



# ***Discover Gold Through Quality***

Quality Control  
Best Practices

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# QUALITY CONTROL BEST PRACTICES

## Quality Control Best Practices Contents

The chapters in the Quality Control Best Practices part of *Discover Gold Through Quality* cover the following:

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Introduction	1
Establishing and Managing an In-House Quality Control Program	2
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In addition, you will find the following:

- Exhibit QC1, *Sample Origination and Closing Documents Checklists*, provides helpful checklists on documents to review in the loan file.
- Exhibit QC2, *Sample Document Review and Red Flag Checklists*, provides helpful checklists on a variety of topics, including mortgage application, credit reports, sales contract, etc.
- Freddie Mac Contact Information

Keep in mind that the best practices noted here are provided to assist you in establishing a new, or improving your existing, quality control program. This information is not a substitute for Freddie Mac's Single-Family Seller/Servicer Guide requirements and may not address all of the circumstances or meet all of the needs of your organization.

## Chapter 1 – Introduction

### Overview

Our extensive research into the practices of successful mortgage lenders has strengthened our belief that reliable and effective quality control programs are essential to the mortgage industry. This publication provides you with requirements and best practices for designing, administering and documenting an effective quality control program for Loan Prospector<sup>®</sup> mortgages, non-Loan Prospector mortgages and mortgages that are manually underwritten.

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### General Requirements

You must meet all of the quality control requirements found in the *Single-Family Seller/Service Guide* (Guide) as a condition to selling home mortgages to Freddie Mac. We have included Guide requirements for reference in this booklet and have indicated the Guide section where you will find the requirement. To ensure that you are in compliance with all of our requirements, please refer to Chapter 48 of the Guide titled “Seller’s In-House Quality Control Program.” The best practices noted in this booklet are based on our experience and actual controls currently being used in the industry. Although you are not required to implement all of these best practices, we encourage you to refer to them and customize your quality control program to reflect your company’s organization, circumstances and needs.

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## Chapter 2 – Establishing and Managing an In-House Quality Control Program

### Overview

While Freddie Mac does not believe that any one quality control program can meet the needs of all Sellers, certain characteristics are found in all effective quality control programs. These characteristics are the foundation of our requirements.

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### General Requirements (see Guide Section 48.1)

To be eligible to sell mortgages to Freddie Mac, you must operate a quality control program for home mortgages that is acceptable to Freddie Mac. Your quality control program should take into account the individual characteristics of your organization. You may use a combination of preclosing and/or postclosing quality control methods based on your specific organization and needs. Your quality control program must:

- Be in writing.
- Provide for standard operating procedures for all employees who will be involved with or affected by the quality control process.
- Operate independently of mortgage origination and underwriting departments.
- Be capable of evaluating and monitoring the overall quality of your mortgage production on a regular and timely basis.
- Include procedures to ensure that sample selection mortgage file reviews and the reporting of findings to senior management are conducted on a timely basis.

Your review of the mortgage file and reverifications must be thorough enough to:

- Determine compliance with the requirements of the purchase documents for mortgages sold to Freddie Mac.
  - Assess whether the mortgage was properly underwritten based on prudent underwriting practices and sound underwriting judgment.
  - Assess the accuracy of the data integrity. This is important whether you are transmitting loan data to investors or using an automated underwriting system.
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## Responsibilities of a Quality Control Representative

When establishing a quality control program, you should designate one individual in your company to be the quality control representative. This representative will have overall responsibility for implementing and coordinating activities under your quality control program.

Depending on the size of your company, the quality control representative may have other responsibilities. However, this individual should not be responsible for mortgage origination, processing or underwriting functions.

Typical responsibilities of the quality control representative may include:

- Maintaining and disseminating up-to-date information on your requirements as well as the requirements of mortgage insurers, applicable government entities and your investors, including Freddie Mac
- Ensuring that your reviewers have the appropriate skills and experience to perform quality control reviews
- Having the authority to modify the program when necessary to meet the objectives of the program
- Reporting quality control findings to senior management
- Working with the appropriate areas to develop recommended solutions to problems uncovered in quality control reviews
- Developing and implementing employee education and training
- Following up with management on quality control findings

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## Mortgage Service Providers (see Guide Section 48.2)

You may find it necessary or desirable to hire mortgage service providers for all or part of your quality control program.

A seller using third party quality control services must:

- Ensure that the work performed by third party quality control services comply with Freddie Mac requirements
- Monitor and evaluate the performance of third party quality control services on a regular basis

If you choose to use these services, you can find information on establishing and maintaining best practices for monitoring mortgage service providers in Chapter 7 of the Wholesale Originations Best Practices section of *Discover Gold Through Quality*.

## Fair Lending Reviews

### Overview

We support your commitment to employ business practices that promote fair lending in all geographic areas and for all borrowers. For some lenders, the fair lending review will be part of a compliance review program. We believe your quality control program should contribute to your efforts to:

- Support fair lending principles
- Monitor your employees' understanding of, and adherence to, fair lending policies
- Determine that fair lending policies are being consistently applied throughout your company
- Apply our underwriting guidelines consistently to each borrower when originating mortgages

### Requirements (see Guide Section 6.2)

As a Freddie Mac Seller, you must agree to comply with the following laws, regulations and orders:

- Title VI of the Civil Rights Act of 1964
  - Title VIII of the Civil Rights Act of 1968, as amended by the Housing and Community Development Act of 1974
  - Section 527 of the National Housing Act
  - The Equal Credit Opportunity Act (ECOA)
  - The Fair Credit Reporting Act
  - Executive Order 11063, Equal Opportunity in Housing
  - All other applicable federal and state laws, regulations and orders
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## Documentation of Your Quality Control Program

### Overview

All quality control activities must be fully documented in writing and reviewed by management on a regular basis. Your findings must be clearly documented and:

- Communicated to management on a regular basis

- Communicated to the origination areas of your company as feedback on their operations
- Available to Freddie Mac upon request

