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Freddie Mac Updates its Quality Control Requirements

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Freddie Mac has updated Chapters 46 and 48 of the Seller/Servicer Guide regarding pre- and post-closing quality control. The changes take effect for loans closed on or after December 1, 2011. Information regarding the QC changes were announced in the August 16, 2011 Bulletin 2011-15.

Pre-Closing Quality Control Requirements

Freddie Mac has added a new requirement for pre-closing quality control reviews. While they have not prescribed specific requirements for pre-closing QC steps, they have created a "best practices and guidance" in a new Section called Pre-closing Quality Control Reviews Section 48.8.

The pre-closing quality control program must include a process to perform quality control reviews on a sampling of mortgages prior to closing. This will provide lenders with the opportunity to identify and address deficiencies prior to loan closing. The goal of an effective pre-closing review process is to monitor origination policies, ensure the accuracy of the mortgage data

and prevent the closing of mortgages with deficiencies such as fraud, inaccurate data and insufficient documentation. The pre-closing quality control process should operate independently of the mortgage origination and underwriting departments when operationally possible. The best practices published by Freddie Mac are as follows.

Procedures

The pre-closing review process should include procedures for:

- Sample selection and timing that permits reviews to be completed prior to closing
- Reporting deficiencies and taking appropriate corrective measures
- Documenting the resolution of defects
- Canceling or postponing settlement when the pre-closing review reveals deficiencies or when the review cannot be completed prior to the scheduled settlement

Sample selection

The sampling process should include mortgages that are representative of the full scope of the lender's product line and production process.

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Lenders must regularly assess its sampling methodology to ensure that its pre-closing quality control process is effective. Additionally, lenders should target samples, as needed, in order to:

- Review the work originated by a new branch office, employee or third-party originator
- Validate that a new product or offering is being originated in accordance with the lender's policies and procedures
- Evaluate the work of a particular employee or mortgage transaction participant when there is a reason to suspect fraud

Validation and re-verification

An effective pre-closing quality control review process should include validation or re-verification of:

- Data entered into Loan Prospector
- Social Security number provided by each borrower
- Income documentation and calculation
- Employment
- Assets required to close or meet reserves requirements
- Appraisal report or property valuation data
- Adequate mortgage insurance coverage
- Whether additional credit was granted and considered in qualifying when the Borrower's credit report reveals inquiries within the previous 120-day period

Post-Closing Quality Control

Effective with loans closed on or after December 1, 2011, Freddie Mac has made changes to its requirements for post-closing quality control reviews. Key changes are explained:

Sample Selection

The post-closing quality control sample must, at a minimum, consist of three sample types: random, targeted and discretionary.

Random -- Mortgages in the random sample are randomly selected from the population so that every mortgage has an equal chance of selection. Loan Prospector mortgages must make up a representative portion of the lender's quality control sample. The QC sample requirements can reflect any of the following populations:

- 10% of the total annual production (or)
- 10% of the total secondary market production (or)
- 10% of the total Freddie Mac mortgage production

Any mortgages excluded from the quality control sample selection process are not eligible for sale to Freddie Mac. QC must be scheduled so that every mortgage within the selected population has a chance of being selected for review within 90 days of the Note Date. Lenders must assign quality control personnel the authority to conduct additional reviews at their discretion and warrant that over the course of each 12-month period, the selected samples are representative of the full scope of the lender's product line and production process within the selected population.

The full scope of a lender's product line and origination process includes all of the following:

mortgages from all product lines; mortgages from all States of operation; mortgages from each third party involved in the origination process and mortgages with high-risk characteristics (for example, high loan-to-value (LTV) ratios, adjustable-rate Mortgages, 3- to 4-unit properties, Manufactured Homes, cash-out refinance Mortgages, Investment Property Mortgages and Caution Mortgages).

A Freddie Mac Seller with a total annual production volume in excess of 5,000 home mortgages may substitute a statistically based sampling methodology that is of sufficient size to ensure a confidence level of 95% and a margin of error not to exceed 2% on an annual basis based on the defect rates for mortgages recently reviewed by the lender's quality control.

