identified risks:
 - < performance >
 - < quality >
 - < operational >
 - < regulatory >
 - < ... >
- This represents ____% of my ____
 - < overall business >
 - < repurchases >
 - < eligibility violations >
 - < growth >
 - < ... >

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An Example

I am sampling 2-4 unit homes, they're risky!

Which is more meaningful?
 ↓ This -or- That ↑

I am sampling 5-10 Multiple Financed Property transactions to assess the quality risk and our operational controls:

- We have had several findings internally and by our investor relative to these transactions.
- We have recently added controls and trained our staff.
- These currently represent X% of our business and we've seen an average monthly growth of Y% over the last 6 mos.

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Now, Match the Tool to the Risk*

and/or

and/or

and/or

and/or

Sample Risks:

- Remedy validation (prior defect)
- New TPO
- Appraiser with quality issues
- Recent underwriter hires
- New product

* Recall, you've already determined where these plot on the risk spectrum

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Leverage Review Type Flexibilities to Increase Effectiveness

Lender determines identified resources can conduct monthly:

40 Full File Reviews

Or the resources can conduct:

20 Full File Reviews + **60 Targeted Reviews** - Income - Assets - Debts

Or even:

20 Full File Reviews + **40 Targeted Reviews** - Income - Assets - Debts + **20 Targeted Reviews: Appraisal Only**

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Tie it Together: Match the Test Type to the Risks

Your Origination Spectrum

Key:

- - Prefunding Targeted
- - Prefunding Full File
- - Post-closing Disc. Targeted
- - Post-closing Disc. Full File

High Risk

► Key: It is all done with purpose; it is not "one size fits all"

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Tie it Together: Another Approach

Risk	Category	Concerns	Risk Level	Magnitude	Testing Tool to Use	Component(s)
Column Options:						
Specify Risk Here	Operational	Commentary Here	High	Large	PF - Full File	Income
	Environmental		Medium	Average	PF - Targeted	Assets
	Quality		Low	Small	PCD - Full File	Employment
	--				PCD - Targeted	Appraisal
						--
Example						
Rental Income	Control (a Remedy)	We've implemented new Rental Income calculator	Medium	Average	PF - Targeted	Income

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Self-Check, Part II

- I will conduct a ____ <full file> <targeted> review on this loan transaction because ____ (recall Self-Check, Part I).
- If the above is a targeted review, I will review the following file components ____ because ____.
 <income>
 <assets>
 <employment>
 <appraisal>
 <...>
- I will conduct the review within our ____ <prefunding QC> <post-closing discretionary> <both prefunding and post-closing discretionary> review process(es) because ____.

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Reassessing Risks, Selections, and Review Types

Remember... **THINGS CHANGE!**

- Lender should reassess their risks, and accordingly their processes to manage those risks, with some frequency
- Fannie Mae does not mandate the frequency
- We will look for this when we review Lender QC programs and execution

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Reverifications, Transaction & Closing Docs

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Overview

Intent: The lender must verify the accuracy and integrity of the information used to support the lending decision for any mortgage loans selected for a QC review.

- All reverification documentation must be retained either in the underwriting file or in the lender's QC records
- If reverifications are performed by an outsource vendor, it is acceptable for the reverification documentation to be maintained with the vendor
- When information obtained through the reverification process differs from the information utilized in the underwriting of the loan, the lender must re-underwrite the loan to verify that the loan remains eligible as delivered to Fannie Mae

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Critical!

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General Requirements for Reverifications

- Unless noted otherwise, the reverifications detailed below are applicable for all loans that are selected via the random selection process:
 - Income (including execution of IRS Form 4506-T)
 - Employment
 - Assets
 - Credit History
 - Owner-Occupancy (for principal residences only)
- The lender will include all reverifications for full file discretionary selections and reviews; the lender will determine what reverifications are necessary for targeted (aka component) discretionary selections and reviews

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Review of Transaction & Closing Documents

Intent: To ensure adherence to the loan transaction, the lender must review each transaction and closing document for completeness, accuracy, and compliance with all underwriting and eligibility.

