

Loan Quality Initiative: Policies and Delivery Implementation

June 2010

An important note about the seminar content

While every effort has been made to ensure the reliability of the session content, Fannie Mae's Selling and Servicing Guides and its updates, including Selling Guide Announcements and Release Notes, are the official statements of Fannie Mae's policies and procedures and control in the event of discrepancies between the information in this seminar and the guides.

Meeting Objectives

- Review the policy clarifications and new policies; implementation approaches and timing
- Provide an overview of the tools and services available for a smoother transition
- Review next steps

What is the Loan Quality Initiative?

- Fannie Mae conducted an extensive analysis to determine the primary drivers of repurchase requests and has launched the **Loan Quality Initiative (LQI)** to identify and implement policy, process, and technology enhancements to improve the compliance with underwriting and eligibility guidelines and mitigate repurchase risk.
- Primary focuses of LQI include:
 - Capturing critical loan data earlier in the process and validating it before, during, and immediately after loan delivery
 - An updated approach designed to stand the test of time across market cycles and risk tolerances
 - Reducing repurchase requests through improved data integrity and consistent and early feedback on policy compliance while maintaining the current business model of relying on lenders to make appropriate decisions in accordance with Fannie Mae's guidelines.

Fannie Mae's Objectives for the Loan Quality Initiative

- Help lenders deliver loans that meet:
 - Standard and negotiated contract terms (*Selling Guide* and variances)
 - Pricing eligibility
 - Credit eligibility
- Know more about the loan before it is purchased
 - Confidence that the data of the delivered loan is complete, accurate, and represents the closed loan
- Provide tools that help lenders consistently meet contract and delivery guidelines

Approach

- Clarify existing and implement new policies
- Collect more critical data
- Provide more validation tools
- Improve the lender feedback loop (reporting and training)

Confirmation of Borrower Identity

Fannie Mae requires lenders to confirm each borrower's identity prior to the extension of credit.

Implementation Approach:

- Lenders will be required to confirm the identity of each borrower whose credit is used for the purpose of determining ability to meet Fannie Mae's underwriting and eligibility standards prior to the extension of credit.
- Fannie Mae's requirements for borrower identity verification are intended to align with lenders' existing federal obligations under laws requiring information and document verification, including the Department of Treasury's Office of Foreign Assets Control (OFAC) regulations and the U.S. Patriot Act.

Timing:

- Policy effective for all loan applications dated on or after June 1, 2010

Confirmation of Borrower Identity: SSN and ITIN

Fannie Mae requires all borrowers to have a valid Social Security number (SSN) or Individual Taxpayer Identification Number (ITIN) (in addition to meeting existing legal residency and documentation requirements) at origination, underwriting and delivery.

Implementation Approach:

Desktop Underwriter® (DU®):

- A valid SSN or ITIN will be required *in addition to the borrower meeting existing legal residency and documentation requirements*.
 - Please note that Fannie Mae's legal residence requirements have NOT been revised.
- Existing "Potential Red Flag" messages focusing on Social Security Number have been changed to verification messages.
- Lenders must take steps to verify the accuracy of the Social Security Number.

Loan Delivery:

- Lenders will also be required to provide the Social Security Number or ITIN at loan delivery for up to two borrowers.

Confirmation of Borrower Identity (continued)

Timing:

- **DU April Update Release** weekend of April 17, 2010; New Messaging in the DU Underwriting Findings Report
- **Loan Delivery Data integrity checks** (format-specific, nine numeric digits, “0” not permitted in certain positions):
 - Loan Delivery Release: May 17, 2010 – Warnings
 - Loan Delivery Release: July 26, 2010 – Edits become fatal
- **Loan Delivery Validation edits** (Validation required if, based on information from the Social Security Administration, the number has reportedly not been issued, was issued prior to date of birth, or belongs to deceased individual):
 - Loan Delivery Release: July 26, 2010 – Warnings
 - Loan Delivery Release: January 3, 2011 – Edits become fatal

Additional Lender Validation Required:

For loans that do *not* pass the delivery edits and for loans that receive Social Security number verification messages from DU:

- Lenders must validate the accuracy of the Social Security number with the Social Security Administration (SSA).
- Upon verification with SSA, these loans must be delivered with Special Feature Code 162, indicating the lender’s compliance with this verification requirement.
- If the SSN cannot be verified with SSA, the loan is not eligible for delivery to Fannie Mae.

Confirmation of Borrower Occupancy

Desktop Underwriter® (DU®) borrower occupancy “Potential Red Flag” messages have been changed to DU verification messages and lenders must obtain documentation that confirms the borrower’s intent to occupy.

