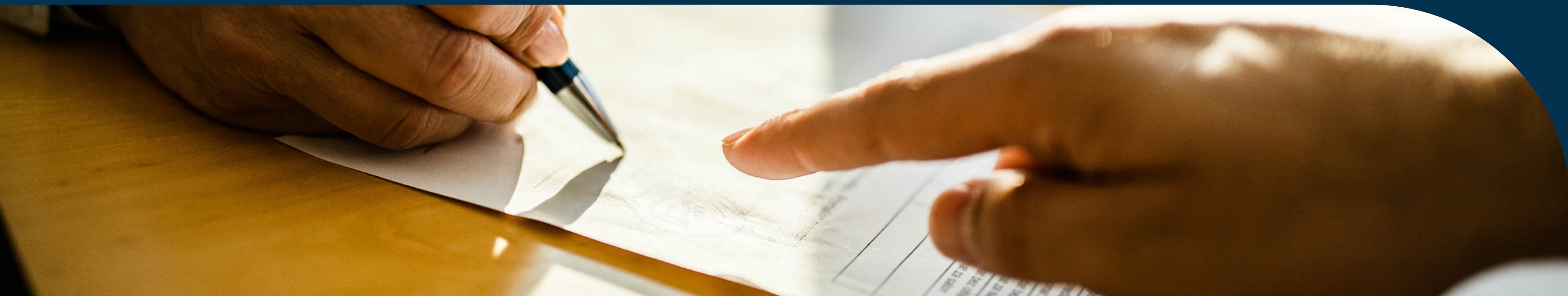

Strengthen your QC program: QC independence and internal audit requirements

This edition of *Quality Insider* is the fourth installment in our series designed to strengthen core QC governance elements. This article focuses on the importance of maintaining clear QC independence and an effective internal audit program of the QC functional area.

QC independence is vital to a strong quality control (QC) program as it preserves the integrity of the QC process. The QC team must be free to perform an impartial review of the loan-level quality and provide unbiased reporting to management. Maintaining a healthy enterprise risk management program requires QC independence to produce QC reporting that surfaces the potential risks facing your organization as well as clear, concise, and actionable insights.

An internal audit provides an independent validation of a lender's governance, risk management and control processes of their QC function. QC testing and reporting processes are critical to ensuring loan quality. A strong QC program actively monitors these functions to identify gaps in quality and subsequently implement action plans. An internal audit helps lenders ensure that their QC program is compliant with the *Selling Guide* and that the QC requirements are consistently and equally applied.

Ask yourself:

- Does our QC department operate independently to ensure all activities are conducted in an unbiased manner and without quality compromises resulting from internal influences or conflicts of interest?
- Do we have an effective, independent oversight process for mortgage origination QC?
- Does our audit program have adequate scope to assess compliance with written policies and procedures?
- Do our audit program personnel possess the necessary familiarity in the mortgage industry to be effective?
- Does our audit program and reporting structure ensure no influence from other business units or bias in the QC conclusions?
- Is our audit program empowered to influence change when gaps are identified?

What is Fannie Mae observing for QC independence (prefunding and post-closing)?

	Gap / Frequently missing	Why behind the Guide
Post-closing QC	• Post-closing QC department is not independent of mortgage originations and production. D1-1-02, Lender Quality Control Staffing and Outsourcing of the Quality Control Process (08/07/2019)	To preserve the integrity of the process, all post-closing QC employees (including those related to establishing, monitoring, and enforcing procedures) must be independent of the production, underwriting, and closing departments. ***This is important to ensure QC staff are not being influenced to alter QC results.*** Lines of reporting must reflect the independence of the audit process at all levels. This ensures all activities are conducted in an unbiased manner and without quality compromises resulting from internal influences or conflicts of interest.
Prefunding QC	• Prefunding QC process does not operate independently of the lender's production department. D1-2-01, Lender Prefunding Quality Control Review Process (03/28/2017)	The lender's prefunding QC process must operate independently of the lender's production department, if practical. At a minimum, prefunding QC must be conducted by individuals who have no involvement in the processing and underwriting decision of the loan being reviewed.

What is Fannie Mae observing for audit review of the QC process?

	Gap / Frequently missing	Why behind the Guide
QC Audit Plan	D1-1-01, Lender Quality Control Programs, Plans, and Processes (08/07/2019)	Internal audit must be able to follow the lender's written QC plan to ensure the QC program is operating at the set standards and independently without influence by parties invested in QC review results. Lenders that fail to maintain an effective QC program will be in breach of their contractual obligations with Fannie Mae.

	Gap / Frequently missing	Why behind the Guide
QC Program Audit	• Does not have a process in place to audit the post-closing QC process, including: ◦ does not have an internal audit function. ◦ has an internal audit function but it is not independent of the business functions it reviews. ◦ does not have a comprehensive written plan to direct the internal audit process across all loan manufacturing and servicing business functions. ◦ has an internal audit program but has not initiated the internal audit process. ◦ has not established an internal audit schedule to specify the areas of review and time frame in which they will be conducted. **D1-3-06, Lender Post-Closing Quality Control Reporting, Record Retention, and Audit (08/07/2019)**	The lender must have an independent audit process to ensure that its QC process and procedures are followed by the QC staff, and that assessments and conclusions are recorded and consistently applied. The findings must be accurately recorded and consistent with the defects noted in the lender's system of record. Lenders must have internal audit and management control procedures to evaluate and monitor the overall quality of its loan production. At a minimum: • The procedures must be independent of all key functions of the loan manufacturing process that they review, so that such procedures provide an objective and unbiased evaluation that adds value and improves the seller's operations. • The seller's lines of reporting must reflect the independence of the audit process at all levels, resulting in activities that are conducted in an unbiased manner and without quality compromises resulting from internal influences or conflicts of interest. • The audit function must not share any reporting lines with the functional areas that it reviews. • The audit function must report directly to the seller's senior management and/or board of directors. The procedures must be consultative, so that they help the seller accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes Results of the QC audit must be distributed to senior management. Fannie Mae requires the audit report to include an affirmative statement that no influence from other business units or bias in the QC conclusions was apparent. Management must distribute the results to the appropriate areas within the organization and an action plan must be established for remediation or changes to policies or processes, if appropriate. The lender must provide copies of the QC loan-level review findings and the results of the internal QC audit to Fannie Mae upon request. Lenders must be able to demonstrate their QC program has: • clearly defined testing protocols that are governed by change control and approval authority that support program-level independence, and • documentation at the loan level that supports changes to audit decisions made during the review and rebuttal process.

An internal audit helps lenders ensure that their QC program is compliant with the *Selling Guide* and that the QC requirements are consistently and equally applied.

Next steps

As part of your enterprise-wide risk management culture, be sure:

- Prefunding and post-closing QC reporting structures must be completely independent of production, underwriting, and closing departments.
- Prefunding reviews are performed by staff not involved in the processing and underwriting of any loans.
- Annually conduct an independent audit review of the QC process to maintain a robust risk management program. Clearly define the scope of the audit process as well as the proposed schedule.

Resources

Quality Control Self-Assessment worksheet

Audit and Management Control Requirements

Internal Audit Self-Assessment

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