QC Calibration – Key Learnings and Observations

How do a lender's quality control (QC) results correlate with Fannie Mae's review of lenders' loans?

Fannie Mae began performing QC calibration exercises across a larger segment of our customer base in 2023. The key objective of QC calibration has been to provide feedback to help lenders determine if their internal QC program is accurately identifying and classifying defects. In addition to transaction-level observations, calibration exercises can also generate observations relative to program governance-related items in the context of Fannie Mae Chapter D *Selling Guide* requirements.

As we wrap up our 2023 reviews, we are pleased to share the insights from the exercises. Each lender selected to participate in the calibration provided Fannie Mae with loans that were randomly chosen during their selection process. Fannie Mae then conducted full-file re-underwrites, looked at QC findings, and evaluated the status of self-reported loans.

Here are some key observations from the calibration exercises lenders can use to strengthen their QC program:

- **At the significant defect level, lenders did a good job of identifying loans with significant defects in their sample (i.e., loans with errors that render them ineligible for delivery).**

  Whether the defects were related to income, assets, or credit, lenders consistently cited them. While Fannie Mae found instances where the lender should have cited a significant defect but did not, those were the exception, not the rule.

- **Collateral-related quality control issues were not identified by lenders at the same frequency and at all severity levels as Fannie Mae.**

  More than half of the lenders cited no appraisal findings in their QC reviews on loans where Fannie Mae cited appraisal findings. Fannie Mae found numerous examples of data integrity issues on appraisals with CU scores under 2.5. Although most significant defects for collateral are cited on appraisals with CU scores above 2.5, rep and warrant relief is only achieved on an appraisal with a sub-2.5 score if the subject is accurately described. The accurate description is key; correct condition and quality ratings are vital, and the photos and words should match.

  Lenders should evaluate their post-closing QC process related to Fannie Mae's collateral risk assessment requirements to ensure they are appropriately identifying collateral quality risk across the quality spectrum. QC areas should meet regularly with origination reviewers to be sure they are working from the same playbook and using the same tools to be certain the same issues are discovered. Finally, lenders and their QC vendors should be utilizing Collateral Underwriter® to strengthen their post-closing collateral risk assessment.

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- **Numerous instances of self-reporting violations were found.**

  Fannie Mae's requirement per *Selling Guide* D1-3-06, is that lenders self-report loans found by the Quality Control team to have a defect making the loan ineligible for sale to Fannie Mae within 30 calendar days of confirming the defect. The calibration exercises identified instances in which the timeframe was exceeded, or loans were simply not self-reported. Lenders are required to self-report loans through Loan Quality Connect™.

- **Lenders may benefit from reviewing the classification of errors/issues related to the 4506-C.**

  The calibration exercises revealed that lenders should consider various defect names related to the variety of 4506-C errors that can arise to assist with root cause analysis. Were the transcripts ordered but not returned in time for the QC review? Were the transcripts ordered but the 4506-C was rejected because of an incorrect address? Were business transcripts not ordered because the 4506-C form was missing? These variations on the core problem – required tax transcripts not in the file – should be categorized differently so lenders have the data to treat the root cause of the problem.

- **There is an opportunity for some lenders to strengthen their defect taxonomy. Similarly, lenders may find value in reviewing the process for writing defect text.**

  Understanding that complete alignment to the Fannie Mae loan defect taxonomy may not be realistic, the calibration exercises nonetheless revealed instances in which lenders can benefit from stronger ties to the taxonomy. For example, citing a loan with the inaccurate defect subcategory of *Appraisal Documentation* does not name the root of the problem on a loan where a field review found the original appraisal's value to be unsupported.

Calibration has many benefits. It adds transparency in the loan review quality, thereby strengthening confidence in defects lenders identify. It reinforces defect standardization, allowing for more actionable feedback.

For lenders who will go through the calibration exercises (or for lenders who undertake calibration exercises internally), approaching calibration results by asking, "Why did a different QC process on the same loan generate a different result?" is the key to benefitting from the process. This learning mindset – taking knowledge from having different eyes on the same loans – leads to the main goal of calibration: improving QC and overall loan quality.

Resources

Fannie Mae Chapter D *Selling Guide*

Post-Closing QC Collateral Risk Assessment Analysis (Form 1033)

Selling Guide D1-3-06 Lender Post-Closing Quality Control Reporting, Record Retention and Audit

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