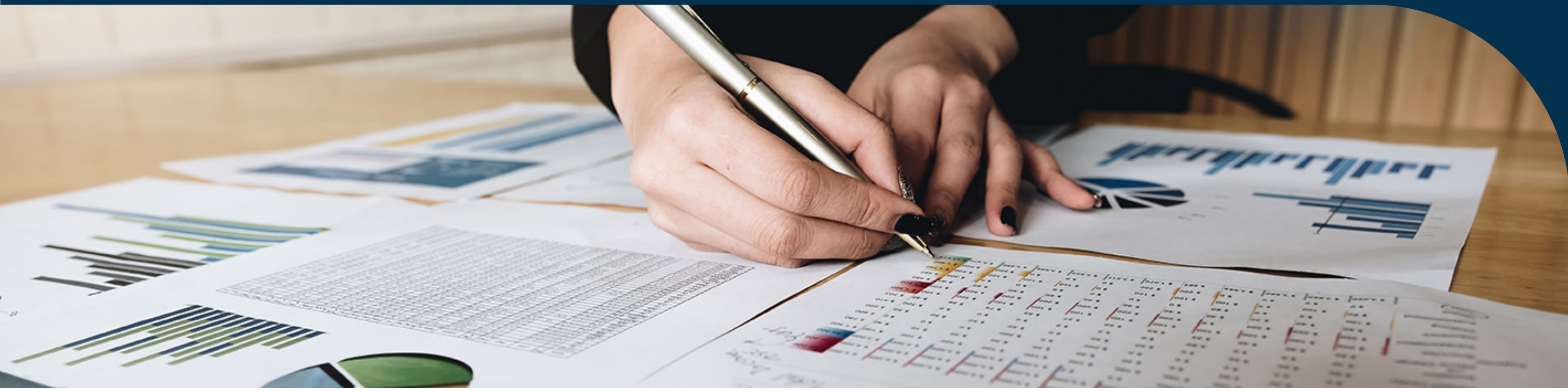

Strengthen your QC program: QC reporting

This edition of *Quality Insider* is the second installment in our series designed to strengthen core QC governance elements. This article focuses on the importance of leveraging QC reports to reduce risk and improve loan quality.

Quality Control (QC) reporting is a crucial tool for communicating results from QC reviews to those stakeholders directly involved with or managing the loan manufacturing process. Reporting transforms data into meaningful information that is extremely useful in analysis, decision-making, and action planning. Our QC engagements with customers, as well as QC program audits, reveal key areas where QC reports can be strengthened to be more informative and actionable. Leverage these insights to identify potential areas of opportunity that can strengthen your existing QC reports.

Ask yourself:

- Are my monthly QC reports meeting our business needs and Fannie Mae's minimum requirements?
- Do my reports accurately reflect the risks facing my organization and provide actionable insights?
- Are my reports structured to be easily digestible for all stakeholders?
- Does my senior management report provide a summary or overview of all available QC results that can be used to drive change?

QC reports should tell your organization's holistic loan quality story to management and frontline staff. QC reports should give senior management a snapshot of potential risk areas, as well as areas where improvement is needed and where things are working well. The information provided in QC reporting should be clear, concise, and most importantly actionable, so that all parties can understand the potential risks facing your organization. The quicker you get the QC results in front of management; the quicker resources can be allocated to correct issues.

QC reports should tell your organization's holistic loan quality story to management and frontline staff.

What is Fannie Mae observing?

QC reporting does **not** include the minimum *Selling Guide* requirements:

	Gap / Frequently missing in reports	Why Behind the Guide
Prefunding	• communication to the source responsible for resolving the defects and documenting the resolutions of the defects	Communication is the key component used to correct and prevent defects. It's important to document all notifications to the responsible employee or department and keep a record of the defect resolution. To bring collective awareness, be sure to share the cited defects with all appropriate areas of operations.
Prefunding and post-closing	• monthly reporting to senior management	Monthly reporting allows all levels of management to monitor and evaluate the quality of the loan origination process. Quality risk should be a key performance indicator (KPI) for your organization. Timely QC reporting is critical to effective quality risk management. Summarizing all quality data in one report allows management to address this KPI in the aggregate (**i.e., what are you seeing holistically across all your samples?**). • The QC results should be illustrative and easily digestible so management can identify trends with the ultimate goal of reducing financial exposure and utilizing resources effectively. • Senior management should get one monthly report with summaries of both prefunding and post-closing QC results. • The QC report should identify individual loan-level issues and include defect trending at least at the subcategory level. The more granular trending is the better. Defect trending leads to action planning and corrective action prevents similar defects from reoccurring. • *Third-party QC vendor (if applicable):* The required 10% vendor review results should also be included in your monthly management report. Visibility into QC vendor accuracy and performance is vital to understanding if the vendor is consistently performing its function accurately. This is imperative to effective QC.
	• description of the sample selection (for all samples tested)	Effective QC reporting should clearly demonstrate the correlation between the sample selections and the defects cited. If QC reviews reveal a spike of a certain defect type in the sample selection, this could indicate an emerging trend and an alert to continue sampling loans with similar identified characteristics. If results of the QC reviews indicate minimal risk, you may want to change your sampling criteria. Maintain consistent sampling criteria for at least a three-month period to allow adequate time for trends to emerge. As a best practice, sample descriptions should reflect the amount of risk the sample represents (e.g., "self-employment income defects are our top driver and we originated 8% of our volume with this income type").

