Fannie Mae

Section 3

Post-Closing Quality Control

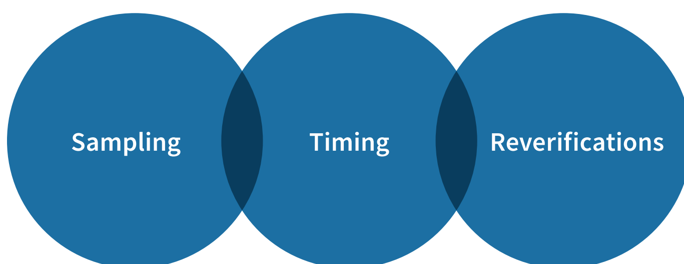
Selling Guide D1-3-01

Post-closing QC is an essential process and key to understanding a lender's quality risk.

The process answers the question, "Is the loan you closed the loan you thought you closed?" If that answer is "no", it is the lender's responsibility to evaluate the severity of the issue and determine if the loan was not eligible to be delivered to the investor. A key part of the quality control (QC) process is also to provide information to eliminate errors on future production. QC results are a critical input to find and correct systemic issues within loan manufacturing. This work can positively impact loans in the origination pipeline and help discover other issues that pose risk.

The post-closing QC process is expected to go beyond the identification and remediation of individual defects. QC should also identify the source and impact of defects. The impact of a defect should be viewed more broadly than just a cause of financial impact to the organization – it can also harm borrowers. Using incorrect income or inaccurate credit data in the origination process can result in an excessive debt-to-income (DTI) ratio that impacts homeowner sustainability.

This section focuses on three key strategies to ensure lenders are properly building and leveraging their post-closing QC program to strengthen controls and operate effectively.



Sampling strategy

Effective QC sampling is fundamental to ensuring your organization has visibility into quality risk. This allows you to leverage actionable insights about the effectiveness of your operational controls and make well-informed QC sampling decisions. This is critical for identifying and mitigating risk as well as strengthening loan manufacturing controls.

Are you being strategic?

- When was the last time you assessed your organization's rationale for selecting your post-closing QC samples?
- Does your QC sampling strategy include trigger points to respond to shifts in production volume and market conditions in order to make necessary changes?
- Are your QC resources sufficient to support the demands of your QC sampling model?

Markets, staff, and loan profiles change over time, and top defects shift as action plans are implemented to remediate and eliminate top issues. Be attentive to your samples and carefully identify areas of new or potential quality risk.

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Fannie Mae requires both random and discretionary sampling as part of the QC file selection process. Random and discretionary samples differ from one another as each method provides a distinct view of risk into your loan population. The review results provide valuable feedback that can drive improvement in the loan manufacturing process and help deliver certainty to your organization by effectively evaluating quality risks and impacts.

Random sampling provides information that represents the quality of your total loan originations for a particular period. The random sample gives you an investor-agnostic look at the overall quality of your originations and can surface issues that exist outside typical high-risk areas. For example, is your origination team less diligent in making sure all derogatory credit is properly addressed on lower loan-to-value transactions? Is your team adhering to the investment quality guidelines for loans that are being placed in an investment portfolio?

The table below is a simple depiction showing distribution of a random QC sample. The chart illustrates how you can ascertain if your sample coverage is adequate across different origination segments. This allows management to see that the sample provides a representative view of different products, purposes, and origination sources.

Random QC sample distribution by product, purpose, and channel

	Conv.	FHA	VA	USDA	Portfolio	COR	LCOR	Purch	Retail	CORR	Broker
Closed loan % (curr. mo.)	55.00%	36.00%	5.00%	2.00%	3.00%	15.00%	23.00%	62.00%	75.00%	20.00%	5.00%
Post-close QC% (curr. mo.)	52.00%	33.00%	6.00%	3.00%	6.00%	12.00%	28.00%	60.00%	71.00%	24.00%	5.00%
Closed loan % (roll 3 mo.)	50.00%	35.00%	5.00%	5.00%	5.00%	20.00%	35.00%	45.00%	78.75%	17.25%	4.00%
Post-close QC% (roll 3 mo.)	49.50%	34.50%	5.00%	5.50%	5.50%	17.00%	33.00%	50.00%	73.00%	20.00%	7.00%

Random sampling – 10% versus statistical method

Lenders have the option to implement one of two methods of random sampling:

- a 10% sample of all monthly loan production, or
- a statistically valid sample of all monthly loan production.