Implementation Approach:

- Lenders should ensure that the borrower has indicated on Form 1003 that property will be their “primary residence”, if the loan is being closed as an owner-occupied primary residence.
- The lender must determine the type of documentation that is most appropriate for the particular loan scenario (purchase or refinance).

Examples include (but not limited to):

- obtaining an occupancy affidavit from the borrower, or
- obtaining additional documentation from the borrower that validates his or her current residence (in the case of a refinance of the existing primary property).

Timing:

- DU April Update Release weekend of April 17; New Verification Message in the DU Underwriting Findings Report.

Validation of Qualified Parties

Fannie Mae is implementing a new policy that prohibits lenders from delivering loans that have been originated, underwritten, or serviced by individuals or companies that are listed on the federal General Services Administration (GSA) [Excluded Party list](#) or HUD's [Limited Denial of Participation list](#).

Implementation Approach:

- Lenders must confirm that any parties to the mortgage transaction are not listed on both the GSA and HUD lists prior to delivery of the loan.

- Lenders can access the GSA and LDP lists in the links provided below:
 - [U.S. General Services Administration \(GSA\) Excluded Parties List](#) - available through GSA's Excluded Parties List System (EPLS), www.epls.gov.
 - The review of EPLS must include a search for actions taken across all Federal agencies.
 - [U.S. Department of Housing and Urban Development Limited Denial of Participation List \(LDP\)](#) - available through one of the following:
 - http://portal.hud.gov/portal/page/portal/HUD/topics/limited_denials_of_participation
 - www.allregs.com

Validation of Qualified Parties (continued)

Implementation Approach (Continued):

- Parties to a mortgage transaction include companies or individuals that are involved in the origination, underwriting, or servicing of a mortgage. Specific individuals include:
 - A person with management or supervisory responsibilities within a Seller/Servicer.
 - Examples include, but are not limited to, loan production managers, underwriting center managers and servicing managers.
 - A person or entity with critical influence on or substantive control over the origination or servicing of a mortgage or any function related to the origination or servicing of a mortgage.
 - Examples include, but are not limited to, loan officers, underwriters, appraisers, and loss mitigation specialists.

- Any party to the transaction included on either list results in the loan being ineligible for delivery. For example:
 - Parties to the transaction excluded from participating in HUD multifamily programs or in a defined geography are considered excluded parties.
 - Any party listed on the GSA excluded party list, regardless of exclusion type, agency, and CT (cause and treatment code) are considered excluded parties.

Timing:

- Policy effective for all loan applications dated on or after June 1, 2010

Borrower Credit: Undisclosed Liabilities

Lenders must determine that all debts of the borrower incurred or closed up to and concurrent with the closing of the subject mortgage are disclosed on the final loan application and included in the qualification for the subject mortgage loan.

Implementation Approach:

- Lenders must have adequate internal controls and processes to support this requirement. Best Practices may include (but are not limited to):
 - Retrieving a refreshed credit report just prior to the closing date and reviewing it for additional credit lines.
 - Direct verification with a creditor that is listed on the credit report under recent inquiries to determine whether a prospective borrower did in fact enter into a financial arrangement with the creditor, which may not be listed on the loan application.
 - Running a Mortgage Electronic Registration System (MERS) report to determine if another mortgage is being established simultaneously.

Timing:

- Policy effective for all loan applications dated on or after June 1, 2010

Property and Appraisal Data: Property Unit Number

If the subject property is a condo or other property type that is identified by a unit number, Fannie Mae will require the unit number to be reflected in the property address on the note and must be delivered in the property address field.

Implementation Approach:

- Unit number must be included on the mortgage note.
- As a reminder, unit number is currently required to be provided at delivery in the “property address” field in the 2000-Character File Format.
- Edits in Loan Delivery will move from warning to fatal.

Timing:

- Policy effective for all loan applications dated on or after June 1, 2010
- Loan Delivery Release: January 2011 – Edits become fatal

Loan Delivery Enhancements: Additional Data

Fannie Mae is changing requirements to the **mandatory delivery of certain data elements** which are currently optional at the time of delivery; and today, may be delivered after funding.

The data elements listed below will be key components in the edit process that will identify eligibility violations (including calculated LTV and DTI) at the time of loan delivery.

Field Name	Edits
Monthly income Monthly debt expense Date of mortgage note Appraisal amount Purchase price	<ul style="list-style-type: none"> ▪ May 17, 2010 – Warnings if data is not delivered ▪ July 26, 2010 – Edits become fatal
Debt-to-income ratio (DTI) Loan Delivery will calculate the DTI based on monthly income and monthly debt expense	<ul style="list-style-type: none"> ▪ July 26, 2010 – Fatal edit if the calculated DTI exceeds Fannie Mae’s maximum published limits
Borrower and Co-Borrower Credit Score	<ul style="list-style-type: none"> ▪ July 26, 2010 – Fatal edit if credit score is less than 620 (with some exceptions) ▪ Note: The minimum credit score requirements that apply based on project eligibility parameters are not changing; the edit is based only on the absolute credit score floor.
Borrower/Co-borrower birth date	<ul style="list-style-type: none"> ▪ January 3, 2011 – Fatal edit if data is not delivered

Loan Delivery Enhancements: LTV Rounding

The rounding rules that determine the LTV/CLTV will be updated in the *Selling Guide* and standardized in Fannie Mae's Loan Delivery system and in DU.

