Takeaways From Fannie Mae’s 2023 QC Boot Camp

High performing organizations that generate high quality results know that delivering high quality mortgages requires intentional and thoughtful action on a regular basis. In June 2023, over 300 mortgage professionals from 190 lenders gathered in Dallas to learn ways to enhance their mortgage quality control (QC) programs. Through nine Fannie Mae-led sessions over two days and opportunities to connect with their peers and Fannie Mae experts, attendees gained valuable insights to improve mortgage loan quality. Here are five of them:

1. Loan defect rates have been climbing since early 2021.

The industry’s gross and net significant defect rates have risen over the last few years, and the gap between them has widened. To address the increasing trend in the defect rate, Fannie Mae continues to take action and make changes that enhance the industry’s control environment so we have a lens of continuous improvement. Fannie Mae shared recently-implemented actions, such as an action-planning framework and Prefunding QC enhancements. We remain focused on helping the industry move back to generating higher-quality loans. A key element of this discussion reflected on the fact that properly evaluating borrower eligibility helps ensure borrower sustainability, reduces cost, and removes noise from the process.

2. Always be thinking about your sampling strategies.

Implementing an effective sampling strategy is critical to the success of your QC reviews. In today’s environment, as audit resources are deployed to monitor and evaluate quality risk, these reviews should be designed to find and address that risk.

Select samples of loans in each review cycle by employing a strategic, intentional rationale. Regularly evaluate the strategy and adjust as risk shifts. Random samples reflect the total quality risk in your entire book of business. Are you assessing how to find the quality risk that your random sample is showing by using targeted samples to pull that risk forward?

Discretionary, or targeted, sampling should be dynamic and a topic discussed by QC and other areas, including Operations, on a monthly or quarterly basis. During these discussions ask: What loans are you sampling? How large are your samples? Do your samples effectively address your risks?

Are you assessing how to find the quality risk that your random sample is showing by using targeted samples to pull that risk forward?

Leverage discretionary sampling to identify areas that may pose unique or elevated levels of risk and confirm controls or processes are working as they should be. A best practice is to employ proactive discretionary sampling during prefunding QC to find and address risk early in the loan manufacturing process.

3. Utilize prefunding QC to the fullest.

Prefunding QC is the most important tool in your QC toolbox for identifying risk and remediating it before you own it. Invest in pulling risk forward, i.e., address risk before loans are closed, use strategic discretionary reviews, and mitigate risks before they become problems or financial liabilities. Consider moving efforts from post-closing QC to prefunding QC to do the important work of identifying as many defects as possible before you close the loan and own the risk. Invest in prefunding QC wisely – the requirements in the Selling Guide are a starting point.

4. Action planning is a vital component of a solid QC program.

Fannie Mae actively works with lenders with elevated defect rates. While many lenders have processes to solve for top defects, these processes often aren't as effective as they could be. True drivers of defects in an organization may not be fully addressed, and quality issues last longer than they should. The key elements of problem solving that generate more effective action plans include:

- **Determine the defect.**
  Clearly define the problem to be solved.
- **Assess current state/root cause.**
  Do not jump to the easiest or first answer that comes to mind. Employ processes that help get to the root of the issue.
- **Design solutions.**
  Once the drivers of a defect issue are identified, deciding on the best path forward and potential trade-offs is important.
- **Establish and execute solutions.**
  Clear ownership, accountability and well thought out timelines are critical elements.
- **Test and evaluate solutions.**
  Implement solutions and design samples to let you validate the changes are working.
- **Monitor effectiveness and sustainability.**
  Once implemented, active monitoring for a defined period ensures success or highlights the need for additional focus.

Though not part of the day-to-day QC work of selecting loans and reviewing them, action planning is a direct result of that work. The information you gather and the stories you tell about loan quality are important, and they should be key factors in changes made within your organization. It's easy to review loans and present data; it's hard to build and maintain relationships with your operations, technology, and risk teams to work together on root cause analysis, design solutions, and execute on those solutions. However, this effort is part of a solid QC program.

5. Effective reporting highlights successes and shines a light on opportunities.

Effective management level reporting is a critical element of an effective QC program. Reporting should clearly reflect the defect rate, which represents risks taken by the organization (the defect rate) and established quality risk appetite (the target defect rate). Examples of critical elements include:

- **Defect capture rate**
- **Accurate reflection of quality risk applied against origination book**
- **Cost of quality related to lender defect rates and targets**
- **Trending that highlights ongoing or emerging opportunities**

Good QC reporting goes beyond sharing numbers. Reporting is an opportunity to tell stories. For example, why might the defect rate on loans with rental income be 13%? Why did we sample loans with rental income? What, if anything, are we going to do about that 13% defect rate?

Reporting also should put numbers in historical context. If you are looking at self-employment income, what is the defect rate in the most recent discretionary review vs. the defect rate six months ago? Are you getting better or worse?

The cost of defects is a part of the story about why taking action based on defect counts and trends is meaningful. Consider reporting as an opportunity to share dollar values. QC is a capital preservation area of the mortgage origination business, and quantifying the cost of defects can help management understand the decisions you make.

Next steps

If you attended QC Boot Camp, engage with your peers and colleagues and evaluate your firm's work in each of these five areas. Ask how you can support your organization and quality teams in implementing continuous improvement opportunities across the above elements.

If you did not attend, utilize the above information to critically evaluate opportunities you may have. As always, Fannie Mae's team of QC Specialists is available to support you and your organization.

Resources

Beyond the Guide Section 2: Prefunding QC

Beyond the Guide Section 6: QC Reporting

Beyond the Guide Section 7: Corrective Action and the Action Plan

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