Targeted -- Each month, the lender must select all mortgages sold to Freddie Mac that become 60 days or more past due in the first six months following the Note Date. These mortgages must be carefully evaluated to determine the presence of any fraud or other deficiency.

Discretionary -- Mortgages in a discretionary sample are selected on a non-random basis from a specific population. Discretionary samples must be selected to evaluate the work of a particular employee or mortgage transaction participant when there is a reason to suspect fraud. Discretionary samples should also be selected as needed in order to review the work of a new branch office, employee or third-party originator, validate that a new product or offering is being originated in accordance with the policies and procedures, or to comply with a request from Freddie Mac to review loans in a specific population.

Quality Control Re-verifications

Effective with loans closed on or before December 1, 2011, lenders must make certain re-verifications on Loan Prospector® and Non-Loan Prospector mortgages selected for post-closing

quality control review. The purposes of the re-verification process are to evaluate the validity and quality of the information used in the original underwriting decision and to protect Freddie Mac Sellers against fraud and misrepresentation. Lenders should begin re-verifying the information listed in this section as soon as possible after the sample selection to facilitate the mortgage file review. Re-verifications may be in written or verbal form. All re-verification documentation must be retained in the mortgage file.

Verifications of employment, income and sources of funds

For post-closing quality control reviews, lenders must re-verify all employment, income and sources of funds used in the original underwriting process and based on the minimum documentation required at the time of origination. Copies of the original verifications should be submitted to the issuers with a request that they confirm the accuracy of the documentation. Any verbal re-verifications of employment, income and source of funds must be documented in writing. The written documentation must:

- Identify the name of the quality control reviewer who made the contact
- Identify the name of the business (employer, bank, etc.)
- Identify the name and title of the individual who provided the verification (employer contact, gift donor, etc.)
- Show the date(s) of the contact
- Confirm that the information in the original verification was accurate or identify any inaccuracy
- Identify the phone number for the individual contacted. The phone number must be obtained from an acceptable third-party source.

- Identify the name of third-party source used to obtain the phone number (phone book, internet, 411 information services, etc.)

Lenders must obtain the Internal Revenue Service (IRS) income information using Form 4506-T (or an alternate form acceptable to the IRS that collects comparable information) for each mortgage selected for quality control review. The IRS form does not need to be resubmitted to the IRS if a response was received during the origination process.

Borrower's Social Security number

For mortgages included in post-closing quality control samples, the lender must validate the Social Security number provided by each Borrower.

Credit reports

For Loan Prospector Mortgages, the lender is not required to obtain a new credit report. Lenders must verify that the identifying information for any Borrower (name, current and previous address and Social Security number) is true, complete and accurate and that it was properly input into Loan Prospector on or before the Note Date. Any credit information obtained from sources other than Loan Prospector must be reviewed.

For Loan Prospector Accept Mortgages and A-minus Mortgages, lenders are not required to review the Loan Prospector-provided credit reports to determine that the credit report was properly underwritten, or that it is in compliance with credit underwriting guidelines, except as noted: for Accept and A-minus Mortgages, the lender must verify that the Loan Prospector-provided credit reports are for the correct Borrower; for A-minus Mortgages, the lender must review the Loan Prospector-provided credit reports to determine compliance with Sections C33.3 and 37.11 of the Guide.

For one out of every 10 Non-Loan Prospector mortgages selected for post-closing quality control review, lenders must obtain either a new Residential Mortgage Credit Report or a three-repository merged in-file credit report. For the remaining Non-Loan Prospector Mortgages in the Lender's post-closing quality control sample, the Lender must obtain new in-file credit reports containing information from one or more of the national repositories. The new credit report should be ordered from a source other than the original reporting agency. The new credit report must be compared with the credit report used when the mortgage was originated.

For Manually Underwritten Mortgages, lenders must re-underwrite the credit and continue to review the mortgage file documents to determine that the mortgage was underwritten to Freddie Mac's requirements. For all mortgages selected for post-closing quality control review, the lender must determine whether additional credit was granted and considered in qualifying when the Borrower's credit report reveals inquiries within the previous 120-day period.