Implementation Approach:

- The new policy will require the result of the LTV/CLTV ratio calculation to be truncated to two decimal places.
- The truncated result must then be rounded up to the next whole percent, e.g., 96.01 → 97%, 80.001 → 80%.
- Lenders must ensure that the LTV/CLTV provided at delivery uses this methodology or one that will result in a higher LTV/CLTV.
- Loan Delivery will calculate the LTV ratio based on the appraised value and/or purchase price (as applicable) and will compare the result to the delivered LTV ratio.

Timing:

- Loan Delivery Release: July 26, 2010 – Warnings based on differences between the calculated LTV ratio and delivered LTV/CLTV (outside of tolerance)
- Loan Delivery Release: January 3, 2011 – Edits become fatal
- DU Release TBD: LTV/CLTV rounding logic will be in a new version of DU later this year

Loan Delivery Enhancements: RWC/IV

Fannie Mae will be updating the policy regarding the underwriting and delivery of loan casefiles with RWC/IV recommendations as noted below.

Implementation Approach:

- Any loan casefile that receives a RWC/IV recommendation from DU may be manually underwritten pursuant to the *Selling Guide* and delivered as a manually underwritten loan, without limited waiver of reps and warrants.
- If the lender delivers the loan to Fannie Mae, it must be delivered as a manually underwritten loan and not as a DU underwritten loan.
 - Loan Delivery will return warning edits (fatal edits in the future) if DU loans with RWC/IV recommendations are delivered.
- Special Feature Code 343 will continue to be required if the RWC/IV recommendation was the result of erroneous credit and the lender chooses to manually underwrite and deliver the loan.

Timing:

- Loan Delivery Release: March 15, 2010 – Warnings if delivered
- Loan Delivery Release: July 26, 2010 – RWC/IV edit becomes fatal (if loan is not delivered as a manually underwritten loan)

Delivery Data Validation

For DU loans, **certain DU data elements** must match the corresponding Loan Delivery data elements.

These comparison fields include:

- LTV/CLTV*
- Credit score*
- Amortization Type
- DTI ratio*
- Number of Units
- Final DU recommendation
- Loan purpose
- Occupancy
- Interest-Only feature
- Social Security Number
- Property Inspection Waiver
- Property Type (co-op, MH)

Implementation Approach:

- DU Compare will be available to lenders for validation before delivery.
- Today, when the compare is run prior to delivery, warnings are issued for data discrepancies outside of tolerances. Additional warning edits are being added and eventually, these edits will become fatal.

Timing:

- Loan Delivery Release: July 26, 2010: additional warning edits added
- Loan Delivery Release: January 3, 2011: Fatal edit for delivery of valid DU Casefile ID and those fields listed above

*Edits will contain an allowable tolerance between the DU and Loan Delivery values

MI Validation Coverage: Clarifying Servicers Responsibilities

Fannie Mae's charter requires that loans with LTV ratios in excess of 80 percent have some form of mortgage insurance coverage or other credit enhancement. Fannie Mae will now also require servicers to direct mortgage insurers, in writing, to provide Fannie Mae with information concerning its insured loans. Lastly, a new policy will be implemented that requires servicers to notify Fannie Mae when mortgage insurance coverage has been rescinded.

Implementation Approach:

- At loan delivery and during the servicing of mortgage loans, lenders are currently required to provide specific information regarding the origination, servicing, and coverage of insured loans owned or securitized by Fannie Mae, including: provider of the coverage;
 - mortgage insurer company code;
 - commitment/certificate number;
 - coverage percentage;
 - the amount of any financed mortgage insurance premium; and
 - whether coverage is currently in force, and if not in force, the specific reason for the cancellation and related documentation.
- As a reminder, servicers must continue to notify Fannie Mae about automatic termination or a borrower-initiated cancellation of mortgage insurance coverage.
- In the future, Fannie Mae expects to provide a service that will assist lenders in validating mortgage insurance coverage information with the insurer prior to loan delivery.

Timing: On-going

Validation Tools and Services: Reports

Summary- and detail-level reports will be available monthly in the Message Manager application. Using the most recent delivery data, Fannie Mae will identify the percentage of loans that received warning/fatal messages and information about specific required data elements that were not delivered.