## General Requirements

Your policies and procedures must document your processes for:

- Sample selection, including methodology, frequency and responsibility (see Guide Section 48.4)
- Reverification, including verbal reverifications (see Guide Section 48.5),
- Loan Reviews (see Guide Section 48.5 and 48.6)
- Transfers of servicing (see Guide Section 48.3)
- File documentation review (see Guide Section 48.7)
- Reporting and follow-up, such as reporting on review results and implementing any corrective actions (see Guide Section 48.9)
- Document retention (see Guide Section 48.10)

## Reverification Process Documentation

In addition to the required reverifications stated in Guide Section 48.5, many Sellers develop reverification procedures for:

- Mortgage applications
- Title searches
- Sales contracts
- Occupancy certifications
- Mortgage and/or rental payment histories
- Noncredit payment references
- Gift letters

When shipping documents containing a borrower's personal information during the reverification process, we recommend several practices to protect information against accidental disclosure to unauthorized recipients. See them in the "Protection of Borrower's Personal Information" section, page QC3-4 in the next chapter.

## File Review Process Documentation

Your quality control review procedures must include a review of:

- The existence and accuracy of documentation required by applicable law

- Compliance with your guidelines, eligibility and underwriting requirements and those of the mortgage insurer and Freddie Mac, as applicable
- Compliance with your warranties regarding Freddie Mac's Exclusionary List
- The settlement statement and related documentation to determine that all conditions of closing have been satisfied
- Loan Prospector® data as entered into the data fields in the last transmission to Loan Prospector, prior to sale to Freddie Mac (Refer to the *Loan Prospector Functionality Guide*)

## **Documenting Reviews (see Guide Section 48.8)**

In documenting your quality control file review results, you must:

- Maintain complete records for each mortgage file selected for quality control review
- Document and explain discrepancies or inconsistencies found in the mortgage file that affect the eligibility of the mortgage based on your requirements or those of the mortgage insurer or Freddie Mac

## **Timely Revisions**

You should revise your quality control program on a timely basis when there are:

- Significant changes in your origination process or products
- Changes in your eligibility or underwriting requirements
- Changes in your investor's or mortgage insurer's eligibility or underwriting requirements

## **Retention of Records (see Guide Section 48.10)**

For at least three years from the date of the quality control review, you are required to retain all records related to:

- Your quality control findings
- Corrective actions taken

Your quality control records must be made available to us upon request and included in the information provided to the new servicer if a transfer of servicing occurs.

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## Quality Control Sampling

### Overview

It is usually not feasible to review every mortgage that your company originates. However, by carefully selecting a sample of cases to review, you should be able to effectively monitor the overall quality of your total mortgage production. You may use any combination of preclosing or postclosing quality control reviews based on your specific operations and needs.

How often you select your quality control sample will depend on your origination volume and what works best in your company. We have found that many Sellers prefer to select a quality control sample at least once a month, which guarantees faster results so corrective actions may be started earlier if necessary.

### Sampling Structure Requirements (see Guide Sections 48.4)

To comply with our sampling requirements, you must:

- Select at least 10 percent of one of the following production populations for quality control review:
  - Your total annual home mortgage production
  - Your total annual secondary market home mortgage production
  - Your total annual Freddie Mac home mortgage production
- Design your sampling procedures so there is a chance that each mortgage within the chosen population will be selected within 90 days of the note date
- Warrant that over the course of each 12-month period, your selected samples are representative of the full scope of your product line and production process
- Ensure that Loan Prospector mortgages make up a representative portion of your quality control sample
- Assign to quality control personnel the authority to conduct additional reviews at their discretion

**NOTE:** Any mortgages excluded from your quality control sample selection process are not eligible for sale to Freddie Mac.

Sellers with a total annual production volume in excess of 5,000 home mortgages may substitute a statistically based sampling method for the 10 percent requirement. Statistical sampling allows you to make reliable numerical estimates about the characteristics of your loan production.

## Selecting a Sampling Method (see Guide Section 48.4)

If you have the option of choosing between the 10 percent sampling method and the statistically based sampling method, you will need to consider the advantages and disadvantages of each to select the appropriate sampling method for your business.

### Advantages and Disadvantages of a 10 Percent Sampling Method

Some of the advantages of using a 10 percent sampling method include:

- Simplicity in design
- Ease of administration
- Quantity of information available in a 10 percent review
- Less involvement by statisticians in the quality control sampling method

Some of the disadvantages of using a 10 percent sampling method are: The number of mortgages that must be reviewed may be prohibitive if your mortgage production volume is very high, and The quality control reviews may not yield statistically valid results.

### Advantages and Disadvantages of a Statistically Based Sampling Method

Some advantages to using a statistically based sampling method include:

- A more efficient process because, in some cases, fewer than 10 percent of your mortgage production will be selected for review
- A smaller statistical sample may free the capacity to focus on targeted and discretionary samples as the need arises
- The ability to make estimates about a population and to quantify the precision of those estimates

Some disadvantages to using a statistically based sampling method are:

- Requires that you use a statistician to design, maintain and periodically review the sampling method
- May not reduce the actual number of mortgages selected for review, especially if your mortgage product lines and/or production processes are changing (for example, adding mortgage service providers, offering new types of mortgages or opening new branch offices in new market areas)

- Provides an alternative only to the random selection portion of the 10 percent quality control sample; it will not eliminate the need to conduct discretionary reviews, when necessary, to warrant that the total sample is representative of the full scope of your product line and production process

## Sampling Components

Once a sampling method has been selected, your quality control program should be designed to include the following three sample types:

- Random sample
- Targeted sample
- Discretionary sample

## Random Samples

Random samples let you obtain an unbiased view of your total mortgage population. In a random sample, every mortgage has an equal chance of being selected. You will select mortgages by using numbers randomly generated through one of the following selection processes:

- A random number table
- A computer-generated program of random numbers
- A calculator capable of generating random numbers

Your use of randomly selected numbers, as compared to simply starting with the 10th mortgage of the review period, will help to prevent bias that can result when employees know in advance which files will be reviewed.