- The Selling Guide provides a representative list reflecting the most common documents that must be reviewed
- The lender must have a process to review recorded documents when received (even if that occurs after the Post-Closing QC review work has been done) to ensure their accuracy, and remediate any errors

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Review of Transaction & Closing Documents (cont.)

Key: If errors are discovered in the post-closing review process, lenders must:

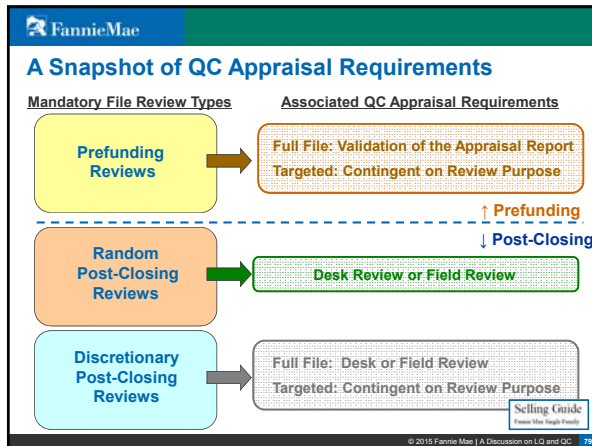
- Determine the significance of the errors
- Promptly correct the document(s) or obtain corrected document(s) from the vendor (for example, mortgage or property insurer or title company)
- Provide corrected documents to the document custodian, if applicable

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Appraisals and Appraisers

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- ### Post-Closing QC: Field & Desk Review Requirements
- Of the loans selected for a **Random Post-Closing QC Review**:
 - 10% (minimum) must have a Field Review*
 - 90% must have a Desk Review

*The 10% field review requirement is based on loans in the random sample that have an appraisal report.
 - For loans selected for a **Full File Discretionary Post-Closing QC Review**:
 - The lender may decide on a Field or Desk Review
 - For loans selected for a **Targeted Discretionary Post-Closing QC Review**:
 - As appropriate for the purpose of the review, the lender may decide on a Field or Desk Review
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- ### The Field Review
- A field review must be completed by an appropriately licensed or certified appraiser who is not affiliated with the original appraiser or appraisal firm.
 - A field review must be prepared on the proper Fannie Mae form-- Form 2000 or 2000A.
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The Desk Review

- A desk review may be completed by an individual who is not a licensed or certified appraiser; however, the appraisal reviewer must be competent in the application of basic appraisal theory for:
 - ✓ assessing market risk
 - ✓ determining if a property meets eligibility requirements, including the LTV/CLTV/HCLTV ratios
 - ✓ prescribing corrective actions in the underwriting process when defects are identified
- Fannie Mae does not have an official desk review form.

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Discussion Point - Approaching Desk Reviews

**If you repeat the same approach
won't you end up with the same results?**

<p>Historically</p> <p>Re-underwriting</p>	<p>Today</p> <p>Consider a Reverification Approach</p> <p style="text-align: center;">↓</p> <p>Leverage Tools and Information</p> <ul style="list-style-type: none"> • Third-Party Analytics • Public Records • Fannie Mae Messaging <ul style="list-style-type: none"> • AVMs • AMC Feedback • Investor Feedback
---	--

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Assessing the Results of a Field or Desk Review

- The lender must review the results of the desk or field review to determine whether any defects are identified.
- If the lender determines that the mortgage loan was not eligible as delivered, the lender must advise Fannie Mae of these findings.

***Example:** The lender delivered a two-unit property loan to Fannie Mae and, after reviewing the appraisal, the lender determines that the property is a mixed-use property. Because mixed-use properties are limited to one-unit dwellings, the loan is ineligible as delivered to Fannie Mae and the lender must self-report the loan.*

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Appraiser Monitoring Requirements

- The lender must develop and maintain a documented process to monitor the appraisers it uses.
- The process, at a minimum, must include an annual review of an appraiser's state licensing or certification status and a procedure for suspending or terminating business with individual appraisers.
- The lender must have a procedure for referring appraisers to the applicable state appraiser licensing and regulatory board.