The reports will provide insight into the future fatal delivery edits and identify the areas that require attention in preparation for the upcoming fatal edits, leveraging production data from each lender's deliveries.

Implementation Approach:

- Review the reports on a monthly basis, and identify areas within the shipping or origination process that are causing data issues (missing or incorrect data)
- Make appropriate adjustments to internal processes and/or technology practices to correct data issues in current production
- Review the following month's report to determine if changes had positive impact on the future potential fatal edits

Timing:

- Loan Delivery Release in late March. Reports available on a monthly basis thereafter.

Validation Tools and Services: Sample Lender Snapshot Summary Report

Seller Summary on Loan Delivery Edit Recommendations Based on Deliveries JAN2010

CAT Code	Z0	Discrepancy Rates
Corp ID	BANK0	
Seller	Sample Lender	
Loans Delivered	5000	
Loans w/ Defects	891	
Defect Rate	18%	
Pools w/ Defects	89%	
TPO Rate	0%	
Loan Delivery Validation		
July26th Missing Purchase Amount (8)	5	0.1%
July26th Missing Appraisal Amount (491)	5	0.1%
July26th Missing Income (3)	9	0.2%
July26th Missing Debt (2)	5	0.1%
July26th Missing Note Date (68)	0	0.0%
July26th Missing SSN (594,597-601,604)	5	0.1%
July26th FICO Floor (78,84)	29	0.6%
July26th DTI Limit (28,34,35)	542	10.8%
Jan2011 Calc. LTV Edit (77)	11	0.2%
Jan2011 Missing DOB (54,57)	11	0.2%
Jan2011 Missing Unit # (733-735)	12	0.2%
DU Compare Attributes		
July26th RWC IV (D67)	1	0.0%
Jan2011 Missing DU Match (D08)	6	0.1%
Jan2011 Property Inspection Waiver	0	0.0%
Jan2011 Manufactured Home (D41-D44)	4	0.1%
Jan2011 Property Type (D85-86)	0	0.0%
Jan2011 #Units (D01)	2	0.0%
Jan2011 Occupancy (D27)	2	0.0%
Jan2011 Origination LTV (D21)	60	1.2%
Jan2011 Origination Combined LTV (D15)	37	0.7%
Jan2011 Purpose COR (D06)	13	0.3%
Jan2011 Purpose Refi (D03, D05)	4	0.1%
Jan2011 Purpose PMM (D02)	0	0.0%
Jan2011 DU FICO (D74, D75)	10	0.2%
Jan2011 DTI (D96)	312	6.2%
Jan2011 Amortization Type (D12,D13,D57,D64)	0	0.0%
Jan2011 Interest Only (D77-D80)	0	0.0%

Future Implementation Date of Fatal Edit and Description

Percentage of loans that would hit each respective delivery edit

Validation Tools and Services: Pre-delivery Validation

The **Pre-delivery Validation Capability**, solution known as **EarlyCheck™** will help lenders identify and resolve potential data quality and eligibility issues *prior* to delivery.

Fannie Mae will be offering this new automated capability that will enable lenders to run many of the new delivery checks (edits and validations) prior to delivery, at any point in the loan origination process.

Implementation Approach:

- Lenders will be able to access this capability via an on-line user interface, direct integration with the lender's Loan Origination System (LOS) or through Loan Delivery.
- The capability may be used at anytime in the origination or delivery process.
- The results of the validation will be provided via real-time reports.

Timing:

- The anticipated roll-out of this new capability is September 2010.

Next Steps

- Review additional data policy “data elements” for possible changes in your delivery file formats and workflow
- Review the additional documentation and verification requirements for undisclosed liabilities, occupancy and SSN verifications
- Review impacts to internal workflows, processes, and resource allocations, for undisclosed liabilities, occupancy and SSN verifications, and exclusionary list.
- Access the Delivery Reports in Loan Delivery to assess delivery impact of the pending fatal edits

Next Steps (continued)

- Look for more information on eFannieMae.com:
<https://www.efanniemae.com/sf/lqi/index.jsp>
 - [Lender Letter LL-2010-03, An Introduction to Fannie Mae's Loan Quality Initiative](#)
 - [Announcement SEL-2010-01, Selling Guide Updates for the Loan Quality Initiative](#)
 - [LQI Summary \(LL-2010-03\) with Key Dates and Resources](#)
 - [FAQs for LL-2010-03](#)
 - [Lender Tips for Identifying Undisclosed Liabilities](#)
 - [Live Web Seminars](#)
 - [Collateral Data Delivery \(CDD\) page](#)

- Visit <https://www.efanniemae.com/lc/webseminars.jsp> to register for this or other upcoming Online Consulting Series sessions