## Random Sample Types

Starting with the random numbers, you are able to select any of the following types of random samples:

- Simple random sample
- Systematic random sample
- Stratified random sample

## Simple Random Sample

To establish a simple random sample, you need to determine how many mortgages you want in your sample, select enough random numbers and pick the mortgages with the corresponding numbers.

## Systematic Random Sample

To establish a systematic random sample, select one random number, pick the mortgage with the corresponding number and choose every 10th consecutive mortgage.

## Stratified Random Sample

To establish a stratified random sample, you must first stratify the entire mortgage population into groups and subgroups. For example, groups may consist of mortgages sold to different investors. Subgroups may consist of fixed-rate mortgages, balloon/reset mortgages and adjustable rate mortgages. Then you select either a simple random sample or systematic random sample from each of these subgroups. One advantage of using a stratified random sampling technique is that you can more effectively select mortgages that represent the full scope of your business.

## Targeted Samples

In addition to your random sample, you may decide to target certain mortgages for review to better understand why problems occurred. Your targeted samples generally will include 100 percent of these mortgages.

For example you might target:

- Mortgages in which the borrower was 30 days late or more within the first four months of origination and
- Mortgages referred to foreclosure within the first 24 months of origination.

## Discretionary Samples

In addition to your random and targeted samples, you may want to review a discretionary sample. You may use a discretionary sample to:

- Focus on a new type of mortgage offered by your company
- Evaluate the work of a particular employee or branch office
- Evaluate the work of a mortgage service provider, appraiser or other supplier of services
- Evaluate the work of mortgage brokers and correspondents
- More closely evaluate mortgages with high-risk characteristics
- Investigate possible misrepresentation or suspected fraud
- Expand your review because of a pattern of deficiencies found in earlier reviews

A discretionary sample includes mortgages selected on a non-random basis. By using discretionary samples, you will gain knowledge on a desired topic much more quickly than if you were to rely only on random sampling.

## Chapter 3 – Implementing an In-House Quality Control Program

### Quality Control Loan Reviews

#### Overview

The review of the original file documentation and reverifications should:

- Verify the existence and accuracy of the information associated with your mortgage files
- Evaluate the underwriting decisions associated with the mortgages
- Determine where additional training may be needed
- Discover errors and omissions as well as intentional violations of rules
- Identify necessary changes in your company's processes and procedures
- Assess whether mortgages conform to the underwriting requirements and guidelines of your company, the insurer and investor
- Determine that regulatory requirements are met
- Determine that specific Freddie Mac warranties and requirements are met
- Monitor the overall quality of mortgage production

#### Prudent Lending Practices

The concept of prudent lending practices should be incorporated in your quality control program. In other words, if your regulator, the mortgage insurer or your investors, including Freddie Mac, have no specific rule to govern a particular topic or situation, you should review the practices of the mortgage banking industry and strive to adopt a practice that is both customary and prudent.

## Checklists

Your quality control program should include the use of checklists to promote consistency and efficiency in your reviews. Checklists should be designed to assist the reviewer in:

- Ensuring the accuracy and completeness of the origination documents
- Evaluating the underwriting decisions and the acceptability of the mortgage
- Verifying the existence of required legal documentation
- Determining that your company policies are met

Your checklist should:

- Promote a thorough analysis of the information by the quality control reviewer
- Take into account the skill level and experience of your reviewers
- Confirm that requirements of your regulator, the mortgage insurer and Freddie Mac have been met
- Be easily executed in a "Yes/No" format (such as "Is the information in the new credit report essentially the same as the information in the original credit report?") or in a directive format (such as "Compare the original credit report to the new credit report.")
- Be updated in a timely fashion to concentrate on identified areas in your operations or policies needing a more intensive review

## Documentation Review

You must include in your quality control review a comparison of the original documents with the reverifications you receive. You must also include a review of the closing documents. (See Exhibit QC1, *Sample Origination and Closing Documents Checklists*)

## Declined Loan Reviews

You should also include a random sample of your declined loan applications in your quality control program and review for:

- Documentation supporting the decision to decline
- Exceptions in lending treatment
- Evidence that fair lending policies are understood and consistently applied throughout the company

## Purchase Document Compliance Reviews

To ensure that the mortgages meet the terms of the purchase documents, you should provide your quality control staff and/or mortgage service provider easy access to copies of your contracts. You should also determine that your mortgage service provider or quality control staff has the most recent Guide bulletins and has received training on the new requirements. Also, your quality control staff must be informed when changes to our standard purchase programs have occurred and/or when requirements have been negotiated with your company.

## Fraud Detection

You are encouraged to use your quality control program as a complement to your other efforts to prevent and detect fraud in your operations. Your quality control program can also be designed to provide valuable feedback to prevent problems before they occur by checking for red flags and reverifying data.

You can find information on fraud prevention and detection in the Fraud Prevention Best Practices section of <i>Discover Gold Through Quality</i> .
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## Red Flags

To assist your origination staff in identifying attempts to misrepresent information or commit fraud, we developed lists of "red flags." (See Exhibit QC2, *Sample Document Review and Red Flag Checklists*).

These red flags represent typical inconsistencies often found in fraudulently obtained mortgages.

The presence of one or more red flags in a file does not necessarily mean there was fraudulent intent. However, the discovery of several red flags during the quality control review may signal the need for a more detailed review of the mortgage.

These red flags are useful tools for your quality control staff to identify the types of documentation or lack of documentation that may lead to the discovery of fraud in a mortgage file. These discoveries should then be used by management to modify your company's origination policies or procedures when appropriate to prevent the fraud from recurring.

## Quality Control Reverification

### Overview

The reverification process is the centerpiece of your quality control program. The success of your quality control program will depend directly on the resources and planning you devote to this area. You should initiate reverifications as soon as possible after sample selection to facilitate the review procedures discussed later in this chapter.