Fannie Mae reserves the right to refuse to accept appraisals prepared by specific appraisers.

National Registry of State Certified and Licensed appraisers: <https://www.asc.gov/National-Registry/NationalRegistry.aspx>



Discussion Point - Considerations on Appraiser Quality

- How do you assess your Appraisers on Quality?
- What are your appraiser
 - Metrics?
 - Standards?
 - Goals?
- How do you communicate expectations and results to your Appraisers?

Let's address any questions




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End of Part II

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Review Results



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The Case for QC Reporting

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QC Reporting Addresses...

What are our key metrics, standards, goals, areas of concern...?
How do/did we test and assess these?
What are the results of the tests and assessments?
What do the result tell us?
What do we then need to do to further improve our loan quality?
What's the status of our current improvement efforts?

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The Criticality of QC Reporting



- Communication Tool
 - applicable to all in the loan manufacturing process!
- Analysis Tool
- Crucial to Action and Improvement
- Records and Documentation

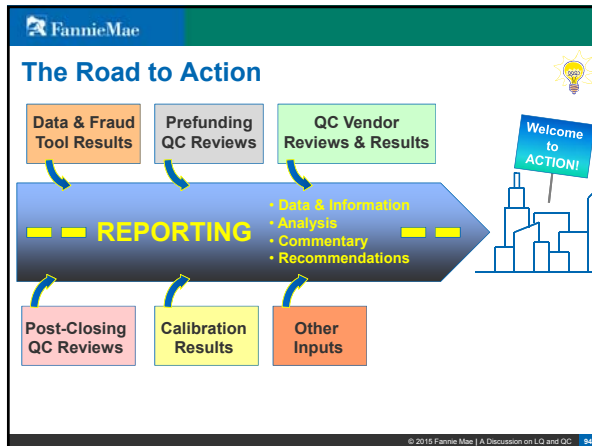
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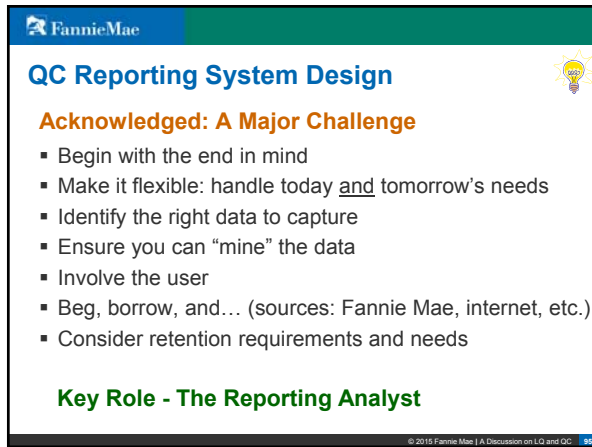
Effective QC Reporting...



- Is objective
- Supplies meaningful information that meets the needs of the end-user
- Illustrates the value of your work and team
- Leads with the key points
- Provides not only data and information, but also analysis, commentary, and recommendations
- Makes a positive impact to Loan Quality

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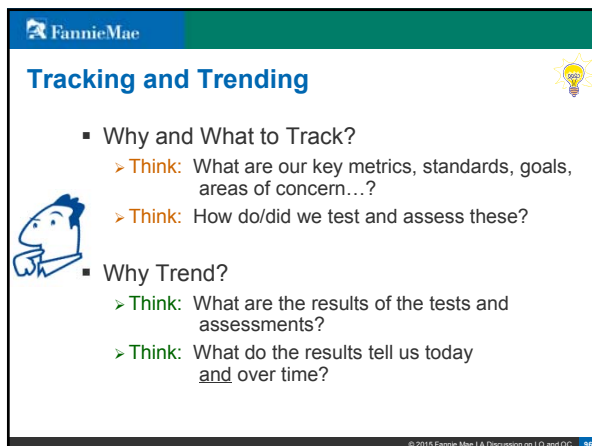
QC Reporting System Design