	Gap / Frequently missing in reports	Why Behind the Guide
Prefunding and post-closing *(continued)*	• defect trending information	• Month-over-month defect trending allows you to review several months at a glance. You'll need aggregate data to identify trends so reviewing trends allows you to determine if specific defects are worsening or improving. • Trending helps identify issues and determine if any action plans should be implemented. **While trending at the category level meets Fannie Mae's *Selling Guide* requirements, a best practice is to trend defects at the subcategory or detail level to identify the root cause of a defect trend. For example, trending at the category level of "income" does not provide the actual defect issue. Was the file missing income documentation or was the income calculated incorrectly? These are two distinct types of defects.**
Post-closing	• final defect rate for the results of the current review period (after resolution of the initial QC defects)	• Fannie Mae requires the final defect rate be reflected in your QC report. This rate is calculated after responses and resolutions have been completed. • The defect rate data should be trended and presented to your senior management so that it's actionable. Over- or under-reporting your defect rate will not paint a true picture of loan quality. • If your final defect rate is constantly trending above your target rate, then action should be taken. Actions could include improving calibration with investor eligibility standards and implementing action plans to address the root cause of defect drivers. • Ensure defect rate information is published after all rebuttals have been received and resolved in the required 120-day QC cycle. • *Note:* If your QC cycle exceeds the 120-day requirement by more than 30 days, you must report this to your Fannie Mae QC specialist.
	• distinguishing between defects related to compliance (federal, state, or local laws and regulations) and underwriting and eligibility defects	The most important element to support Fannie Mae's mission of facilitating equitable and sustainable access to homeownership is for lenders to originate loans that meet compliance requirements and have high credit quality. Separating compliance defects from credit defects in QC reporting is necessary to identify potential compliance gaps.

	Gap / Frequently missing in reports	Why Behind the Guide
Post-closing *(continued)*	• using consistent methodology and terminology across each type of review and results (random results reported separately from discretionary results)	• Fannie Mae requires random and discretionary samples in the post-closing review process. Random samples are compiled from your entire book of business, while discretionary samples are used to target high-risk pockets of the origination book. • It is important to highlight the review results of the higher-risk transactions separately from the random reviews. The results from the random reviews can be extrapolated over the entire book of business, while the discretionary results provide insight into potential risks your organization is facing. • ***Note:*** **Utilizing the same defect taxonomy in pre-funding and post-closing reviews will generate consistency, clarity, and action planning across your organization.**
	• QC results properly categorized using the defect severity levels defined in the lender's QC plan, including assigning the highest severity level to loans ineligible for sale to Fannie Mae	• Fannie Mae's minimum requirement is that lenders have one severity level reserved for defective loans classified as ineligible for sale to Fannie Mae. However, we recommend implementing at least two or three levels of defect severity. Two severity levels allow a lender to clearly differentiate between investor ineligibility and all other manufacturing defects; three severity levels allow a greater level of granularity in categorizing the impact of a defect and can help prioritize levels of remediation. Having more than three severity levels can occasionally make it more difficult to classify defects consistently. Ultimately, the number of severity levels utilized should be determined by what best fits your institution's QC defect taxonomy framework. • As a best practice, we recommend utilizing Fannie Mae's Loan Defect Taxonomy to categorize your defects. Alternatively, you can develop your own defect taxonomy.
	• intended corrective actions and action plans	• One of the biggest gaps identified by Fannie Mae is lack of corrective action and action planning against an observed defect. When QC reports reveal defect trends, it's vital to analyze the defect root cause and remedy the issue. • Fannie Mae requires action plan reporting to ensure lenders are actively managing to their quality metrics and remediating identified trends. Effective action planning helps improve the manufacturing process, reduce defects, and ultimately reduce costs.

Bringing it all together

QC reporting is vital in facilitating a continuous feedback loop between management and operations, which is paramount to a successful QC program. The results of both prefunding and post-closing reviews provide a comprehensive picture of your organization's loan quality. Defects identified in post-closing QC reports can highlight areas that may need to be reviewed during prefunding reviews and vice-versa. Reporting can also call out deficiencies that may require corrective action or action planning. QC reporting is the cornerstone for open lines of communication between all departments and enables feedback that produces sustainable origination loan quality.

Next steps

Leverage Fannie Mae's *Selling Guide* to confirm your baseline QC reporting contains all required components. We recommend implementing the following best practices to strengthen your QC reporting and take it to the next level.

- ✓ Socialize your existing QC reports with senior management and stakeholders to gather feedback on the value of the current data and information being provided. Are there additional data points management would like to see or data they found wasn't valuable?
- ✓ Make your QC reports living documents and continuously look for ways to refresh the look and feel of the reports, as well as the data sources used to supplement your QC data (i.e., add repurchase financial information correlating to specific significant defects). Be proactive in finding new ways to display data and make it meaningful to your organization (e.g., using visualization and analytics software; QC vendor reporting).
- ✓ Trend using actual defect details. For example, trend by "undisclosed mortgage" defects versus the broad defect category "liabilities" or by "income calculation – self-employment" rather than just "income".
- ✓ Leverage QC reporting to generate "scorecards" that incorporate QC results data that can be used to highlight individual or group successes and identify training opportunities.
- ✓ Design a suite of QC reports for the different audience levels within your organization. Fannie Mae's QC Boot Camp webinar *Improving Loan Quality Through Effective QC Reporting* discusses designing reports specifically for senior management, department managers, and frontline staff. Providing different QC reporting for all levels can help build a culture of loan quality.

Resources

Selling Guide D1-1-01, Lender Quality Control Programs, Plans, and Processes (08/07/2019)

Quality Control Self-Assessment worksheet

2021 QC Boot Camp Webcast Replays: Improving Loan Quality Through Effective QC Reporting

Loan Defect Taxonomy

May 2022 Quality Insider: Effective quality control action planning

Want more Quality Insider?
Get the inside scoop to get the most out of your quality control processes. **Read now >**