### General Requirements (Guide Sections 48.5)

You must make certain reverifications on Loan Prospector<sup>®</sup> and non- Loan Prospector mortgages selected for quality control review. The purposes of the reverification process include:

- Evaluating the validity and quality of the information used in the original underwriting decision
- Protecting you against fraud and misrepresentation

You should begin reverifying the information listed in this section as soon as possible after the sample selection to facilitate the mortgage file review. Reverifications may be either in written or verbal form. All reverification documentation must be retained in the mortgage file.

### Protection of Borrower's Personal Information

When shipping documents containing a borrower's personal information during reverification, you should take steps to protect information against accidental disclosure to unauthorized recipients. Try to limit the personal information shipped to what is needed for the intended purpose; for example, you may require only the last four digits of a Social Security Number.

For personal information that needs to be mailed, we recommend that:

- The shipper should confirm the correct address and contents of the shipment
- The envelope or package should not be marked "confidential"
- Unless necessary, the information should not be sent to a residential address
- The shipper should confirm pick-up and receipt
- An inventory of the sent material should be maintained, in order to know the potential impact of a lost shipment

Before you fax or mail documents with sensitive or private borrower information, we suggest that you confirm the accuracy of the fax number or mailing address.

## **Verbal Reverification (see Guide Section 48.5)**

Although we strongly encourage written reverifications, you may obtain verbal reverifications on employment, income and sources of funds.

Any verbal reverification must be documented in writing and retained in the mortgage file. The verbal reverification documentation must:

- Identify the name of the quality control reviewer who made the contact
- Identify the name of the employer
- Identify the name and title of the individual contacted at the employer
- Show the date of contact
- Confirm that the information in the original verification was accurate or identify any inaccuracy

## **Other Reverifications**

You may need to reverify more documents than those required by Freddie Mac to:

- Meet the requirements of your regulator, other investors or mortgage insurers
- Investigate cases of suspected misrepresentation or fraud
- More fully document the overall conclusion of acceptability in a file that appears marginal after the required reverifications are reviewed

## **Original Verification**

The original verification of employment, income, sources of funds and payment history should be:

- Photocopied
- Attached to a letter requesting confirmation of the accuracy of the documentation
- Mailed to the issuer of the original verification with a self-addressed stamped envelope (Add "Do Not Forward" on the front of your envelope)

## **Credit Reports (Guide Section 48.5(c))**

For Loan Prospector mortgages, you are not required to obtain a new credit report. However, any credit information obtained from sources other than Loan Prospector must be reviewed.

For one out of every 10 non-Loan Prospector mortgages in your sample, you must obtain either a new Residential Mortgage Credit Report or a three-repository merged in-file credit report.

For the remaining non-Loan Prospector mortgages, you must obtain a new in-file credit report containing information from one or more of the national repositories.

You should obtain the new report from a source other than the original reporting agency. You must compare the new credit report with the credit report used when the mortgage was originated.

For Loan Prospector Accept Mortgages and A-minus Mortgages, you are not required to review the Loan Prospector-provided credit reports to determine that the credit report was properly underwritten, or that it is in compliance with credit underwriting guidelines. However, you must verify that the Loan Prospector-provided credit reports are for the correct borrower.

For manually underwritten mortgages, you must re-underwrite the credit and continue to review the mortgage file documents in accordance with Guide Section 48.7 to determine that the mortgage was underwritten to Freddie Mac's requirements.

If the mortgage requires an Indicator score to establish eligibility of the mortgage for the product offering, you must confirm that the score listed on Form 1077, Uniform Underwriting and Transmittal Summary, and the method used to select the score are correctly identified.

## **Appraisal, Inspection Reports and No-Appraisal MAF (Guide Section 48.5(e))**

To evidence that the mortgaged premises is acceptable for the transaction, each mortgage file must contain one of the following Freddie Mac reports:

- Form 70, Uniform Residential Appraisal Report
- Form 2055, Exterior-Only Inspection Residential Appraisal Report
- Form 70B, Manufactured Home Appraisal Report
- Form 72, Small Residential Income Property Appraisal Report
- Form 465, Individual Condominium Unit Appraisal Report

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- Form 466, Exterior-Only Inspection Individual Condominium Unit Appraisal Report
- Form 2070, Loan Prospector Condition and Marketability Report, or Fannie Mae Form 2075
- Home Value Models: A print out of the Last Feedback Certificate with a Minimum Assessment Feedback of Form 2070 or PIA, and may include Freddie Mac Form 2070 and Fannie Mae Form 2075

You may select from one of the following options:

- Option 1 - Of every 10 mortgages selected for quality control review, one must be a field review and the remaining nine mortgages may be desk reviews
- Option 2 - Of every 10 mortgages selected for a quality control review, three must be a field review. No desk reviews are necessary for the other seven mortgages

If the Mortgage was originated using the Home Value Models: Property Inspection Alternative, the Seller is not required to order an appraisal or a review appraisal. However, the Seller is required to determine:

- The Mortgage met all the eligibility requirements of Sections 44.9 and 44.10
- The address information and all other information entered into Loan Prospector was true, complete and accurate
- The property address used by Freddie Mac and returned on the Loan Prospector Feedback Certificate is the address of the Mortgaged Premises
- The Mortgage met all the eligibility requirements for the Property Inspection Alternative
- The Last Feedback Certificate returned a Minimum Assessment Feedback of 2070 or Property Inspection Alternative, and is dated within 120 days of the Note Date
- The Mortgage was not a Seasoned Mortgage

If the Mortgage was originated using Home Value Models: Form 2070, the Seller is not required to order an appraisal or a review appraisal. However, the Seller is required to determine:

- The Mortgage met all the eligibility requirements of Sections 44.9 and 44.10
- The address information and all other information entered into Loan Prospector was true, complete and accurate
- The property address used by Freddie Mac and returned on the Loan Prospector Feedback Certificate is the address of the Mortgaged Premises
- The Mortgage met all the eligibility requirements for Form 2070 or 2075
- The Last Feedback Certificate returned a Minimum Assessment Feedback of 2070 or Property Inspection Alternative, and is dated within 120 days of the Note Date

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- Form 2070 or 2075 did not required an upgrade to an appraisal
- The Mortgage was not a Seasoned Mortgage

For purposes of performing field reviews, the following quality control requirements apply:

1. If the Mortgage is secured by a 1-unit property and was originated using an appraisal report, the Seller must obtain a field review with the results reported on a field review report, such as a Freddie Mac Form 1032, On-Unit Residential Appraisal Field Review Report.
2. If the Mortgage is secured by a 2- to 4-unit property, the Seller must obtain a field review with the results reported on a field review report, such as Freddie Mac Form 1072, Two- to Four-Unit Residential Appraisal Field Review Report.