Both samples require the lender to randomly select loans. Knowing which sampling method is best for your organization is essential to efficiently allocating your QC resources.

- The **random 10% sampling method** is generally used by lenders with annual production of 3,500 or fewer loans. Benefits of this sampling method include:
  - simple implementation without the need to manage a statistical calculation process
  - no periodic evaluation required to ensure the sample size is valid
  - tends to strike the most balanced use of QC resources for smaller production populations
  - produces results that can be used to extrapolate loan quality conclusions across the entire book of business

- The **statistical sampling method** is generally advantageous for lenders with annual production of more than 3,500 loans. Benefits of this sampling method include:
  - produces statistically valid results that can be used to extrapolate loan quality conclusions across the entire book of business with different confidence and margin of error factors
  - for lenders with a consistent defect rate, produces a predictable monthly sample that does not vary due to large swings in production volume.

If the statistical sampling method is used, at a minimum, the statistical sampling model (variables) must be calculated using a 95% confidence level with a 2% precision rate and a statistical statement of a **maximum** of six months. Lenders with strong risk management controls frequently use a three-month (Fannie Mae recommended) or one-month statistically valid statement. This strategy increases the sample size, reduces the margin of error, and provides a more accurate view of the quality of the overall book of business over a shorter period. A random sample must contain a minimum selection count that will still provide a meaningful monthly review. Statistical samples can generate smaller sample sizes with more precision; however, a notable misstep is being dismissive of results that identify only one or two defects. Mitigate this risk by setting a minimum floor on your sample size. Whether you choose the 10% or statistical sampling method, a full-file review must be completed.

Although these samples have specific attributes that influence their selection, full-file reviews are still useful in testing for known and unknown risks and can provide information to assist in action planning.

Discretionary or targeted sampling

Discretionary selections supplement a lender's random sample. The purpose of a discretionary sample is to **identify and test loans that may pose unique or elevated risks and validate that certain controls and processes are working as intended**. This supports the overarching goal of the selection to provide insights on the general loan production quality. Some lenders perform multiple discretionary samples for specific individual risks while others may perform a single discretionary sample with a group of defined risk attributes. Discretionary loan samples provide a more surgical approach to loan testing and can be accomplished through either full-file or component reviews that are tailored to the specific purpose of the discretionary testing.

Discretionary review requirements

Discretionary selections allow you to optimize your reviews and target high-risk loan characteristics identified in your prefunding and post-closing random selections. The risk factors utilized in your selection criteria should be current, relevant, and defined in the monthly reporting. Targeted component reviews allow flexibility to increase the overall number of reviews completed on your loan production.

Discretionary full-file sampling strategies

Full-file reviews require reverification of all components. Below are some examples of when full-file reviews are appropriate:

- sample targeted to test new hires, new products, and/or newly implemented processes
- sample targeted to test at least one loan from all third-party originators for an annual review
- selections based on layered risk loan attributes

Although these samples have specific attributes that influence their selection, full-file reviews are still useful in testing for known and unknown risks and can provide information to assist in action planning.

Discretionary component file sampling strategies

Targeted reviews allow reverification of only those elements being tested. Optimizing QC resources while monitoring many possible risks is always a challenge. As discussed in the prefunding section, component reviews are an effective way to accomplish this objective.

Targeted areas may include:	Full-file	Component
Validate all required assets from sale of property were documented		✓
Loans with complex income calculations (e.g., rental, self-employed, or short history of income)		✓
Confirming borrowers were employed at closing		✓
Loans originated / processed through various business sources, branch offices, personnel, contractor, third-party originator, or appraiser	✓	✓
Loans with top defects identified in prefunding or investor results		✓
Analyzing root causes for development of action plans to reduce known defects in the future or to test the effectiveness of implemented corrective actions		✓

Note: Some files may start out with a component review but wind up needing a full-file review. This highlights the flexibility component reviews can bring to your testing strategy.