Acknowledged: A Major Challenge

- Begin with the end in mind
- Make it flexible: handle today and tomorrow's needs
- Identify the right data to capture
- Ensure you can "mine" the data
- Involve the user
- Beg, borrow, and... (sources: Fannie Mae, internet, etc.)
- Consider retention requirements and needs

Key Role - The Reporting Analyst

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Tracking and Trending

- Why and What to Track?
 - > **Think:** What are our key metrics, standards, goals, areas of concern...?
 - > **Think:** How do/did we test and assess these?
- Why Trend?
 - > **Think:** What are the results of the tests and assessments?
 - > **Think:** What do the results tell us today and over time?

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The Spectrum for Effective Reporting

The Front Line	Department Managers	Senior Management						
Critical Data: <ul style="list-style-type: none"> Firm & Industry Trends Identified Defects Miscalculations Specific Commentary 	<ul style="list-style-type: none"> Predominant Defects Defect Trends Responsible Parties "Broken" Processes 	<ul style="list-style-type: none"> Key Risk Factors Trending Results vs. Goals Narrative Summaries 						
Format: ← Charts, Graphs, Lists, Narratives, etc. as required by the User →								
Frequency: (see also notes on Slides 108-109) <table border="0"> <tr> <td>• Weekly</td> <td>• Bi-weekly</td> <td>• Monthly</td> </tr> <tr> <td>• Monthly</td> <td>• Monthly</td> <td></td> </tr> </table>			• Weekly	• Bi-weekly	• Monthly	• Monthly	• Monthly	
• Weekly	• Bi-weekly	• Monthly						
• Monthly	• Monthly							

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QC Reporting Requirements

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Overview

- Lenders must design reporting procedures that are useful internal management tools for evaluating and monitoring the quality of their mortgage loan production.
- Reporting procedures must be in writing and identify critical components to be included in the reports.

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General Requirements

- Both Prefunding and Post-Closing Reporting is to be conducted monthly, at a minimum.
- Reporting to use consistent methodology and terminology across all review types.
- Reports must distinguish between compliance-related defects and credit-related (underwriting and eligibility) defects.

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Review Type Reports & Summary Reports

- Lenders must report on each review type:
 - Prefunding Reviews
 - Post-Closing Random Reviews
 - Post-Closing Discretionary Reviews
- Lenders must also summarize the results of each individual review type into a comprehensive, summary report of all QC findings. **Gap!**

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Distribution

- Reports of summary-level findings must be distributed to senior management. Rebuttals must be completed prior to final reporting to senior management.
- Reports of loan-level findings must be distributed to the business units, specifically to parties within the business units responsible for the resolution.

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Minimum Components

- Reports for Random Post-Closing reviews must reflect the final defect rate for the current review period, taking into account responses and resolution of the initial QC findings.
- A defect must be identified by its severity level.
- Reports must include selection criteria where appropriate and defect trending information, such as key issues and top defects.

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The Need to Take Action

- When findings and trends are identified through the review processes, the lender must establish an action plan for specific corrective actions to be taken, including the expected resolution and timely implementation.

Critical!

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Discussion Point: When QC is Outsourced...

- The Lender retains ownership.
- The Lender should lead in report design.
- The Lender should develop management reports to record and evaluate the performance of the QC vendor.