When the field review consists of a review of an appraisal report, the appraisal review must:

- Be prepared by a qualified appraiser (see Guide Section 44.2) not affiliated with the original appraiser or appraisal firm
- Either concur with, or provide a different opinion regarding, the value and marketability of the mortgaged premises as of the effective date of the original appraisal and not as of the date of the appraisal review
- Be used to evaluate the quality of the original appraisal report
- Include an exterior review of the subject property and comparables
- Include a review of the accuracy of the factual data in the original appraisal report

When a desk review of the original appraisal or inspection report is required for the remaining mortgages in your quality control sample, the reviewer need not be an appraiser. However, the reviewer should be familiar with the subject's market area and be qualified to:

- Address the appropriateness of the data presented in the report
- Address the appropriateness of the comparable sales (as applicable)
- Conclude that the appraiser's rationale for the final reconciliation of value was supported (as applicable)

## **Verification of Employment and Income (Guide Section 48.5(a))**

You must reverify all verifications of employment and income used in the original underwriting process based on required minimum documentation.

The original documentation verifying employment and income may include:

- Verification of employment and income forms
- Paystubs
- Salary vouchers
- W-2 forms
- Tax returns
- Financial statements
- Compensation award letters
- Other documentation verifying income

For Loan Prospector mortgages, you must use the rules for stated and calculated income. You must reverify the employment or income information that required verification.

You must obtain IRS income information using Forms 8821 or 4506 (or an alternate form acceptable to the IRS that collects comparable information) for each mortgage selected for quality control review where federal income tax returns were required as original income documentation.

For these mortgages selected for quality control review, the IRS form does not need to be sent again to the IRS if an original response was received during the origination process. (It is important to note that IRS Forms 8821 or 4506 expire 60 days from the date the borrower signs them.)

## **Verification of Self-Employment**

You must reverify information related to the borrower's self-employment.

The original verifications may have included:

- Tax returns
- Financial statements

You should contact the appropriate person or organization to reverify the information. For example:

- Ask the IRS for copies of the borrower's personal and business tax returns with the IRS Form 4506 (Request for Copy of Tax Form), IRS Form 8821 (Tax Information Authorization) or any similar form acceptable to the IRS
- If an accountant prepared the financial statements, ask the accountant to confirm the authenticity of the financial statements

### **Verification of Source of Funds (see Guide Section 48.5(b))**

You must reverify all original documentation verifying sources of funds for:

- Down payment
- Closing costs
- Prepaid items

The original documentation may include

- Verification of deposit forms
- Depository account statements
- Stock and securities account statements
- Gift funds
- A signed settlement statement or other evidence of conveyance and transfer of funds if a sale of assets was involved

### **Payment History**

You should reverify all mortgage payment histories, rental payment histories and other large liabilities used in the original underwriting process based on the required minimum documentation.

The original payment history documentation may include:

- Direct written references from the mortgagee, landlord or creditor
- Mortgage payment history
- References contained in the credit report (You should review the new quality control credit report.)
- Canceled checks to cover the most recent 12-month period (Note generally, these will not be reverified, provided you have evidence that the checking account is valid.)

## Mortgage Application

A copy of the original, signed mortgage application should be mailed to the borrowers with a request that the borrowers:

- Acknowledge their signatures
- Verify that the information shown is valid
- State whether they were asked to sign a blank or incomplete mortgage application
- State whether they were asked to omit any information requested on the mortgage application

We recommend that you confirm the accuracy of the fax number or mailing address before you fax or mail documents with sensitive or private borrower information. For additional guidelines for protecting borrower information, go back to “Protection of Borrower’s Personal Information” on page QC3-4.

## Occupancy Verification

You should verify the occupancy status of the property any time there is a “red flag” that an owner-occupied property is not occupied by the borrower

You must verify the occupancy of the property for all mortgages secured by 3- to 4-unit primary residences that are selected for quality control review.

You may use any one or more of the following procedures to verify occupancy:

- Send the borrower a certified letter to the subject property address
- Physically inspect the subject property
- Use directory assistance or cross-reference services
- Verify the name and address on checks submitted for housing payments
- Review homeowner's insurance records
- Check with utility companies
- Check with homeowners associations

## Follow-Up Procedures

Your quality control program should include policies addressing reverification requests that are not returned in a reasonable amount of time. You may want to employ steps to reverify the existence of the sources of information before mailing a second request or attempt to verbally reverify the information. Effective follow-up procedures should be part of your program.

## Resource Recommendation

You should provide your staff with the necessary resources to confirm or reverify information in the mortgage file. The following is a list of resources and resource materials that you may use to confirm or reverify information and representations made in the mortgage file:

- Directory Assistance – confirm occupancy or addresses of individuals or entities on verification documents
  - Cross-Reference Directories – obtain a telephone number for an address or obtain a name and address for a telephone number
  - Credit Reports – discover undisclosed obligations, Social Security Number irregularities, aliases, employment histories and address histories or discrepancies
  - United States Postmaster – identify the registered owner of a post office box
  - Secretary of State's Office – verify the existence of and to obtain information on corporations
  - Social Security Number Verification – confirm the issuance and validity of a Social Security Number
  - FICA Taxable Wage Tables – verify wages and taxes on paystubs and W-2 forms
  - Mail Drops – obtain from either the local postmaster or directory and use to evaluate the information provided on verification documents
  - State and County Licensing Offices – confirm employment information on licensed professions
  - Online Databases – provide information regarding individuals, businesses and properties
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## Data Integrity Review (see Guide Section 48.6)

### Overview

Your quality control review procedures for all mortgages must include a review of the completeness and accuracy of the information you obtained in the origination process.