Component reviews typically take less time to complete, which enables you to cast a wider net over known risk components, yielding more efficient use of review resources. Employing component reviews saves time, which may increase the percentage of loans that can be reviewed without having to increase staff. Full-file reviews are best leveraged for loans with layered or broader risk.

Other data to consider

Continued advancements in the manufacturing process, along with enhanced reporting capabilities, provide opportunities to target selections on a variety of data points to assist in your discretionary selections.

- Automated underwriting system recommendations can be targeted to determine if the loan met the underwriting recommendations.
- Income validation sources can identify calculation discrepancies.
- Undisclosed debt monitoring tools can help target loans with higher DTI ratio concerns.
- Closing disclosure data elements can identify excessive interested party contributions.
- Collateral Underwriter® scores and messaging can be used to assess the appraisal.
- EarlyCheck™ identifies eligibility defects that would be flagged at loan delivery.

Leveraging data to make informed discretionary selections is a best practice. The prefunding QC section of this guide addresses sampling effectiveness and defect capture rates – concepts that can be equally effective in post-closing discretionary testing.

Leveraging data to make informed discretionary selections is a best practice.

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Post-closing QC timing strategy

Mortgage loans must be selected for post-closing QC reviews on at least a monthly basis. Effective as of the September 2023 QC cycle, the entire QC process (selection, review, rebuttal, and reporting) must be completed within 90 days from the month of the loan closing.

Example: Fannie Mae required 90-day post-closing QC audit time

Audit cycle stages	Day 1-10	Day 11-70	Day 70-90
Prior month's funded loans selected and prepared for QC review. Initiate reverification process: credit/employment/income/asset, etc.	*10 days*		
Complete comprehensive file reviews with reverification, remediation, and rebuttals complete, and sample closed.		*60 days*	
Post-closing monthly QC reports created and published to senior management by day 90.			*20 days*

The 120-day QC cycle was a legacy requirement that was put into place prior to technology enhancements that allow for a shorter cycle. Many lenders perform their QC cycles within a much shorter timeframe to get QC results to the business as quickly as possible. Providing management with results in a shorter time enables senior leadership to action plan and remediate top issues shortly after the issues have been detected. The example below demonstrates how time frames for each step can be adjusted to achieve shorter timelines that best practice lenders achieve versus the Fannie Mae minimum required 90-day cycle.

Example: Process excellence 45-day post-closing QC audit time

Audit cycle stages	Day 1-5	Day 6-35	Day 36-45	Day 64-90
Prior month's funded loans selected and prepared for QC review. Initiate reverification process: credit/employment/income/asset, etc.	*5 days*			*45-day lift in executive management reporting*
Complete comprehensive file reviews with reverification, remediation, and rebuttals complete, and sample closed.		*30 days*		
Post-closing monthly QC reports created and published to senior management by day 90.			*10 days*	

Start the reverification process as soon as possible - reverifications often require multiple attempts, and an effective QC review includes having reverifications in the file when reviewed!

Reverification strategies

The reverification of all information relied upon to make the underwriting decision is critical to an effective post-closing QC review process. Benefits to performing reverifications include:

- validates the accuracy of the data used to support the loan decision
- provides data that helps ensure the loan is **still eligible for sale to Fannie Mae** when irregularities are identified in the credit or collateral file
- serves as a preventive control by keeping industry participants mindful that a portion of loans will be verified again
- significantly contributes to the identification of misrepresentation by finding file irregularities that lead to identifying individual and systemic fraud schemes.

"Reverification" is confirming that employment, income, asset, and collateral data used to qualify the borrower is true, accurate, and justified. Each element of the loan file can require different methods to ensure complete reverifications. The following tables highlight the expectations for the reverification process.