Verification of owner-occupancy

For all mortgages secured by Primary Residences that are selected for post-closing quality control review, lenders must verify that the Borrower is occupying the mortgaged premises as a Primary Residence.

Appraisal, inspection & the Property Inspection Alternative (PIA)

For post-closing quality control reviews, lenders must select from the following options:

Option 1 - Of every 10 mortgages selected for quality control review, one must be a field review and the remaining nine mortgages may be desk reviews

Option 2 - Of every 10 mortgages selected for a quality control review, three must be a field review. No desk reviews are necessary for the other seven mortgages

For purposes of performing field reviews, the following quality control requirements apply:

- If the mortgage is secured by a 1-unit property and was originated using an appraisal report, the lender must obtain a field review with the results reported on a field review report, such as a Freddie Mac Form 1032, One-Unit Residential Appraisal Field Review Report.
- If the mortgage is secured by a 2- to 4-unit property, the lender must obtain a field review with the results reported on a field review report, such as Freddie Mac Form 1072, Two- to Four-Unit Residential Appraisal Field Review Report.

The lender does not need to obtain a field review during the quality control review if one was obtained during the origination process. The field review must:

- Be prepared by a qualified appraiser not affiliated with the original appraiser or appraisal firm
- Either concur with, or provide a different opinion regarding, the value and marketability of the Mortgaged Premises as of the effective date of the original appraisal and not as of the date of the appraisal review
- Be used to evaluate the quality of the original appraisal report
- Include an exterior review of the subject property and comparables
- Include a review of the accuracy of the factual data in the original appraisal report

When a desk review of the original appraisal or inspection report is required for the remaining

mortgages in the lender's post-closing quality control sample, the reviewer need not be an appraiser. However, the reviewer must be familiar with the subject's market area and be qualified to address the appropriateness of the data presented in the report, address the appropriateness of the comparable sales (as applicable) and conclude that the appraiser's rationale for the final reconciliation of value was supported (as applicable).

Data Integrity Review

Effective with loans closed on or after December 1, 2011, a lender's post-closing quality control review procedures for all mortgages must include a review of the completeness and accuracy of the information obtained in the mortgage origination process. The data integrity review of the information must include a process for checking data fields entered in Loan Prospector® and ensuring that all data submitted is valid.

Lenders must perform a data integrity review on all mortgages sampled to ensure that the loan data is accurate and consistent. Source documentation to be reviewed includes:

- Uniform Residential Loan Application(s) (Form 65)
- Employment and income verification
- Sales contracts
- Tax return
- Credit data
- Asset documentation
- Appraisal and inspection report
- Mortgage delivery data, including the Key Number when applicable

If during a post-closing quality control review, a lender determines that the Key Number for a Loan Prospector Mortgage is missing or is inaccurate, the lender must notify Freddie Mac within 30 days of the finding.

Reporting Requirements

The quality control program must provide that all pre-closing and post-closing quality control activities be fully documented in writing and reviewed by management on a regular basis. The results of quality control reviews must be reported in writing to the lender's senior management within 90 days of selection of the mortgage files for review. The lender must thoroughly analyze findings affecting the acceptability or eligibility of mortgages and initiate any necessary corrective actions. Freddie Mac Sellers must notify Freddie Mac in writing within 30 days of determination that a post-closing quality control finding affects the eligibility of a mortgage sold to Freddie Mac, except that findings related to fraud or possible fraud must be reported in accordance with Section 7.3 of the Guide.

Retention of Quality Control Records

For at least three years from the date of the pre-closing or post-closing quality control review, lenders must retain all records of its quality control findings, along with documentation of any corrective action taken. These records must be made available to Freddie Mac upon request and must be included in the information provided to the new Servicer if a Transfer of Servicing occurs. Lenders should review the revised requirements in Chapter 48 to ensure that they have clear understanding of all changes.

<http://www.allregs.com/ao/main.aspx?did2=e3135ef6a92b4ddeb84ed0a3a320a517>