The data integrity review of the information must include a process for checking data fields entered in Loan Prospector and ensuring that all data submitted is valid. In order to assist in this process, the quality control reviewer must have access to documentation that lists the required codes and formats for all data fields.

### Procedures for Review

You must perform a data integrity review on all mortgages sampled to ensure that the loan data is accurate and consistent. Source documentation to be reviewed includes:

- Mortgage applications
- Employment and income verifications
- Source of funds verifications
- Sales contracts
- Tax returns
- Credit data
- Asset documentation
- Appraisal and inspection reports
- Mortgage delivery data (SCC codes)
- The Loan Prospector Key Number when applicable

If you determine that the Key Number for a Loan Prospector mortgage is missing or is inaccurate, you must notify Freddie Mac in writing within 30 days of the finding.

You must also check the information provided to Loan Prospector, including the:

- Borrower's name
- Property address
- Property type
- Terms of the transaction (including financing)
- Capacity of the borrower to repay the mortgage

## Chapter 4 – Quality Control Program Reporting Requirements

### Overview

Reporting is a crucial component of any quality control program. The effectiveness of your program will depend on all of your quality control activities being fully documented in writing and reported to senior management on a regular basis.

Management must have these reports to:

- Monitor the overall quality of mortgage production
- Be able to respond to specific quality control findings and take steps to resolve identified problems
- Monitor the operation of the quality control program
- Document that the company complies with our eligibility requirement for a quality control program

Just as your quality control program should be adapted to the size and structure of your organization and origination process, your reporting policies and procedures should be adapted to your needs.

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### General Requirements (see Guide Section 48.9)

You must maintain complete records for each mortgage selected for quality control review and document discrepancies or inconsistencies that affect the eligibility of the mortgage based on your requirements as well as those of the mortgage insurer and Freddie Mac.

The results of your quality control reviews must be reported in writing to your senior management within 90 days of selection. We recommend reporting on a monthly or quarterly basis. You must thoroughly analyze findings affecting the acceptability or eligibility of mortgages and initiate necessary corrective actions.

You must notify us in writing within 30 days of your determination that a quality control finding affects the eligibility of a mortgage sold to Freddie Mac.

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## Developing Quality Control Reports

Your quality control program may need only a few reports, or your program may require numerous reports depending on your company's size, specific operations and needs.

You should ensure that your reports:

- Are timely
  - Are provided to the proper areas of management
  - Contain useful information in the right amount of detail
  - Elicit appropriate responses, including corrective action when appropriate
  - Provide tracking and trending of results to monitor the quality of the originations
- 

## Types of Reports and Records

You should develop standard record keeping and reporting requirements tailored to meet the design of your quality control program. Some of the records and reports you may want to maintain are listed below:

- Mortgage sample selection documentation – shows which mortgage files were selected for quality control review and how they were selected
- Individual mortgage file report – written by the quality control reviewer and contains the findings of the quality control review of a specific mortgage
- Summary report of individual findings – prepared on a regular basis and summarizes the findings of the individual mortgage file reports, helping to identify trends, fraud or other problem areas. We recommend preparing the report weekly or monthly
- Reporting of quality control findings to affected areas – provided to the department heads of those areas directly concerned with the individual findings. The department heads should be asked to provide comments, recommendations or explanations
- Regular report of quality control findings to senior management – presented to management on a regular basis (monthly or quarterly). The report contains the summary report of individual findings plus the responses from the affected department heads

## QUALITY CONTROL BEST PRACTICES

- Management's response to quality control findings – management's response to the quality control findings; it includes recommendations and explanations of the steps the company intends to take to resolve any problems
- Special problems report – prepared and given to management immediately when fraud, willful misrepresentation or other serious origination problems are discovered during the quality control review. The report states the facts of the special problem and includes copies of any evidence that will assist management's understanding of the problem
- Corrective actions status report – tracks the company's progress in implementing management's plans for corrective actions
- Report to investors, mortgage insurers or government agencies – presents material findings to the investor, mortgage insurer or government agency. For example, we require that you notify us with such a report within 30 days of your determination that a finding affects the eligibility of a mortgage sold to Freddie Mac
- Tracking and trending reports – tracks the historical quality of the originations
- Special reports – consider other reports for your quality control program, such as branch office reports, reports of targeted reviews, mortgage service provider reports and fair lending reports

## **Exhibit QC1 – Sample Origination and Closing Documents Checklists**

### **Origination Documents to Review (see Guide Section 48.7)**

You must include the following documents in your quality control review for comparison with the reverifications you receive:

- Form 65, Uniform Residential Loan Application
- Credit documentation
- Employment and income documentation
- Sources of funds documentation
- Appraisal and inspection documentation
- Sales contract
- Form 1077, Uniform Underwriting and Transmittal Summary

### **Closing Documents to Review (see Guide Section 48.7)**

You must include the following closing documents in your quality control review to ensure the information is accurate, complete and consistent with other documents in the mortgage file:

- Notes and riders
- Security instruments and assignments
- Mortgage insurance certificate, or policy or mortgage guaranty certificate
- Modification or assumption agreement
- Title binder or final title insurance policy (both if available) or other evidence of title
- Plat or survey
- Settlement statements (HUD-1 or other form)
- Leasehold estate documents
- Hazard insurance policy or certificate
- Flood insurance policy or certificate or flood zone determination documents
- Underwriter's approval and any conditions of closing
- Closing instructions

## **Exhibit QC2 – Sample Document Review and Red Flag Checklists**

The following information is provided as a starting point in developing your checklists and lists of red flags. The suggestions we provide are not intended to be all-inclusive and do not necessarily mean fraud is present. However, they indicate the need for additional review and documentation. We encourage you to incorporate them into your quality control reviews.