Income and employment reverification

Reverification	Questions to ask, things to consider, best practices to increase confidence in accuracy
Employment	Was the borrower(s) employed at the time of closing? (Note: Borrower Not Employed at Closing is a top defect cited by Fannie Mae.)
Income	Was the income used to qualify the borrower(s) represented accurately? • If the employer is not willing to reverify income, ask if they can confirm the amount if provided to them.
Self-employment	Can you verify if a business is legitimate? This is especially critical for self-employed borrowers. • To validate a business, try one or more of the following tactics (this is critical if the borrower is self-employed): ◦ Perform an online search of the business address to confirm its existence. ◦ Look for current business advertisements. ◦ Search business name and/or phone number via reverse look-up. ◦ Search state and corporate/LLC business licensing websites (i.e., Dunn & Bradstreet®, Manta, etc.).
4506-C Tax Transcripts	• Upon receipt, reconcile transcripts with income documents used to qualify the borrower(s) and look for discrepancies. • Compare income documents and information (e.g., borrower's name and address against W-2s) to Form 4506-C to prevent rejections of the form. • **Tips for success:** ◦ Add checks in prefunding /pre-purchase QC to ensure the signed Form 4506-C is completed correctly. ◦ Order transcripts as early as possible during the post-closing QC cycle to allow adequate time to receive them prior to the start of the QC review. ◦ If using a QC vendor, consider pulling transcripts in-house and sending them to the vendor. Alternatively, if the QC vendor's attempt to obtain transcripts fails, ask the vendor to refer the loan back to your QC team for review and a reattempt. ◦ Ensure QC cites a defect when Form 4506-C can't be executed. Discrepancies identified during the reconciliation of tax transcripts versus the income data used to qualify the borrowers can reveal both income and employment misrepresentation.
Social Security / Disability Awards Letter	Is Form SSA-3288 completed accurately? • Pay any fee associated with obtaining this information from the Social Security Administration. • Perform a routine prefunding QC targeted component review of Form SSA-3288 prior to loan closing. Test for presence, accuracy, and completeness so that if errors are found, they can be corrected prior to loan closing and funding.

Source of funds reverification

Funds used for down payment, closing costs, and any required reserves must be reverified directly with the source of the original documentation (such as financial institutions and gift donors). Asset reverification significantly contributes to the identification of misrepresentation, highlighting areas where there may be heightened risk that requires additional oversight and manufacturing controls.

Reverification	Questions to ask, things to consider, best practices to increase confidence in accuracy
Assets	• Do balances on the reverification bank statements align with the balances reflected on the origination bank statements? • Are there any undocumented large deposits? This is especially critical when reviewing for undisclosed debts to source the borrower(s) down payment. • Do payroll deposits align with the income documentation used at origination? This can be helpful in determining if the bank statement has been altered from its original state. • Is the borrower an account holder on the reverification bank statement? • Are there any red flags on the documentation used to qualify the borrower(s)? • Review bank statements for recent payroll deposits; the information may indicate a change in the income level and/or payroll deposits from a different organization. Expect high-income earners to have direct deposit.
Gifts	• Do gift letter reverifications support that the funds were not borrowed?

Having insight into your reverification results is imperative to the overall success of your QC program. Asset reverifications provide valuable information on the overall risks facing your organization and allow your QC department to proactively mitigate these risks.

Occupancy reverification

A vital step to validating occupancy of the subject property is identifying inconsistencies in the loan file that raise questions about the authenticity of the occupancy as disclosed. The presence of one or more red flags in a file does not necessarily mean the occupancy is inaccurate, but it should warrant further investigation.

Reverification	Questions to ask, things to consider, best practices to increase confidence in accuracy
Occupancy	• Check to see if borrowers changed their mailing address shortly after closing or loan setup. • Contact the insurance company and validate the terms of coverage - has a homeowner's policy been converted to landlord policy or vice-versa? • Reverify any lease agreements in the file, especially on the borrower's departure home, to confirm the authenticity. • Use MERS® registration to identify potential undisclosed mortgages: Is the borrower in the process of purchasing a new primary home or a new rental? Is the borrower in the process of obtaining a cash-out refinance on another property? • Validate the borrower's primary residence with driver's license, voter, or vehicle registrations. • Confirm whether the borrower has applied for homestead exemption at the subject property. • Use third-party tools and/or door knockers to confirm who resides in the subject property. • Review the servicing notes to identify changes to the mailing address or indications that the occupancy is not accurate at origination. • Track any returned mail that was addressed to the subject property.