➤ **A QC Vendor executes reviews**

➤ **The Lender manages Loan Quality**

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A Few Road Maps

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A Senior Management Report Suite

Overall Summary

- Defect Rates & Trends
- Severity Distribution
- Extrapolated Results
- Results vs. Goals
- Financial Exposure
- Key Issues

Key:
PC = Post-Closing
EV = Eligibility Violations

<p>Prefunding QC Summary</p> <ul style="list-style-type: none"> Selections: What and Why? Full File or Targeted and Why? No. of Loan Reviewed Defect Trends Key Learnings 	<p>Random PC QC Summary</p> <ul style="list-style-type: none"> Population Description 10% or Statistical? Extrapolated Results Defect Rates & Trends Key Learnings 	<p>Discretionary PC QC Summary</p> <ul style="list-style-type: none"> Selections: What and Why? Full File or Targeted, and Why? No. of Loans Reviewed Defect Trends Key Learnings
<p>Action Plan Summary</p> <ul style="list-style-type: none"> Top EVs and Med. Defects Root Cause Synopsis Remedies: What, Who, When & Status Observations 	<p>QC Vendor Summary (when applicable)</p> <ul style="list-style-type: none"> Key Metrics: Results to Goals (e.g., Time Mgmt., Decision Mgmt.) Performance Synopsis Audit Results Details 	<p>Appendix</p> <ul style="list-style-type: none"> As necessary when defined by User

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A Middle Management Report Suite

Department Summary

- Corporate Defect Rates & Trends
- Defect Distribution by Dept. Inclusive of Severity + Suspected Root Cause
- Key Observations
- Recent Efforts and Results

Key:
PC = Post-Closing
EV = Eligibility Violations

<p>Department Details</p> <ul style="list-style-type: none"> Department Goals, Results and Trending Defects by Responsible Party Defects by Suspected Root Cause Defects by Severity & Incidence 	<p>Action Plan Summary</p> <ul style="list-style-type: none"> Specific Dept. Responsibilities Key Dates and To Do's Remedy Implementations & Testings 	<p>Appendix</p> <ul style="list-style-type: none"> As necessary when defined by User
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Note:
 These reports could be issued at different frequencies. For example, the Department Summary may be issued monthly while the other reports may be issued bi-weekly.

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Front Line Report Suite

Company & Industry Information

- Defects, Rates & Trends
- Severity Distribution
- Fraud Observances & Trends
- Recent Company Learnings

Key:
PC = Post-Closing
EV = Eligibility Violations

Individual Summary

- Loan Level Findings Including EVs & Non-EV Defects
- Defect Classification
- Defect Commentary (e.g., miscalculation)
- Feedback

Note:
These reports could be issued at different frequencies. For example, the Company & Industry information may be issued monthly while the Individual Summary may be updated weekly.

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Report Samples

Report samples are in the Appendix, including:

- Senior Management Report Suite
- Middle Management Report Suite (using an Underwriting Department)
- Front Line Suite (using an underwriter)
- Miscellaneous Samples

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Fannie Mae's Loan Quality Review Results Reports

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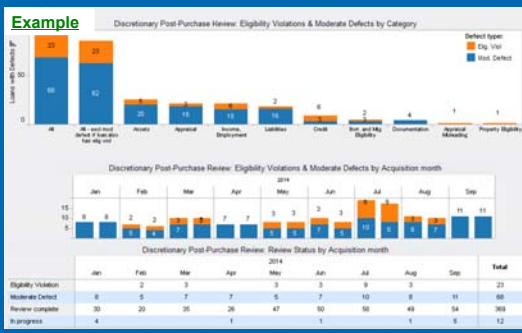
Fannie Mae's Loan Quality Review Results Reports

Background

- Issued Monthly
- Based on completed full file reviews, including:
 - Random Reviews
 - Discretionary Reviews
- Uses our Defect Classification System (see Appendix)
- We currently employ a two-tier severity system:
 - Eligibility Violation
 - Eligible with Moderated Findings (aka Moderate Defect)
- We provide loan lists detailing:
 - Eligibility Violations
 - Eligible with Moderate Finding(s)
 - No Defects