### **Mortgage Loan Application Checklist**

- Review the mortgage loan application for completeness and signatures
- Compare the initial (handwritten) and final (typed) applications for unexplained discrepancies
- Compare what is shown on the application with what was verified in the credit, income, employment and assets documentation
- Compare the borrower identifiers (name, address, Social Security number) with other information in the mortgage file
- Compare the property description with that on the appraisal report or inspection report and legal documents

### **Mortgage Loan Application Red Flags**

- Significant or contradictory changes from handwritten-to-typed loan application
- Unsigned or undated loan application
- Invalid Social Security number
- Number of years on the job/in that profession inconsistent with borrower's age
- Borrower is purchasing the property from their landlord or employer

### **Credit Report Checklist**

- Compare the original credit report to the new credit report for conflicting information
- Determine whether the date of the original credit report was within requirements
- Review the original credit report and payment histories for completeness and derogatory information
- Determine whether the original credit report indicates that public records information was checked
- Determine whether direct verifications were obtained for all significant debts not rated on the original credit report

- Compare the borrower identifiers on the original credit with the mortgage application
- Determine whether inconsistencies and discrepancies were resolved before loan closing
- Determine if the Indicator score and the method for selecting the score, if applicable, was indicated on the Form 1077

## Credit Report Red Flags

- No credit history (possible use of alias or different Social Security number)
- Invalid Social Security number or differs from that on other documents
- Personal data not consistent with handwritten mortgage loan application
- Unresolved significant differences between the original and new credit report
- Also Known As (AKA) or Doing Business As (DBA) indicated
- Employment information is different from mortgage loan application and verification of employment
- Recent inquiries from other mortgage lenders

## Salaried Employment and Income Checklist

- Compare original verifications of employment and income with reverifications
- Check to see whether two full years of employment and income were verified
- Determine if material discrepancies exist among the verifications, the mortgage loan application and credit report
- Determine whether all income used in qualifying the borrower was verified
- Determine whether the dates of original verifications were within requirements
- Determine whether the verification documents used (verification of employment form, paystub, W-2 form) were complete and acceptable
- Determine whether employment and income documentation inconsistencies and discrepancies were resolved before closing the loan

## Salaried Employment and Income Red Flags

- Evidence of “white-outs” or alterations
- “Squeezed-in” numbers
- Appearance that verification of employment form was hand carried
- Round dollar amounts
- Employer's address shown only as a post office box or mail drop service

- Handwritten paystubs or W-2 forms
- Income out of line with type of employment

## Self-Employment Checklist

- Review tax returns and financial statements for consistency and completeness
- Compare reverifications to the original documentation
- Consider whether there is consistency among the mortgage loan application, credit report and business documentation
- Assess whether the underwriter correctly analyzed the documentation required for a self-employed borrower

## Self-Employment Red Flags if Dealing With a Self-Employed Borrower

- Tax returns not signed or dated by the borrower
- No estimated tax payments by self-employed borrower (Schedule SE required)
- Evidence of “white-outs” or alterations on the tax returns
- Business expenses are inconsistent with type of business (for example, truck driver with no car and truck expense)

## Self-Employment Red Flags if Dealing With a Salaried Borrower

- Co-borrower's maiden name is the same as the signature of employer (possibly self-employed)
- Self-employment tax claimed, but self-employment not disclosed
- Borrower listed as the “Manager” on the verification of employment (confirm borrower is not the owner)
- Mortgage loan application reflects the same telephone number for borrower and employer

## Source of Funds Checklist

- Compare original verifications of source of funds with reverifications
- Determine whether sufficient funds were verified
- Determine whether the dates of the original verifications were within requirements
- Determine whether gift funds were properly verified
- Determine whether verification of deposit forms or depository account statements show unexplained recent large deposits or unreported debts

- Determine whether the source of significant sales contract deposits was verified and that the amount agrees with that shown on the settlement statement
- Determine whether source of funds documentation inconsistencies and discrepancies were resolved before closing
- Determine whether any new depositors were recently added to the borrower's account

## Source of Funds Red Flags

- New bank account (verify previous bank account)
- Round dollar amounts (especially on interest bearing accounts)
- Evidence of "white-outs" or alterations
- "Squeezed-in" numbers
- Recent large deposits without acceptable explanation
- Illegible signatures with no further identification
- Source of funds consists of unverified gift, equity exchange, note, sale of residence or repayment of personal loan

## Appraisal Report and Inspection Report Checklist

- Determine whether an experienced state certified or licensed real estate appraiser from the state in which the property is located performed the appraisal
- Check to ensure all conditions on the appraisal report and all applicable upgrade requirements were met before closing
- Compare the original appraisal report or inspection report to the review appraisal report, if one was obtained, for conflicting information
- Review the original appraisal report or inspection report for consistency and completeness
- Assess whether the appraiser's conclusions and market value estimate were supported by the information contained in the original appraisal report
- Determine whether the original appraisal report is free from mathematical errors
- Review the size of the gross and net adjustments for reasonableness
- Review the similarity of the comparable properties used
- Determine whether the date of the original appraisal report was within requirements
- Determine whether the flood zone information is correct
- Check the appraiser's name against the Freddie Mac Exclusionary List

## Appraisal Report and Inspection Report Red Flags

- Appraisal report or inspection report was ordered by any party to the transaction other than the lender (buyer, property seller, Realtor)
- Comparable properties not verified as recorded

## Sales Contract Checklist

- Determine whether all parties signed the contract and addenda
- Determine whether the information in the contract is consistent with other file documentation
- Determine that the source of a large earnest money deposit was verified