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What to do when reverifications are not returned

Despite your best efforts, there are times when reverifications do not get returned. In those instances, other activities can provide a level of assurance that the information used for the lending decision was accurate. The depth of additional due diligence and time spent should take into account the likelihood of a potential issue or indication of red flags. See *Beyond the Guide* Section 4, Red Flags, Fraud Detection, and Managing Risk Tools, for more detail.

Reverification	Questions to ask, things to consider, best practices to increase confidence in accuracy
Employment	• Email the borrower at his/her work email address to request a reply. • Obtain the borrower's employer's work number from the internet and call to speak to the borrower. • Use social media to look for evidence of borrower job changes. • Review bank statements for recent payroll deposits; the information may indicate a change in the income level and/or payroll deposits from a different organization. Expect high-income earners to have direct deposit. Do the asset amounts align with what is expected for the income level? • Review the credit report; is the employer listed differently from what is disclosed on the application?
Income	• Recheck Social Security withholdings on paystubs and W2s in the loan file (confirm correct percentage through IRS.gov). • Review the credit report; is the employer listed differently from what is disclosed on the application? • Review bank statements for recent payroll deposits; the information may indicate a change in the income level and/or payroll deposits from a different organization. Expect high-income earners to have direct deposit. Do the asset amounts align with what is expected for the income level? • Search websites such as Glassdoor.com or Indeed.com for salary ranges for the borrower's profession, which might raise a red flag that warrants further investigation. • Check websites for state and federal employee salaries that are public records (i.e., teachers, police officers, city workers, etc.).
4506-C Tax Transcripts	• Track attempts to obtain transcripts and the IRS rejection reasons (e.g., sent date, receipt date, rejections; by branch, originator, third-party originator). • When transcripts are not received, document the attempt and the rejection reason in the QC file. • Review periodically for trends (higher level of failures for certain staff or origination sources). • If a trend of failed attempts is identified, conduct a component discretionary QC sample targeting the trend characteristics. Focus reviews on income only and obtain tax transcripts. • Investigate the root cause of all rejections and implement a corrective action plan, when necessary.
Assets	• Do payroll deposits align with the income documentation used at origination? This can be helpful in determining if the bank statement has been altered from its original state. • Is the borrower an account holder on the reverification bank statement? • Are there any red flags on the documentation used to qualify the borrower(s)? (See Red Flags, Fraud Detection, and Managing Risk Tools section.) • Do the asset amounts align with what is expected for the income level?

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Reverification tracking: a powerful QC review tool

A reverification tracking system is a highly recommended best practice and can be a very effective tool for optimizing your overall reverification success rate. Aggregating reverification data helps organizations be more effective in several ways. First, from a risk management perspective, it can help identify different parties (loan officer, branch, broker, correspondent, etc.) with reverification return rates significantly lower than average. This can indicate a potential discrepancy worth monitoring or investigating. Second, from a review efficiency perspective, tracking average return times for reverifications can help optimize your process to ensure reverifications are present at the start of the file review process, allowing for fewer touches in post-closing QC. Capturing even a couple of unique data elements from the reverification process can provide important data for your organization.

A tracking system should capture:

- date the reverification was sent,
- target receipt date based on average turn times for the entity,
- follow-up date based on the average number of days needed for processing,
- second attempt sent date,
- date each reverification was received.

Optional information to capture could include the name of underwriter, processor, loan officer, branch, third-party originator, employer, and/or financial institution.

Loan-level reverification information can be summarized to show the overall success rate, as well as to highlight potential reverification inconsistencies or anomalies, which can be investigated and corrected.