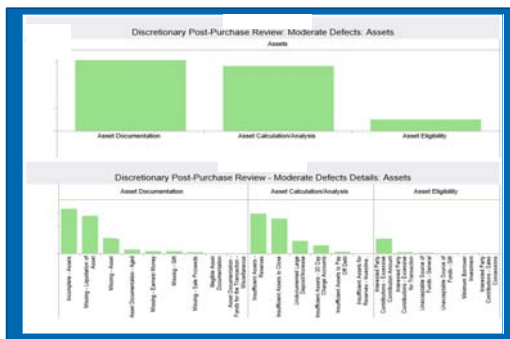
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Snapshot - Overview



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Snapshot – Asset “Moderate” Defects



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Let's address any questions



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End of Part III

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Taking Action



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Remediation (Action Planning & Implementation)

Intent: When trends are identified through the review process, the lender must establish an action plan for specific corrective action to be taken, including the expected resolution and the time frames for implementation.

The lack of Action Planning and Implementation remains a significant gap

**No Action, No Change –
No Change, No Improvement**

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Concepts for Action Planning and Implementation

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“You don’t have to be great to get started, but you have to get started to be great.”


- Les Brown

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The Action Planning and Implementation Process (“The Process”)

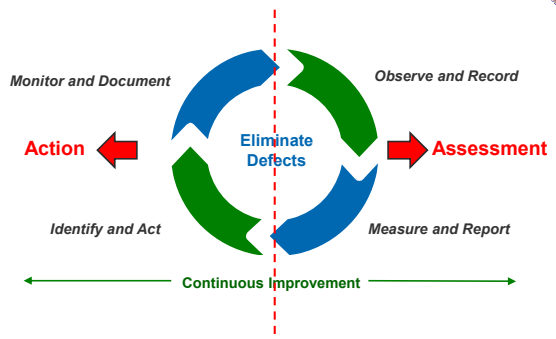


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A Framework: Quality Control Cycle

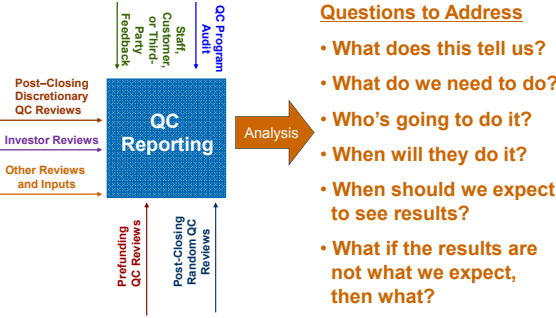


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Formulating an Action Plan



Questions to Address

- What does this tell us?
- What do we need to do?
- Who’s going to do it?
- When will they do it?
- When should we expect to see results?
- What if the results are not what we expect, then what?

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Defect Analysis - Reporting

A Detail Report Example
Focus = The Defect

Defect Detail - Action Plan Report
 <Pre-funding> <Random Post-closing> <Discretionary Post-closing>
 <Month/Year> <Reporting Period>

Defect Category / Specialty
 Frequency of Occurrence & Pattern
 Defect Observed
 Defect Location
 Defect Description
 Defect Cause
 Proposed Corrective Action
 Risk Assessment Matrix
 Item discussed at CO/CA
 Management Meeting
 Meeting Comments
 Defect Resolution Date
 Defect Implementation Date
 Implementation Comments
 Defect Resolution Date
 Meeting of Notes
 Meeting of Date of completion
 Meeting of Date
 Defect Resolution Date
 Defect Resolution Comments
 Additional Comments

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Sample Action Plan Management Report

Comprehensive Action Plan Tracking Report based on Pre- and Post-Closing Reviews - Month Year Meeting Update

Item	Finding	% of Defects in Prior 3 Mos.	Severity	Suspected Root Cause	Meeting Originally Discussed	Planned Actions	Owner	Date to Implement	Expected Improvement Date	Observed Improvement Date	Date Closed
A											
B											
C											


Focus = What, How, Who, and When


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The Process - "Identify"


- Observe and Record
- Measure and Report
- Identify → Defect Analysis
 - Incidence and Severity
 - Responsible Party
 - Root Cause
 - Reporting


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The Process - "Act" 


- Observe and Record
- Measure and Report
- Identify
- **Act**  **Addressing the Root Cause**
 - The Plan → What
 - Timeline → When
 - Owners → Who
 - Reporting


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The Process - "Monitor" 

- Observe and Record
- Measure and Report
- Identify
- Act
- **Monitor**  **Validating the Remedy**
 - Testing
 - Capturing the Results
 - Analysis
 - Effective or Not Effective?