## Sales Contract Red Flags

- Seller shown as a relative, Realtor or employer
- No Realtor involved
- Sales price substantially below market value
- Assignment of contract or borrower not shown as purchaser

## Legal and Closing Document Checklist

- Determine that the correct legal instruments were used
- Determine that the legal documents are complete and consistent with the other information in the mortgage file
- Check the legal documents for proper signatures
- Determine that the title is properly vested and title exceptions are acceptable
- Determine whether underwriting conditions were met and closing instructions were followed
- Determine whether required insurance policies were obtained
- Review the settlement statements (HUD-1 or other forms) to ensure they were completed properly
- Determine whether required disclosures were executed by the borrower

## Legal and Closing Document Red Flags

- Terms of the closed mortgage differ from the terms approved by the underwriter
- Unusual credits or disbursements shown on settlement statements (HUD-1 or other forms)

- Power of attorney used without explanation
- Names and addresses of property seller and buyer vary from other loan documentation
- Evidence of “white-outs” or alterations without initials
- Reference to undisclosed secondary financing
- Reference to undisclosed double escrow

## Owner-Occupancy Checklist

- Ensure the borrower certified their intent to occupy the property as a primary residence
- Review the facts of the case to determine whether to accept the borrower's occupancy certification at face value
- Determine whether discrepancies or conflicting information concerning the borrower's occupancy status were properly resolved before closing

## Owner-Occupancy Red Flags

- Significant or unrealistic commute distance from subject property to employment
- The borrower is purchasing a smaller or less expensive home from their current primary residence without explanation
- The borrower intends to rent or sell their current residence with no documentation
- Appraisal report reflects “Occupant” as a tenant or vacant on an owner-occupied refinance application
- The mortgage file contains postclosing documentation (transfer of property, returned mail or collection difficulties) that may indicate the property is not owner-occupied

## Underwriting Judgment Checklist

- Assess whether the information required to make the underwriting decision was properly verified and documented
- If the loan is not an Accept Mortgage, re-evaluate the creditworthiness of the borrower to determine whether the underwriter correctly evaluated the borrower's credit reputation
- Re-evaluate the income stability of the borrower to determine whether the underwriter correctly evaluated the borrower's continuance of income
- Determine whether the loan decision was based on documentation in the mortgage file and described on Form 1077 or another document in the file

## QUALITY CONTROL BEST PRACTICES

- Determine whether the borrower's verified funds were sufficient and that the sources were properly verified
- Review the appraisal report or inspection report to determine the appropriateness of the comparables and whether they support the final estimated market value
- Determine whether the mortgaged premises is acceptable collateral for the transaction
- Determine whether the effect of large property seller contributions was properly considered
- Determine whether the requirements of your company, the mortgage insurer and your investors, including Freddie Mac, were met
- Determine whether any significant discrepancies were resolved before loan closing
- Consider whether the underwriter's approval was
  - Supported by evidence in the file
  - Reasonable
  - Prudent

## Underwriting Judgment Red Flags

- Approval clearly not supported by file documentation
- Unresolved material discrepancies contained in file documentation

## Loan Prospector<sup>®</sup> Loan Checklist

- Check to be sure that the most recent Loan Prospector Feedback Certificate is in the file
- Check the data fields entered in the last transmission to Loan Prospector to ensure the validity of the data
- Confirm the accuracy of the Special Characteristic Code (SCC)
- Notify Freddie Mac of significant data discrepancies
- Check to be sure the Loan Prospector Key Number is accurately reflected in the delivery data

## Exclusionary List

- Check all parties (individuals and companies) to the transaction against Freddie Mac's Exclusionary List

## Freddie Mac Contact Information

Please use this list to identify the Freddie Mac contact for your specific business need. If you're unsure of the appropriate contact, or have general questions, please call our lender helpline, (800) FREDDIE or (800) 373-3343.

### Corporate Headquarters

8200 Jones Branch Drive  
McLean, VA 22102-3110  
(703) 903-2000

### Quality Control Offices

#### Corporate

Attn Corporate Office Quality Control  
Freddie Mac  
8200 Jones Branch Drive, MS 287  
McLean, VA 22102-3110  
Telephone number: (703) 903-2062  
Fax number: (703) 903-2068

#### Southeast/Southwest

Attn Southeast/Southwest Quality Control  
Freddie Mac  
2300 Windy Ridge Parkway  
Suite 200, North Tower  
Atlanta, GA 30339-5665  
Telephone number: (770) 857-8800  
Fax number: (770) 857-8808

#### North Central

Attn North Central Quality Control  
Freddie Mac  
333 West Wacker Drive  
Suite 2500  
Chicago, IL 60606-1287  
Telephone number: (312) 407-7400  
Fax number: (571) 382-4871

#### Northeast

Attn Northeast Quality Control  
Freddie Mac  
8200 Jones Branch Drive, MS 271  
McLean, VA 22102-3110  
Telephone number: (703) 903-2146  
Fax number: (703) 903-2387

### Wholesale Originations

Contact your account manager for questions or comments relating to wholesale originations.

## Additional Resources

### Guarantor Line

(703) 761-7170

### Fraud Hotline

(800) 4FRAUD8 *or*  
(800-437-2838)

### Document Custodial Services

21550 Beaumeade Circle  
P.O. Box 5000  
Ashburn, VA 20147  
(703) 724-3000

### *Single-Family Seller/Servicer Guide*

<http://www.FreddieMac.com/sell/guide/>

### The Learning Center Glossary

<http://www.FreddieMac.com/learn/glossary/>

### Please contact our Lender Helpline...

(800) FREDDIE *or* (800) 373-3343

8 a.m. to 8 p.m. Eastern time every business day

### ...For information on the following topics:

- Underwriting
- Loan Prospector<sup>®</sup>
- Loan Delivery
- Loan Servicing (performing & non-performing loans)
- Technical Issues (MIDANET<sup>®</sup>, GoldWorks<sup>®</sup> & Loan Prospector)
- Historical Rate Information
- Training Registrations
- Publications
- Billing