Example of a reverification tracker summary report

Reverification	Oct-20					Rolling 3-month				
Tracking	Ordered	Received	Success rate	Discrepancy*	Discrepancy rate	Ordered	Received	Success rate	Discrepancy	Discrepancy rate
Asset documentation	184	152	82.61%	4	2.63%	389	303	77.89%	9	2.97%
Gift letters	13	9	69.23%	1	11.11%	27	22	81.48%	5	22.73%
Income documentation	196	187	95.41%	11	5.88%	553	514	92.95%	18.00%	3.50%
Employment	190	175	92.11%	2	1.14%	537	494	91.99%	13.00%	2.63%
IRS transcripts	87	83	95.40%	3	3.61%	235	224	95.32%	13.00%	5.80%
Credit reports	101	101	100.00%	0	0.00%	286	276	100.00%	1.00%	0.35%
Field reviews	11	11	100.00%	4	36.36%	29	29	100.00%	6.00%	20.69%

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Example of discrepancy tracker report

October discrepancies	Total issues	Details
Assets	4	Assets Not Supported (3); Account Does Not Belong to Borrower (1)
Gift letters	1	Donor Did Not Sign Gift Letter
Income documentation	11	Income Not Supported (9); Income Statements Fraudulent (2)
Employment	2	Borrower No Longer Employed (2); Borrower Time on Job Inaccurate- Missing Full Two-year History (1)
IRS transcripts	3	IRS Code 10 Reject
Field reviews	4	Value Not Supported- CURS 3.5 (1); Use of Dissimilar Comparable Sale(s)- CURS 4.5 and 5 (2); Subject View of Location Reported Inaccurately- CURS 1.5 (1)

Track the success rate for all entities involved in the loan manufacturing process and create an aggregate view to identify potential areas of risk. Tracking the reverification success rate and capturing key data points enables the QC department to more easily spot outlier return rates that may warrant a closer inspection. This will help to increase your QC program's efficiency and enable implementation of proactive mitigation measures.

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Next steps – tips for a successful reverification process

Efficiency is critical in every phase of the mortgage process, including post-closing QC. It is more efficient to have all reverifications received before the file is reviewed by the QC auditor. This allows the auditor to have all critical information available for a one-time QC file review.

- Get a head start by pulling your post-closing QC sample as early as possible (i.e., pull weekly throughout the month as loans close; you can sample early even if you don't start reviews for several weeks).
- Start ordering reverifications immediately after the loan has been selected for review, increasing the likelihood of having responses received when your auditor starts or allowing time for a second attempt.

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- Establish a reverification tracking mechanism for follow up.
  - What is the overall success rate?
  - Do you have target rates in place?
  - Do you have indicators to alert you to anomalies?
  - Do you have an action plan in place in case of poor results?
- Attempt to reverify several times until you are successful. Fannie Mae has noticed increased success for lenders who perform two or more inquiries. Once you have successfully received your reverifications, analyze all documents with a critical eye. If something doesn't add up, investigate further.
- If a written reverification is not received, follow up with a phone call to try to reverify the information verbally. Be sure to capture the telephone number, name, and title of the person who provided the information.
- Having insight into your reverification results is imperative to the overall success of your QC program. Reverifications provide valuable insight into the overall risks facing your organization and allow your QC department to proactively mitigate these risks.

Reverifications serve as a detective and preventive control in the QC process. They significantly contribute to the identification of potential misrepresentation, highlighting areas where there may be an increased risk that calls for additional oversight and manufacturing controls. Reverifications provide useful information about a subject transaction, and aggregated reverification data creates a powerful tool that provides insights to help you build a more effective QC process. Aggregating reverification data can highlight trends and potential risks that you cannot see on a loan-by-loan basis.

Reverifications significantly contribute to the identification of potential misrepresentation, highlighting areas where there may be an increased risk that calls for additional oversight and manufacturing controls.

Resources

Selling Guide D1-3-01

Best practices for income and employment verifications

Guidelines Related to the IRS Form 4506-C and Tax Return Transcripts

QC Self-Assessment Worksheet

QC Post-Closing Collateral Risk Assessment FAQs

Post-purchase Review Process Overview

Sample Quality Control Vendor Management Documents

Reverifications Tracker Template

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