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The Process - "Document" 

- Observe and Record
- Measure and Report
- Identify
- Act
- Monitor
- **Document**  **Memorializing the Process**
 - Capturing It All
 - Sharing Lessons Learned

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Memorializing the Process – Reporting

Defect Detail - Action Plan Report	
May 2015 Reporting Period	
Account Collected	Responsible GSA Letters
Defect Category	FCI
Defect Cause	FCI
Priority of Occurrence & Impact	FCI
Assigned To	FCI
Current Line	FCI
Current Step	FCI
Current Lead	FCI
Current Date	FCI
Current Org	FCI
Defect Cause	Internal Guidelines Incomplete
Proposed Corrective Action	Update Guidelines (Update all Act (process))
By (Responsible Member)	Incidence Note
Date Received at QC/CA	May-15
Responsible Member	FCI
Meeting Comments	Expect quick resolution
Final Implementation Date	Aug-15
Implementation Comments	Corrected 1 month delay to priority of defect resolution in FCIS
Defect Resolution Date	Aug-15
Meeting #1 Dates	Used Pre-Workshop targeted selections
Meeting #2 Date if applicable	Used Post-Workshop targeted selections
Meeting #3 Dates	FCI
Defect Resolution Date	Aug-15
Resolution Comments	
Incidence Comments	How success/failure with def rate targeted discretionary selector processes

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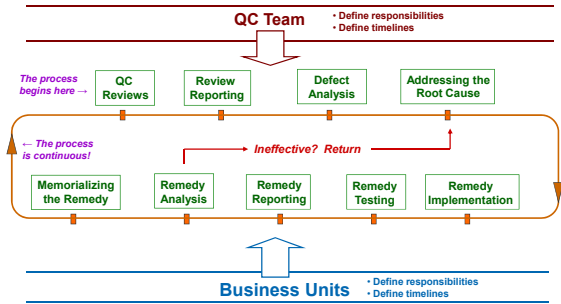
Memorializing the Process – Reporting

► Capturing it all

Item	Finding	% of Defects in Prior 3 Mths	Severity	Suspected Root Cause	Meeting Originally Scheduled	Planned Actions	Owner	Date to Implement	Expected Improvement Date	Observed Improvement Date	Close?
A	DR - Income Calculation Analysis Complex income sources are driving top Eligibility findings across Random and Discretionary Sample -	50%	Eligibility	Retail - Staff Not Using Income Calculator Correspondent - Lenders are not properly calculating income	3/1/20xx	Retail - Targeted pre-workshop sample to ensure 100% compliance. Note compliance with result in the action Correspondent - Implement Targeted sample in Correspondent on income at 75% of volume	Retail - R. Luo Corr - B. Fox	Retail - 6/1/xx Corr - 6/1/xx	Retail - 7/1/xx Corr - 6/15/xx	In progress	In progress
B	Mortgage Eligibility FIC not eligible for Military 5-10 Financial Package	12%	Eligibility	Lack of knowledge by staff	3/1/20xx	Implement System add to ensure correct FIC	M. Roberts	8/1/20xx	8/2/20xx	In progress	In progress
C	Funds to Close - Insufficient Funds to Close Documented	10%	Eligibility	Purchase Transactions where evidence of fund to close has been a closing condition	2/1/20xx	Implemented mandatory use of Asset Worksheet in Retail	B. Smith	3/1/20xx	3/1/20xx	4/15/20xx	4/30/20xx

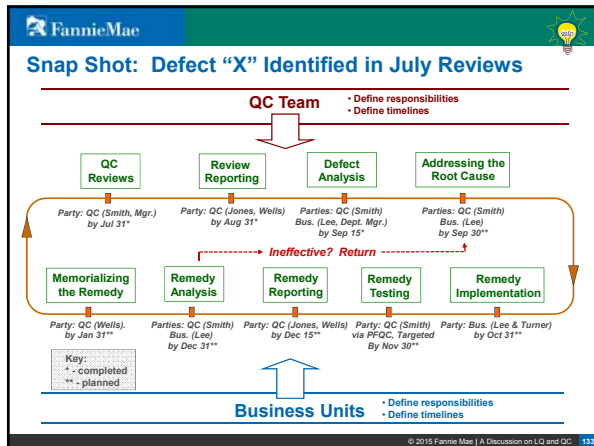
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Ongoing Action Planning and Implementation Activities



Best Practice Lenders Foster Collaboration Between QC and the Business

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Eligibility Violations

- The lender must notify Fannie Mae **within 30 days** of confirmation that one or more defects identified through the QC file review process results in the loan being ineligible as delivered to Fannie Mae.
- Use the Lender Self-Report Mailbox (Self_Report@fanniemae.com) as described in *Selling Guide* E-1-03, List of Contacts.

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Procedures for Lender Self-Reporting

- When making the self-report to Fannie Mae, the lender must provide Fannie Mae with a written report of its findings and copies of the relevant documentation that support the reason for the finding.

Example:

If tax return transcripts reveal that qualifying income was inaccurate such that the borrower was not qualified for the loan on the terms and pricing offered, the lender should provide copies of the original income documentation and the tax return transcripts with its notification to Fannie Mae.

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Discussion Point - Investor Self-Reporting Tracking Example

Eligibility Violations Investor Self-Reports as of March 31, 20XX						
Loan #	Rating	Investor	Audit Month	Self-Reported?	Explanation for Not Self-Reporting	Self-Report Date
123456789	Eligible	Fannie Mae	Jan. 20XX	No		
321654987	Ineligible	Investor "X"	Jan. 20XX	Yes	Received documentation to cure violation	1/15/20XX
132457689	Ineligible	FHA	Feb. 20XX	Yes		2/28/20XX
987654321	Eligible	Fannie Mae	Feb. 20XX	No	Docs + info provided; corrected pricing	
123879456	Ineligible	Fannie Mae	Mar. 20XX	Yes		3/14/20XX
789654123	Ineligible	Investor "X"	Mar. 20XX	Yes		3/26/20XX

Let's address any questions on any content discussed today



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Concluding Comments

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Our Recommendations

- QC is a key Enterprise risk function
- Map out what must and what could be improved
- Prioritize, plan, and act
- Stay engaged

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Fannie Mae Loan Quality Resources

- Business Portal (see Appendix)
- Fannie Mae staff
 - Customer Account Team
 - QC Specialists
 - Selling Guide Support Team (for approved, delivering Seller/Service) [888-Fannie8 \(888-326-6438\)](tel:888-Fannie8), [Select Underwriting Option](#)
- Training including live web seminars
- Applications: DU®, EarlyCheck™, CU™
- A dedicated Loan Quality (“Certainty”) web page:
 - Tools (e.g., QC Self-Assessment)
 - Checklists & Process Flows
 - Defect Hierarchy, and more

Are you leveraging all that’s available to you?


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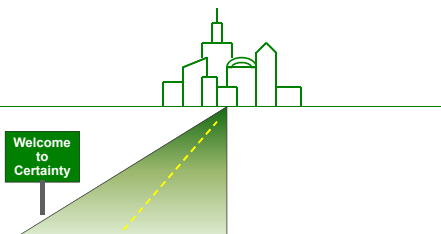
The Appendix

- Business Portal Resources
- QC Reporting Samples
- Fannie Mae Defect Classification System Info


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Thank You for Attending!



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End of Presentation

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